

DOCUMENT RESUME

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[Adequacy of Regulations Governing the Negotiation of Noncompetitive Contracts over \$100,000 Based on Catalog or Market Prices]. PSAD-78-51; B-39995. December 12, 1977. 3 pp. + enclosure (11 pp.).

Report to Joel W. Solomon, Administrator, General Services Administration; by Richard W. Gutmann, Director, Procurement and Systems Acquisitions Div.

Issue Area: Federal Procurement of Goods and Services: Reasonableness of Prices Under Negotiated Contracts and Subcontracts (1904).

Contact: Procurement and Systems Acquisition Div.

Budget Function: Miscellaneous: Financial Management and Information Systems (1002).

Organization Concerned: Department of the Interior; Department of Commerce; Department of Health, Education, and Welfare; Department of Transportation; Veterans Administration.

Federal Procurement Regulations state that contracting officers shall, with some exceptions, obtain contractors' cost or pricing data in support of proposed prices for noncompetitive contracts. A review of the pricing of 204 noncompetitive fixed-price contracts and modifications with Federal agencies showed that there was no assurance that the prices negotiated for 201 of the contracts were reasonable. Findings/Conclusions: Where cost or pricing data is required, a cost analysis or review and evaluation of the contractor's data and judgmental factors applied in estimating the cost of performing the contract are to be performed. One exception to the requirement is where the contracting officer determines that the proposed price for an item is based on an established catalog or market price for a commercial item sold by the contractor in substantial quantities to the general public. Because of the lack of specific criteria in the Federal Procurement Regulations, contractors were granted exemptions from furnishing cost or pricing data for 201 of 204 contracts without adequate assurance that the exemptions were justified. In many cases procurement personnel granted the exemptions without obtaining contractors' price lists or other pricing documents, and, in most cases, sales data were not obtained. An analysis of sales data from contractors for selected items procured under 70 of the contracts indicated that the granting of an exemption for many items was not warranted. Recommendations: The Administrator of General Services should approve a proposed change in the Federal Procurement Regulations providing specific guidelines for determining the types of supporting data which should be obtained and analyzed in order to determine whether exemptions from furnishing cost or pricing data are warranted.

(SC)



04405

UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

PROCUREMENT AND SYSTEMS
ACQUISITION DIVISION

B-39995

DEC 12 1977

The Honorable Joel W. Solomon
Administrator of General Services

Dear Mr. Solomon:

As part of our effort to monitor civil agencies' compliance with laws, regulations, and procedures in negotiating noncompetitive contract prices, we evaluated the adequacy of regulations governing the negotiation of noncompetitive contracts over \$100,000 based on catalog or market prices.

In addition to the Federal Supply Service, General Services Administration, our review included six procurement offices of four civil departments and one administration. (See enclosure, p. 11.) We reviewed 204 noncompetitive contracts, each valued at over \$100,000, awarded on the basis of catalog or market prices during the 21-month period ending March 31, 1977. Collectively contracts reviewed were valued at about \$131.7 million. The details of our review are included as an enclosure to this report.

Federal Procurement Regulations state that contracting officers shall require contractors, with some exceptions, to submit or identify in writing the cost or pricing data supporting their proposed prices for noncompetitive contracts and contract modifications valued at over \$100,000. Contracting officers may grant contractors exemptions from this requirement when they determine that proposed prices are for commercial items sold in substantial quantities to the general public at established catalog or market prices. The rationale for this exemption is the presumption that, if many buyers have bought an item at a specified price, the forces of the market place will produce a fair price.

Because of the lack of specific criteria in the Federal Procurement Regulations, contractors were granted exemptions from furnishing cost or pricing data for 201 of the contracts without adequate assurance that the exemptions were justified. Although procurement personnel granted exemptions on the basis

PSAD-78-51
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of contractors' claims of substantial sales to the general public at catalog or market prices, they did not obtain sufficient data to substantiate the claims or otherwise determine the reasonableness of the proposed prices. (See enclosure, p. 2.)

We found that in many cases procurement personnel granted the exemptions without obtaining contractors' price lists or other pricing documents. (See enclosure, p. 2.) This data is needed to determine that proposed prices were based on established catalog or market prices. Further, in most cases sales data was not obtained. (See enclosure, p. 4.) This information is needed to determine whether the contractor sold the items in substantial quantities to the general public at regularly established prices and for a current period.

Although Federal Procurement Regulations set forth the conditions which must be met before contractors can be granted exemptions, they do not contain specific guidance for obtaining, verifying, and analyzing data supporting claims for exemptions. (See enclosure, p. 8.) Such guidance is provided in the Armed Services Procurement Regulation and a supplementary pricing guide used by defense agencies. (See enclosure, p. 8.)

Because adequate sales data had not been obtained by the agencies, we obtained sales data from contractors for selected items valued at about \$35 million procured under 70 of the contracts reviewed. An analysis of the data, using the armed services criteria, indicated that the granting of an exemption for many items was not warranted. (See enclosure, p. 5.)

CONCLUSIONS

Contracting officers granted contractors exemptions from the requirement to submit cost or pricing data for items to be purchased on the basis of contractors' claims that the items were sold in substantial quantities to the general public at published prices. However, in most cases the contracting officers did not obtain adequate sales or market information to support these claims. Our analysis of sales data we obtained directly from contractors showed that, in many instances, exemptions granted were not warranted. Accordingly contracts were negotiated without adequate assurance that the prices paid were fair and reasonable.

We believe the above condition occurred because the Federal Procurement Regulations do not contain specific guidelines for determining the types of supporting data which should be obtained and analyzed in order to determine whether exemptions are warranted.

AGENCY ACTIONS

On September 29, 1977, the General Services Administration's Director, Federal Procurement Regulations, proposed an amendment to the Federal regulations to make them conform with the Armed Services Procurement Regulation regarding contractors' claims for exemption from submission of certified cost or pricing data. The Director, Federal Procurement Regulations, told us that the change was proposed in the interest of achieving uniformity in Government regulations and in recognition of the General Accounting Office's concern for the lack of guidance in this area. We had discussed our review objectives with a member of the Director's staff before we began our examination and, subsequently, briefed procurement personnel on the results of our examination. The proposed change provides additional guidance, which our review shows is needed by contracting officers, to obtain and analyze information to determine whether exemptions should be granted.

RECOMMENDATION

We recommend that you approve the proposed change to the Federal Procurement Regulations to provide better guidance for obtaining and analyzing information to determine whether exemptions from submission of cost or pricing data should be granted.

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Copies of this report are being sent to the Veterans Administration; Department of Health, Education and Welfare; Department of Transportation; Department of Interior; Department of Commerce; Office of Management and Budget; and the Office of Federal Procurement Policy. We are also sending copies of this report to the Senate and House Committees on Appropriations; the House Committee on Government Operations and the Senate Committee on Governmental Affairs.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs, not later than 60 days after the date of the report, and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the report. We would appreciate receiving a copy of these statements.

Sincerely yours,



R. W. Gutmann
Director

Enclosure

PRICING GOVERNMENT CONTRACTS ON THE
BASIS OF CATALOG OR MARKET PRICES

BACKGROUND

The Congress has historically required that Government purchases of goods and services be accomplished using full and free competition to the maximum extent practicable. Offering all qualified contractors the opportunity to compete helps to minimize favoritism and collusion and provides greater assurance that acceptable supplies and services are obtained at the lowest prices.

In the absence of competition, Federal Procurement Regulations state that contracting officers shall, with some exceptions, obtain contractors' cost or pricing data in support of proposed prices. Where cost or pricing data is required, a cost analysis or review and evaluation of the contractor's data and judgmental factors, applied in estimating the cost of performing the contract, shall be performed. These actions increase the assurance that prices, negotiated in the absence of competition, will be fair and reasonable.

One exception to the requirement is where the contracting officer determines that the proposed price for an item is based on an established catalog or market price for a commercial item sold by the contractor in substantial quantities to the general public. The rationale for this exemption is the presumption that, if many buyers have bought an item at a specified price, the forces of the market place will produce a fair price.

CATALOG EXEMPTIONS GRANTED
WITHOUT ESTABLISHING VALIDITY

We reviewed the pricing of 204 noncompetitive fixed-price contracts and modifications valued at about \$131.7 million. Contracting officers granted contractors an exemption from the requirement to submit cost or pricing data for these contracts on the basis that they were for goods and services sold by the contractors in substantial quantities to the general public at established catalog or market prices. We found, however, that contracting officers granted the exemptions for items, procured under 201 of the contracts, at a value of about \$127.3 million, without obtaining the data needed to determine whether the required conditions, which would justify the exemptions, were met. As a result, there was no assurance that the prices negotiated for the 201 contracts were reasonable.

Existence of catalog or market
prices not established

The Federal Procurement Regulations state that one of the conditions, which must be met before granting an exemption to the requirement for submission of cost or pricing data, is that the proposed price must be based on an established catalog or market price. The regulations, however, provide no definite guidance as to what data should be obtained to establish that such prices exist. (See p. 8.)

Price catalogs, lists, or similar documents, which could be used to demonstrate that proposed prices were based on

established catalog or market prices, were not obtained from contractors for any of the items included in 88 of the contracts reviewed. Contracting officers had no information from contractors. Therefore, they made their determinations that established prices existed on unverified contractor statements, that proposed prices were based on such prices, or were prices offered to their most favored customers. Following is an example.

A contractor was exempt from furnishing cost or pricing data in support of proposed prices for a contract valued at \$673,538, on the basis of the contractor's certification that the price offered was that granted its most favored customers, and a statement that it was its best offer. Procurement personnel did not obtain from the contractor a price list or other documents that would demonstrate the evidence of a catalog or market price.

Substantial commercial
sales not verified

Another condition, which must be met prior to granting an exemption to the requirement for submission of cost or pricing data, is that items being procured be sold in substantial quantities to the general public at regularly established prices. The regulations do not, however, contain definite guidance on obtaining, verifying, and analyzing data to determine whether this condition is met. (See p. 8.)

Information was not obtained by procurement personnel on contractors' sales of items purchased under 188 contracts. Procurement officials at agencies which obtained no sales data told us that such data was not requested because it was unclear as to whether such data was required by the regulation or they had sufficient knowledge of items being procured to determine whether they were commercial items. The contract files, however, did not contain the reasons why sales data was not obtained.

For items procured under the 13 other contracts, data was primarily provided by contractors on the (1) percentage of total sales made to commercial customers and to the Government or (2) total dollar value of sales, with listings of customers, but no segregation of sales by individual customers. None of the information obtained demonstrated the extent to which sales were made at established catalog or market prices. Following is an example.

A contracting officer granted a contractor an exemption from furnishing cost or pricing data in support of proposed costs for a contract valued at \$100,477, on the basis of the contractor's certification that the price offered was based on established market prices of commercial items sold in substantial quantities to the general public. The contractor also stated that commercial and Government sales were 90 percent and 10 percent, respectively. The contract file contained no evidence that procurement personnel

requested the contractor to provide a price list . . . additional sales data to prove substantial sales to the general public at published prices.

MANY ITEMS NOT SOLD IN SUBSTANTIAL
QUANTITIES TO THE GENERAL PUBLIC
AT ESTABLISHED PRICES

Because sales data was not requested or incomplete data was obtained for items included in the 201 contracts, we obtained sales data from contractors for 172 selected items procured under 70 of these contracts for a 1-year period prior to contract award. These items were valued at about \$35.2 million. The value of all items, priced as commercial items, under the 70 contracts was about \$40.7 million.

We analyzed the sales data using the Armed Services Procurement Regulation criteria. (See pp. 9 and 10.) Our analysis showed that 49 of the 172 items procured under the 70 contracts were not sold by the contractors in substantial quantities to the general public at published prices. Sales data received for an additional 22 items indicated that further review and analysis would be needed to determine whether the exemptions should have been granted. The following are the overall results of our analysis by contract line item and value.

	<u>Number of items</u>	<u>Percent of total</u>	<u>Contract value</u> (millions)	<u>Percent of total</u>
Items sold to the general public in substantial quantities	101	58.7	\$24.0	68.2
Items not sold to the general public in substantial quantities	49	28.5	8.4	24.0
Items for which exemption justification was uncertain	<u>22</u>	<u>12.8</u>	<u>2.8</u>	<u>7.8</u>
Totals	<u>172</u>	<u>100.0</u>	<u>\$35.2</u>	<u>100.0</u>

The following are examples of contract actions involving items not sold in substantial quantities to the general public.

A procurement office awarded a contract valued at \$222,018 without obtaining a commercial price list or sales data from the contractor; yet, the contract file contained a statement that the contract price was based on established catalog or market prices of commercial items sold in substantial quantities to the general public. The contracting officer accepted the proposed contract prices as fair and reasonable on the unverified basis that they were the same as offered to all Government agencies and favored customers for custom-made items.

We requested sales data from the contractor, for selected items valued at \$215,268, for a 1-year period prior to the award of the contract. The contractor's reply to our request

showed that there had not been any sales of the items during the 1-year period. The information, provided by the contractor and that contained in the contract file, did not establish that the contractor had met the conditions needed for an exemption from submission of cost or pricing data.

Another contract, valued at approximately \$624,184, was awarded on the basis of established catalog prices, of items sold in substantial quantities to the general public, without the contracting officer obtaining any sales data to support the contractors' claim. Sales data provided to us by the contractor showed that, while about 77 percent of its total sales were made to the general public during a 1-year period prior to contract award, only 10 percent of the sales to the general public was made at published catalog prices, less only published discounts. The remaining 90 percent was made at other than published list prices, discounts, or discount rates. Using armed services criteria, this sales data would not support the exemption granted.

GUIDANCE NEEDED FOR DETERMINING
WHETHER EXEMPTIONS SHOULD BE GRANTED

Federal Procurement Regulations allow contracting officers to exempt contractors from submitting cost or pricing data, in support of proposed prices for commercial items, when specified conditions are met. The regulations do not, however, contain (1) definite guidelines on what types of data should be obtained from contractors to assist in establishing whether or not the required conditions for exemption

are met, (2) criteria for analyzing the data, and (3) guidelines on when data should be verified. In addition, agencies we reviewed had not established such guidelines and criteria.

The Armed Services Procurement Regulation, applicable to defense agencies, does, however, contain guidelines on obtaining price and sales data and criteria for analyzing it. In addition, the Armed Services Procurement Regulation Manual for Contract Pricing, a pricing guide, contains supplementary guidance for obtaining and analyzing data and some guidelines on when data should be verified.

Obtaining supporting data

The Armed Services Procurement Regulation requires contractors requesting an exemption to furnish the buying office a copy of the price catalog, or similar document, containing list prices and discounts upon which catalog prices are based and the source, date, or period of the market quotation, including the base amount and applicable discounts. Contractors are also required to provide sales and market information to support that each catalog or market priced item proposed at a value of over \$10,000 has been sold, at an established price, to the general public in substantial quantities. For a market priced item, the nature of the market must be described. For a catalog priced item, required information includes sales data for a specified recent representative period indicating

the number of units sold to the (1) Government, its instrumentalities, and prime and subcontractors, (2) general public at catalog prices less only published discounts, and (3) general public at other than published list prices, discounts, or discount rates.

Additional data required to be provided by contractors includes price and quantity information, on three of the lowest priced sales, to the general public within the specified sales period. This includes the lowest price sale, at both published and unpublished prices, and discounts for quantities comparable to those being procured, or the sale most near the quantities if there were no comparable sales.

Analyzing obtained data

The Armed Services Procurement Regulation and Manual contain criteria for analyzing sales data to determine whether sales to the general public are substantial and are at established prices. The need for criteria by defense contracting officers was disclosed in our December 1969 report to the Congress on Improvements Needed in Negotiating Prices of Noncompetitive Contracts Over \$100,000 on the Basis of Contractors' Catalog or Market Prices (B-39995).

Subsequently, the following guidelines were included in the Armed Services Procurement Regulation and Manual:

- Sales to the general public are presumed to be substantial if (a) they are not negligible, (b) they account for 55 percent or more of total sales, and (c) at least 75 percent of general public sales are made at catalog prices.

--Sales to the general public are generally not substantial if (a) they are negligible, (b) they account for less than 35 percent of total sales, or (c) less than 55 percent of general public sales are made at catalog prices.

--Sales to the general public in substantial quantities are questionable and require additional fact finding if (a) such sales are between 35 and 55 percent of total sales or (b) between 55 and 75 percent of general public sales are made at catalog prices. A key factor to consider in this situation is whether there are similar items sold in the market place in substantial quantities.

Verification of data

The Armed Services Procurement Manual states that data submitted by a contractor may need verification. The kind of facts that may need verification are total units sold, market price justifications, unit prices of listed sales, and sales to the general public at either published or nonpublished prices, and discounts when analysis of submitted data does not clearly indicate whether exemptions are justified. Verification should be limited to those parts of the data that are significant and uncertain.

Procurement Offices Reviewed

Location

Supply Services Division, National Bureau of Standards, Department of Commerce	Boulder, Colorado
Procurement Branch, Division of Administrative Services, National Institutes of Health, Public Health Service, Department of Health, Education and Welfare	Bethesda, Maryland
Procurement and Contracts Branch, United States Geological Survey, Department of Interior	Reston, Virginia
Contracts Division, Logistics Service, Federal Aviation Administration, Department of Transportation	Washington, D.C.
Procurement Division, Office of Comptroller, United States Coast Guard, Department of Transportation	Washington, D.C.
Office of Procurement and National Automotive Center, Federal Supply Service, General Services Administration	Washington, D.C.
Marketing Center, Veterans Administration	Eines, Illinois