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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-173639



Dear Senator Dominick:

By letter dated July 8, 1971, you requested that we provide you with a report on our reactions to certain Department of Transportation cost accounting procedures. Your letter enclosed copies of letters to you from Mr. O. E. Bartoe of Ball Brothers Research Corporation and from the Office of the Secretary of Transportation concerning the Department's policy on allowable costs under prime contracts for systems management.

Mr. Bartoe, in his letter to you, expressed his concern that the Department of Transportation was deviating from uniform Government procurement practices in a manner which could result in (1) a contractor not recovering all reasonable and necessary costs associated with a contract, or (2) an inequitable allocation of a contractor's costs among its various customers. Mr. Bartoe's concern arose from a provision in a request by the Department for proposals for management services which stated:

"It is the governments desire to subcontract as much of the effort as possible. In addition, the Department of Transportation does not wish to pay the prime contractor a fixed fee, overhead or G&A charges on subcontract work. In order to benefit from the contractor's organization, a fixed amount or nominal charge arrangement may be considered against subcontracts."

Department officials advised us that this provision was not included in the request in an attempt to preclude any contractor from recovering the reasonable and necessary costs associated with a contract. They stated that the provision was included because of the Department's recognition that the type of systems management contract it planned to award varied considerably from conventional research and development type contracts-- which call for extensive in-house effort--and that under the planned contracting arrangements, up to 80 percent of the total prime contract dollars would relate to subcontractors' work. The Department has indicated that a considerable portion of a contractor's indirect costs, necessary and reasonable to support in-house work, would not be of direct benefit in the management of the subcontracts, and has concluded that, if it followed the normal contracting practice of applying a standard fixed rate to subcontract dollars for a contractor's overhead and general and administrative expense, a very substantial and unwarranted additional cost to the Government would be incurred.

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The Department's actions in this case meet the requirements of Government procurement regulations. Paragraph 1-15.203(d) of the Federal Procurement Regulations, which are applicable to civil agencies, provides that a contractor's method of allocating indirect costs (i.e., overhead, and general and administrative expense) shall generally be acceptable unless:

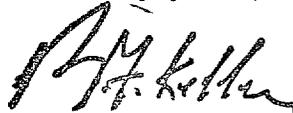
- a particular contract calls for a significant departure from the normal work of the contractor;
- a significant change occurs in the nature of the contractor's business, the extent of subcontracting...or other relevant circumstances.

Comparable sections of the Armed Services Procurement Regulations and the National Aeronautics and Space Administration Procurement Regulations contain wording identical to the Federal Procurement Regulations. Considering the circumstances of the procurement and the authority contained in the Federal Procurement Regulations, it appears that the Department was fulfilling its responsibility for obtaining a fair and reasonable price to the Government for services.

We have discussed the problem of allocating indirect costs to Government contracts with representatives of the Cost Accounting Standards Board. They have informed us that circumstances such as those outlined in Mr. Bartoe's letter will be carefully considered in the development of any cost accounting standard covering the allocation of indirect costs.

We trust the information furnished will serve your purposes.

Sincerely yours,



[Deputy] Comptroller General
of the United States

CHK
The Honorable Peter H. Dominick
United States Senate