

June 1999

CONTRACT MANAGEMENT

DOD Pricing of Commercial Items Needs Continued Emphasis



DISTRIBUTION STATEMENT A
Approved for Public Release
Distribution Unlimited

19990628 000



GAO

Accountability * Integrity * Reliability



United States General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-280125

June 24, 1999

The Honorable James Inhofe
Chairman
The Honorable Charles Robb
Ranking Minority Member
Subcommittee on Readiness and Management Support
Committee on Armed Services
United States Senate

The Department of Defense (DOD), with the support of the Congress, is increasing its purchases of commercially available products and services. While the current level of commercial purchasing is relatively small and sole-source commercial purchases even smaller, DOD expects commercial purchases to increase in the future and believes determining fair and reasonable prices for commercial sole-source items will continue to be challenging. The Federal Acquisition Regulation (FAR) cautions DOD contracting officers not to obtain more information than is necessary for determining price reasonableness and it emphasizes the need to limit information requests of the contractor. However, when needed, contracting officers may ask contractors to provide sales prices for the same or similar items, an explanation of the contractor's discount policy, or cost data.

The FAR defines price analysis as the process of examining and evaluating a proposed price without evaluating its separate cost elements or profit. Price analysis techniques include (1) comparing proposed prices in response to a competitive solicitation; (2) comparing a currently offered price to previously paid prices if both the validity of the comparison and the reasonableness of the previous prices can be established; (3) using parametric methods such as dollars per pound or other measurement units; (4) comparing offers to competitive published price lists, published market prices, and discount or rebate arrangements; (5) comparing proposed prices with independent government cost estimates; and (6) comparing proposed prices with prices obtained through market research for the same or similar items.

As you requested, we (1) determined the extent of price analysis DOD contracting personnel were performing to arrive at fair and reasonable prices for commercial sole-source items, (2) evaluated how well contract

personnel performed price analyses, and (3) determined what guidance and training was available to assist them in determining price reasonableness. We reported our preliminary observations during testimony before the Senate Subcommittee on Acquisition and Technology, Armed Services Committee, in March 1998.¹ This report supplements the information presented in that testimony.

Results in Brief

In 33 of the 65 commercial sole-source purchases we reviewed, price analysis consisted of comparing the offered price to an offeror's catalog or price list, and/or to the price(s) the government previously paid for the same or similar items. Contracting officers accepted the offered price in 30 of the 33 purchases and negotiated lower prices in 3 cases (9 percent). In the other 32 purchases, contracting personnel used one or more additional price analysis tools such as obtaining commercial sales cost information. Contracting officers accepted the offered price in 19 of the 32 purchases and negotiated lower prices in 13 cases (41 percent).

The price analysis performed by contracting personnel were often too limited to ensure that prices were fair and reasonable. For example, some contracting personnel believed that when the offered price was the same as the catalog or list price, it could be considered a fair and reasonable price. In several cases, contracting personnel did not use pertinent historical pricing information contained in contract files that should have raised questions about the reasonableness of offered prices. Further, contracting officers, generally, were not using a discretionary solicitation clause that requires offerors to provide information other than certified cost and pricing data, such as sales data, in support of their offered prices. In addition, some contracting officers paid prices that included unneeded services. Finally, many contracting officers were not documenting in the contract file how they determined that a price previously paid for an item was fair and reasonable and, therefore, could be relied on in evaluating the currently offered price.

Reasons given for the limited price analysis included workload burdens and urgent requirements for items. DOD officials also noted the reduced negotiation leverage that contracting officers now have when purchasing commercial items in a sole-source environment.

¹Defense Acquisition: Improved Program Outcomes Are Possible (GAO/T-NSIAD-98-123, Mar. 18, 1998).

DOD continues to provide guidance and training to assist contracting personnel in contracting for commercial items and in performing sound price analysis. However, based on our work, DOD's efforts have yet to be fully understood or embraced by all DOD contracting personnel. In time, the training should improve their price analysis and negotiating skills. Also, recent legislation requires increased guidance for contracting personnel on price analysis tools, the appropriate use of information other than cost or pricing data, and the role of support agencies. The guidance should also help government contracting personnel become smarter buyers in the commercial marketplace. As of May 1999, regulations to implement the act had not been published.

We are making recommendations to the Secretary of Defense to improve the price analysis performed by DOD contracting personnel.

Price Analysis Performed by Contracting Personnel

While the FAR grants DOD contracting officers wide latitude on the type and extent of price analysis techniques they can use, contracting officers are required to perform sufficient price analysis to determine whether offered prices are fair and reasonable. The more knowledgeable contracting personnel are about the basis and makeup of commercially offered prices, the better the position they will be in to evaluate the reasonableness of offered prices. Our review of 65 commercial sole-source purchases showed that for 33 purchases, price analysis consisted of comparing the price offered to a catalog or price list, and/or to the price(s) previously paid for the same or similar items by the government. Contracting officers accepted the offered price in 30 of these 33 purchases and negotiated lower prices in 3 (9 percent).

For the other 32 purchases, contracting personnel used one or more additional price analysis tools. For 21 of these purchases, some commercial sales information was obtained. Depending on the circumstances, sales information can be useful in comparing the reasonableness of prices offered by contractors to prices paid by commercial customers for the same or similar items sold in comparable quantities. However, in many of the 21 cases, the quantities the government required were significantly larger than the quantities reflected in the commercial sales information. Contracting officers accepted the offered price in 13 of these 21 cases and negotiated lower prices in 8 cases (38 percent). With regard to sales information, contracting personnel have another tool available to them. A 1998 Defense Contract Audit Agency (DCAA) memorandum emphasized its availability to review sales and other

data provided by contractors in support of their offered prices for commercial items. However, contracting personnel requested this support for only one of the purchases we reviewed. A number of contracting personnel told us they were unaware that this DCAA support was available.

For the remaining 11 purchases, contracting personnel used other pricing tools such as obtaining cost information. Contracting officers accepted the offered price in 6 of these 11 purchases, and negotiated lower prices for 5 purchases. In total, contracting officers accepted the offered price in 49 of the 65 purchases (75 percent) and negotiated a price reduction in 16 cases (25 percent).

Price Analysis Often Limited

We found that price analysis being performed by contracting personnel were often too limited to ensure fair and reasonable prices. For example, some contracting personnel believed that when the offered price was the same as the catalog or list price, it could be considered a fair and reasonable price. In several instances the price analysis performed by contracting personnel did not address pertinent historical pricing information. In addition, some contracting officers paid prices that included unneeded services. Further, contracting personnel, generally, were not using a discretionary solicitation clause that requires offerors to provide information other than certified cost and pricing data, such as sales data, in support of their offered prices. Finally, many contracting officers were not documenting in the contract file how they determined that a price previously paid for an item was fair and reasonable and, therefore, could be relied on in evaluating the currently offered price. While we believe some price analyses were often too limited, we cannot say whether the prices would have been different had better price analysis been performed.

Comparing Price Offered to Catalog or List Price

FAR and service guidance make it clear that contracting personnel cannot simply rely on catalog or list prices in making a price reasonableness determination. While catalog prices are an appropriate source of pricing information, contracting personnel must evaluate catalog prices while considering such things as quantities to be purchased, delivery times, market conditions, and sales to other customers. Contracting personnel must do sufficient price analysis to enable them to determine the reasonableness of an offered price and to document the results of their price analysis.

In our review, we found 22 purchases where the price analysis was based only on catalog prices. For eight of these purchases, the price analysis consisted of simply comparing the offered price to a current catalog or list price less whatever discount was offered. For 14 additional purchases, the offered price was also compared to previous prices that were the same as the catalog or list price less whatever discount was offered. In all 22 cases, the contracting officer accepted the offered price. In our discussions with contracting personnel, some believed that catalog or list prices could be accepted as fair and reasonable because they assumed that these are the prices paid by commercial customers.

Not Using Pertinent Contract File Information

In several cases, contracting personnel did not use pertinent historical pricing information contained in contract files that should have raised questions about the reasonableness of offered prices. For example, in June 1998, a DOD contracting officer paid \$7,320 each for 31 generator adapter kits, in part, based on a comparison to prior government purchases since April 1995 at the same price and other small quantity commercial sales in 1998 at \$9,727 each. The price analysis for this purchase referred to an August 1997 management directive cautioning that historical prices should only be used if they were prior to 1993 because more recent purchases from this contractor were overpriced by about 300 percent. Nevertheless, the 1995 price was used to support a price reasonableness determination for the 1998 price of \$7,320. According to information in the files, DOD had purchased eight of these items in 1989 for \$1,129 per unit. The price analyst told us that because of her workload she did not have time to research the price reasonableness of the 1989 purchase made by another DOD buying office.

In a second case, in October 1996, using a commercial contract, an Air Force contracting officer paid \$1,307 each for 81 aircraft engine vanes for the KC-135 aircraft. The commercial price was based on the catalog price less a 7.5-percent discount. This part is also used on the F-16 engine and was bought by the Air Force in September 1995 under a separate noncommercial contract for \$300 each. The contracting officer was aware of lower prices for common parts but did not believe that it was appropriate to use another contract to purchase the vanes. In discussing this situation with Air Force contracting personnel, they advised us that the noncommercial contract could have been used to purchase the vanes.

In a third case, in November 1996, a parts distributor offered a price of \$453 per unit for 381 wiring harnesses used on C-130 aircraft. The Defense

Logistics Agency (DLA) contracting officer accepted this price based on a comparison to commercial sales prices, with the largest purchase being for seven units at \$495 each. According to information in the contract files, DOD purchased 461 wiring harnesses directly from the manufacturer in 1993 for \$103 each and 194 units in 1994 at \$91 each. Subsequently, the manufacturer declined to sell the item directly to the government but instead referred DLA to its authorized distributor. The contracting officer did not use the historical pricing information to attempt to negotiate a lower price with the distributor for the 1996 purchase. A DLA official told us it has initiated a review of the price paid for this purchase.

In another case, an Air Force contracting officer determined that an offered unit price of \$2,718 for 83 B-1B hydraulic-cylinder blocks was fair and reasonable when compared to a 1996 unit price of \$2,535, a 7-percent increase over 17 months. However, the contracting officer told us she did not consider other information in the contract file showing that the unit price paid for this item had increased from \$441 in 1989 to \$2,535 in 1996, a 475-percent increase. She said she was only required to compare the currently offered price to the last price paid.

Not Using Solicitation Clause for Obtaining Information

We found that contracting officers, generally, were not using a discretionary solicitation clause requiring offerors to provide information other than certified cost and pricing data, such as sales data, in support of their offered prices. The FAR allows contracting officers to insert this clause in solicitations when they determine that such data will likely be needed to evaluate price reasonableness.² For a commercial item, this clause requires offerors to submit, at a minimum, information on the prices at which the same or similar items have been sold in the commercial market that is adequate for evaluating the reasonableness of prices offered the government. For commercial items where the price is listed in a catalog, the clause also requires offerors to explain the basis of each offered price, its relationship to the established catalog price, and an explanation of how the proposed price relates to the price of recent sales in quantities similar to those requested by the government. DLA guidance recommends this clause in all solicitations and contracts for sole-source commercial items.

²FAR clause 52.215-20 or its predecessor FAR clause 52.215-41.

We found that some contracting personnel were unfamiliar with this clause while others did not have a clear understanding about when it should be used for commercial purchases. Some contracting supervisors believe that because this clause is also applicable to noncommercial contracts, there may be some confusion among contracting personnel about its applicability to commercial contracts.

Paying Prices That Included Unneeded Services

The FAR and military service guidance emphasize that in determining price reasonableness, contracting personnel must understand the basis for an offered price. Accepting offered prices without considering such things as quantities to be purchased, delivery times, market conditions, or sales to other customers can result in prices that are not fair and reasonable. For example, the catalog prices of commercial aircraft parts are often based on small quantities delivered rapidly; in contrast, government requirements may be for larger quantities to be placed in inventory and delivered over much longer periods of time.

We identified two instances where contracting officers paid commercial catalog-based prices to restock inventories rather than to meet urgent requirements requiring rapid delivery. In the first instance, the contracting officer purchased 11 wing components in December 1996 for \$38,693 each, which was the contractor's published catalog price. The catalog prices were based on a 10-day delivery period. However, the government's required delivery was July 1998—19 months later—for routine restocking of spare parts. In the second instance, in March 1997, the Air Force placed an order for 404 engine acoustical panels at the commercial catalog-based price of \$588 each based on a 10-day delivery period. However, because of the large quantity ordered, the contractor indicated that delivery could not start until the end of August 1997 and would not be completed until April 1998, over a year after the order was placed. Nevertheless, the order was placed at a price based on 10-day delivery. In both cases, we found no indication that contracting personnel inquired about the possibility of lower prices for extended delivery times.

In contrast to these two situations, we found another buying activity that negotiated a large discount for items not requiring rapid delivery. The contracting officer negotiated a 61-percent discount off the offeror's commercial catalog prices for about 8,000 engine spare parts. Delivery would be based on the time required to manufacture the items ordered rather than the short delivery times provided for in the catalog. The government would, however, be required to pay the premium prices paid by

commercial customers if the shorter catalog delivery times were required to meet urgent needs.

Not Documenting the Reasonableness of Prior Prices

The FAR provides that a contracting officer can compare currently offered prices to prior prices, if both the validity of the comparison and the reasonableness of the previous price(s) can be established. However, we found that many contract files did not show how contracting officers determined that a price previously paid for an item was fair and reasonable and, therefore, could be relied on in evaluating the currently offered price. This issue has been previously recognized as a potential problem. For example, an Air Force Institute of Technology and Federal Acquisition Institute Contract Pricing Resource Guide, referenced in the FAR, cautions that, "It is not uncommon to review an item purchase history and find that no basis other than the last price paid has been used for years to determine price reasonableness."

Reasons Given for Limited Price Analysis

Contracting personnel offered a number of reasons why they did not perform more extensive price analysis. Some said that given their workload, the most they could do was to compare the offered price to the catalog price or to the last price paid by the government. They said they did not have enough time to obtain commercial sales information or develop detailed independent cost or parametric estimates. At two activities, managers acknowledged that workforce downsizing had increased the workload of contracting personnel. At one activity, they said management's priority had been to clear a large backlog of purchase orders, which made price a secondary consideration.

In some cases, contracting personnel said pressures from their customers to meet urgent requirements prevented more extensive price analysis and negotiations over price. In these instances, customers told contracting personnel that they were less concerned about price than meeting mission requirements or keeping to overhaul and repair schedules. In a few cases, contracting personnel said that additional price analysis was not needed because the offered prices compared favorably to prices previously paid.

DOD officials noted that one difficulty facing contracting officers is that some contractors take advantage of their position as sole-source commercial item providers. Further, one official stated that some contractors refuse to negotiate what the government would consider fair and reasonable prices. DOD officials noted that in these situations

contracting officers do not have enough leverage. For example, negotiations by DLA with one sole-source supplier resulted in a price that DLA did not believe was fair and reasonable because it was almost double the cost of the item. In this instance, the negotiated price was about three times the price previously paid. Nevertheless, DLA decided to purchase the item at a price it considered excessive, but limited the quantity to the amount needed until an alternative source could be developed from among manufacturers who make similar items.

Efforts to Improve Price Analysis

DOD continues to add to the training and guidance it offers contracting personnel to assist them in performing price analysis in a commercial contracting environment. Between June and August 1997, each of the military services and DLA issued additional guidance on the pricing of commercial items. The guidance recognizes the challenges that contracting officers face in determining whether prices for commercial items are fair and reasonable, especially when there is no competition. The guidance also stresses the importance of negotiating prices when buying commercial items, and reemphasized FAR guidance regarding the pricing of commercial items and the contracting officer's responsibility to ensure that prices paid by the government are fair and reasonable. The guidance cautioned contracting officers about the need to fully understand the basis of commercial catalog prices and not to assume that they are fair and reasonable just because they are in a published commercial catalog. Further, the guidance reminded contracting personnel that for commercial acquisitions, the FAR allows them to request information other than certified cost and pricing data to the extent necessary to determine price reasonableness.

In fiscal year 1998, the Office of the Deputy Under Secretary of Defense (Acquisition Reform) sponsored a series of satellite broadcasts to provide training on acquisition reform, including the pricing of commercial items. Specific subjects covered included commercial pricing practices; performing market research; and the use of historical, comparative, and parametric pricing techniques. A June 1998 session was devoted entirely to the pricing of commercial spare parts in a sole-source environment. In addition, during calendar year 1998, both DLA and the Air Force provided contracting personnel with 1-day training courses on commercial acquisition and pricing. The topics covered by this training were similar to DOD's satellite broadcasts.

Also, in February 1998, the Deputy Under Secretary of Defense (Acquisition Reform) issued a Commercial Pricing Information Guide. The guide emphasizes the link between good market research and the ability of contracting officers to negotiate fair and reasonable prices for commercial items. In June 1998, the Air Force Materiel Command issued its own supplementary Commercial Acquisition Guide. In addition to discussing price analysis techniques that can be used for commercial purchases, the guide emphasizes the importance of sound market research in determining price reasonableness and the need for contracting personnel to adequately document the results of their research in the contract files. Further, DOD, DLA, and military services have established Internet Web sites with additional guidance and tools to assist contracting personnel in performing market research and in acquiring and pricing commercial items.

Other opportunities to obtain training on pricing commercial items included presentations by DOD and DLA officials during DOD's 1998 Acquisition Reform Week Activities, and classes sponsored by DOD's Defense Acquisition University. DOD is continuing its efforts to develop additional training on commercial pricing, including computer-based training.

Recent Legislation

The Fiscal Year 1999 Strom Thurmond National Defense Authorization Act required clarification of the procedures and methods used by government contracting personnel to determine the reasonableness of commercial prices. This act requires FAR revisions to provide specific guidance on (1) the application and precedence of specified price analysis tools; (2) the circumstances under which contracting officers should require contractors to provide prior sales prices for the same or similar items, or other information, other than certified cost and pricing data, in support of their commercially offered prices; and (3) the roles and responsibilities of DOD support organizations, such as the DCAA, in procedures for determining price reasonableness. The act also requires DOD to track price trends for commercial items, and to take appropriate action to address any unreasonable escalation in prices identified by the price trend analysis.

The same act also directed that the FAR be revised to require offerors, as a condition for entering into a contract, to provide sales and other information, other than certified cost and pricing data, in support of their offered prices when such information is requested by the contracting officer. This requirement would be subject to any exceptions that the

Federal Acquisition Regulatory Council determines appropriate. As of May 1999, regulations to implement the act had not been published.

Conclusions

The current contracting environment for sole-source commercial items presents negotiating challenges for DOD contracting personnel. Based on our work, DOD's efforts to improve the quality of price analysis have yet to be fully understood or embraced by all DOD contracting personnel. However, it is important to recognize that DOD is in the midst of training its contracting personnel on commercial pricing. In time, effective training should improve their price analysis and negotiating skills. Recent legislation requiring increased guidance for contracting personnel on price analysis tools, the appropriate use of information other than cost or pricing data, and the role of support agencies should also help government contracting personnel become smarter buyers in the commercial marketplace.

Beyond these actions, we believe that two areas deserve additional attention. One is the lack of awareness or understanding by contracting personnel concerning the use of a solicitation clause that requires contractors to provide information other than certified cost and pricing data in support of their offered prices. The second is the failure of contracting personnel to use pertinent historical pricing information contained in contract files that should have raised questions about the reasonableness of offered prices. Recent commercial prices paid by some DOD contracting officers may reflect insufficient training or a lack of understanding of what constitutes good price analysis in a sole-source environment.

Recommendations

We recommend that the Secretary of Defense direct the Under Secretary of Defense for Acquisition and Technology to

- include, as part of DOD's efforts to implement recent legislation, clarification of the circumstances when it is appropriate to use the FAR clause (52.215-20) requiring an offeror to provide information on the prices at which the same or similar items have been sold in the commercial market and
- issue a memorandum to contracting personnel emphasizing the importance of understanding and using historical pricing information for sole-source commercial item purchases.

Agency Comments

In commenting on a draft of this report, DOD concurred with our recommendations. DOD said it would issue the guidance recommended by the draft report as part of its implementation of the requirements of the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999.

Scope and Methodology

To determine and evaluate the price analysis DOD contracting personnel were performing to arrive at fair and reasonable prices for commercial sole-source items, we focused on the purchase of aircraft parts. We did this because aircraft parts and related end items represented the largest category of commercial sole-source purchases DOD made during fiscal year 1997. Within aircraft spare parts, we selected those DOD buying activities that were major purchasers of commercial sole-source items. We obtained this information by analyzing DOD's DD350 database, which contains all contract transactions over \$25,000. Based on our analysis, we selected the following DOD buying activities for review:

- Air Force's Air Logistics Center, San Antonio, Texas;
- Air Force's Air Logistics Center, Oklahoma City, Oklahoma;
- U.S. Special Operations Command, Fort Eustis, Virginia;
- Defense Supply Center, Columbus, Ohio;
- Defense Industrial Supply Center, Philadelphia, Pennsylvania; and
- Defense Supply Center, Richmond, Virginia.

In addition, we selected the Naval Inventory Control Point, Philadelphia, Pennsylvania, because it was located at the same address as the Defense Industrial Supply Center in Philadelphia.

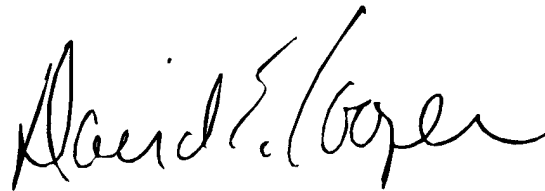
For each of these buying activities, we obtained additional information from the activity on commercial sole-source purchases. From this information, we further narrowed the universe down to those sole-source commercial purchases over \$100,000 where the price was negotiated during fiscal years 1997-98. Finally, we judgmentally selected a total of 65 contract actions amounting to about \$79 million for review. For each contract action, we reviewed the information in the contract file, including the price analysis and negotiation memorandums, and identified the price analysis tools contracting personnel used to determine fair and reasonable prices. We also discussed this information with selected contracting personnel who conducted the price analyses. Based on these reviews and discussions, we evaluated how well contract personnel performed their price analyses.

To identify the guidance and training available to contracting personnel to assist them in determining a fair and reasonable price, we asked DOD, DLA, and military service representatives to provide us with available guidance and training on commercial purchases. We reviewed this information and discussed it with selected contracting personnel and management at DOD buying offices.

Our work was performed in accordance with generally accepted auditing standards.

We are sending copies of this report to the Honorable William Cohen, Secretary of Defense; the Honorable Jacob J. Lew, Director, Office of Management and Budget; and Lieutenant General Henry T. Glisson, Director, Defense Logistics Agency. Copies will also be made available to others on request.

Please contact me at (202) 512-4587 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix II.



David E. Cooper
Associate Director
Defense Acquisitions Issues

Contents

Letter	1
Appendix I Comments From the Department of Defense	16
Appendix II Major Contributors to This Report	20

Abbreviations

DCAA	Defense Contract Audit Agency
DLA	Defense Logistics Agency
DOD	Department of Defense
FAR	Federal Acquisition Regulation

Comments From the Department of Defense



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

June 7, 1999

DP/CPF

Mr. David E. Cooper
Associate Director, Defense Acquisitions Issues
National Security and International
Affairs Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "CONTRACT MANAGEMENT: Commercial Item Pricing Needs Continuing Emphasis", dated May 6, 1999 (GAO Code 707321/OSD Case 1808).

GAO examined 65 sole source purchases of commercial items to assess the adequacy of price analyses performed by DoD contracting personnel in arriving at fair and reasonable prices. The GAO concluded that those price analyses were, in many instances, too limited to assure that prices agreed to were fair and reasonable. The report recommends that contracting personnel be given additional guidance regarding the importance of obtaining historical pricing information and the correct use of that information in performing price analysis, whether or not offered prices are included in published catalogs or price lists. The report also says the contract file needs to be adequately documented to support a contracting officer's conclusion that historical prices may be relied on in determining that offered prices are fair and reasonable.

The Department of Defense (DoD) concurs with the recommendations of the report. We will issue the guidance recommended by the draft report as part of our implementation of the requirements of the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999. Section 803 of the Act includes a requirement for clarification of procedures and methods used by government contracting personnel to determine the price reasonableness of commercial items when the procurement of those items is exempt from any requirement for submittal of certified cost or pricing data. FAR Case 98-300,



Appendix I
Comments From the Department of Defense

recommended for issuance as an interim rule by the Defense Acquisition Regulations Council on May 19, 1999, includes the clarifications called for by the statute. The case is being forwarded to the Civilian Agency Acquisition Council for action.

Thank you for the opportunity to comment on the subject final report.

Sincerely,



Eleanor R. Spector
Director, Defense Procurement

Enclosure

GAO DRAFT REPORT
MAY 6, 1999

**"CONTRACT MANAGEMENT: Commercial Item Pricing
Needs Continuing Emphasis"**

(GAO CODE 707321) OSD CASE 1808

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

GAO Recommendation 1: The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense for Acquisition and Technology to include, as part of its efforts to implement recent legislation, clarification of the circumstances when it is appropriate to use the Federal Acquisition Regulation (FAR) clause (52.215-20) requiring an offeror to provide information on the prices at which the same or similar items have been sold in the commercial market.

DoD Response: Concur. The Director of Defense Procurement will issue a memorandum to the DoD contracting community that will include, among other things, a reminder that the clause at FAR 52.215-20 is an appropriate vehicle for inclusion in solicitations where it is known that the government will require offerors to submit cost information, other than certified cost or pricing data, to be used by the contracting officer to establish that offered prices are fair and reasonable.

This memorandum will be issued within thirty days of the issuance of FAR Case 98-300, Determination of Price Reasonableness and Commerciality, as an interim rule. FAR Case 98-300 was approved for publication as an interim rule by the Defense Acquisition Regulations Council on May 19, 1999, and will soon be forwarded for the action of the Civilian Agency Acquisition Council. The content of that case is discussed below, in response to GAO Recommendation 2

GAO Recommendation 2: The GAO also recommended that the Secretary of Defense direct the Under Secretary of Defense for Acquisition and Technology to issue a memorandum to contracting

ENCLOSURE

Appendix I
Comments From the Department of Defense

personnel emphasizing the importance of understanding and using historical pricing information for sole-source commercial item purchases.

DoD Response: Concur. Subsection (a) of Section 803 of the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 requires regulatory guidance be developed to clarify the Federal Acquisition Regulation (FAR) procedures and methods to be used for determining the reasonableness of prices of commercial items. The approval by the Defense Acquisition Regulations Council and Civilian Agency Acquisition Council of FAR Case 98-300, will modify FAR Parts 12 and 15 to comply with the statutory direction.

This case will add specific guidance to the FAR regarding the appropriate application and precedence of such price analysis tools as catalog-based pricing, market-based pricing, historical pricing, parametric pricing, and value analysis, as well as the circumstances under which contracting officers should require offerors of exempt commercial items to provide information on prices at which the offeror has previously sold the same or similar items, or other information other than certified cost or pricing data. The coverage also indicates the role and responsibility of Department of Defense support organizations in procedures for determining price reasonableness.

The Director of Defense Procurement will issue a memorandum to the DoD contracting community within thirty days of the publication of FAR Case 98-300 as an interim rule. The memorandum will cite that case in addressing the importance of understanding and using historical pricing information for sole-source commercial item purchases, and will also include a reminder of the potential use of FAR Clause 52.215-20 as a vehicle for obtaining that historical pricing information.

Major Contributors to This Report

**National Security and
International Affairs
Division, Washington,
D.C.**

Paula J. Haurilesko
Thomas W. Hopp
Julia M. Kennon
Leslie E. Schafer
Charles W. Thompson

Boston Field Office

Paul M. Greeley

**Los Angeles Field
Office**

Carlos M. Garcia
Noel J. Lance