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REPORT TO THE CONGRESS



LM095465

Fees Allowed Nonsponsored
Not-For-Profit Organizations
By Various
Government Agencies B-146810

B-146810

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BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

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NOV. 26, 1971

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

B-146810

To the President of the Senate and the
Speaker of the House of Representatives

This is our report on fees allowed nonsponsored not-for-profit organizations by various Government agencies.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), the Accounting and Auditing Act of 1950 (31 U.S.C. 67), and the authority of the Comptroller General to examine contractors' records as set forth in 10 U.S.C. 2313(b).

Copies of this report are being sent to the Director, Office of Management and Budget, and to the departments and agencies mentioned in the report.

A handwritten signature in cursive script, appearing to read "Thomas B. Arto".

Comptroller General
of the United States

D I G E S T

WHY THE REVIEW WAS MADE

In a previous report, the General Accounting Office (GAO) advised the Congress that there was need to improve Federal agencies' guidelines for contracting research work with Government-sponsored nonprofit contractors (B-146810, February 1969). These are nonprofit organizations sponsored by an agency which has assumed responsibility for providing sufficient work and revenues to ensure retention of capabilities acquired to meet Government needs.

In addition to contracting with sponsored nonprofit organizations, Government agencies obligated during fiscal year 1969 about \$260 million for basic and applied research to be performed by nonsponsored not-for-profit institutions other than colleges and universities. For comparison purposes, GAO has now examined into agency policies and practices in the allowance of fees to nonsponsored not-for-profit organizations at six Department of Defense and eight civil agency offices that award cost-plus-fixed-fee contracts for research with not-for-profit organizations on a significant scale.

At three of these larger nonsponsored not-for-profit research institutes, information was obtained on Government fees received. These three were selected because their clients include nearly all departments of the Government and because they are generally in competition with universities and other not-for-profit organizations, both sponsored and nonsponsored, as well as with commercial organizations, for the award of Government research projects.

GAO's review did not include an evaluation of the reasonableness of profit ranges prescribed in Government regulations for payment to either commercial or nonprofit organizations, the profits or fees paid, or the profits or fees actually earned. A comparison was made of fees allowed nonsponsored not-for-profit organizations in relation to profit rates allowed commercial organizations.

FINDINGS AND CONCLUSIONS

In many instances, nonsponsored not-for-profit organizations which pay no Federal income taxes on fees earned on Government work are allowed approximately the same rate of fee on estimated costs that commercial profit-making organizations receive for doing similar work.

Most Federal civil agencies do not make any distinction between tax-exempt organizations and commercial organizations in computing fee objectives. The Atomic Energy Commission (AEC), however, developed guidance in 1963 for considering the tax posture of not-for-profit organizations in fee negotiations.

GAO's detailed analysis of contracts awarded by six civil agency procurement offices during a 4-year period to the three not-for-profit organizations showed that the composite weighted average fee rate was only 0.6 of a percentage point less than the average fee paid commercial organizations.

The average varied substantially for each of the six procurement offices, from 0.4 of a percentage point more for one agency on fees paid to one not-for-profit to 2.1 percentage points less for another agency on fees it paid to another not-for-profit. (See pp. 8 to 16.)

The Department of Defense (DOD) revised its procurement regulations in December 1966 in recognition of the tax-exempt status of not-for-profit organizations. Fee objectives in contracts with such organizations were to be adjusted by application of a special factor of minus 3 percentage points where the proceeds of the contract were not subject to Federal income taxation.

During a 2-year period after issuance of the revised procurement regulation, the composite weighted average rate of fee paid the three nonprofits by DOD was only 1.2 percentage points less than the average fee paid commercial organizations. (See pp. 17 to 22.)

DOD reported to GAO that there was nothing in its written policy to the effect that fees to nonprofits are to be less than fees to commercial organizations. GAO is of the opinion that application of a minus 3 percentage point adjustment would have such a result, all other factors being equal.

In GAO's opinion, most agencies of the Federal Government have not given adequate recognition to the tax-exempt status of not-for-profit organizations nor to the need for an appropriate adjustment of fees to place them on an equitable basis with their commercial competitors. Without this recognition nonsponsored not-for-profit organizations may have a competitive advantage when dealing with Government agencies, such as that which results from their ability to retain and use a higher percentage of earnings to improve physical plant and technical capabilities.

The nonsponsored not-for-profit research institutes included in GAO's review do not agree that their fees should be so adjusted. They contend that the Congress, in granting tax exemption, recognized the need for, and encouraged the development of, independent not-for-profit organizations as being in the public interest and that therefore adjustments of fees based on this tax exemption would defeat congressional policy and intent. The institutes did not identify the basis for their contention.

GAO's review of legislative background material concerning tax exemption of not-for-profit organizations did not disclose any consideration of the fee structure other than the stipulation by the Congress that none of the net earnings of the not-for-profits should inure to the benefit of any private individual.

RECOMMENDATIONS OR SUGGESTIONS

In a draft of its report provided to various Government agencies and the three contractors, GAO had proposed that the Director, Office of Management and Budget (OMB), head an interagency study leading to the development of a Government-wide policy governing the negotiation of fees to not-for-profit and commercial organizations, which gives consideration to the tax posture of each type of organization. (See p. 23.)

GAO also suggested that, pending the development of the Government-wide policy, each agency reevaluate its current policy and take steps necessary to ensure that fee payments are adjusted to adequately recognize the tax-free status of not-for-profit organizations.

AGENCY ACTIONS AND UNRESOLVED ISSUES

Comments on the draft report were received from the agencies and contractors.

The General Services Administration proposes to convene an interagency task group to develop an appropriate temporary Federal Procurement Regulation which would provide uniform civilian agency adherence to a requirement for adjusting fee payments in recognition of the tax-free status of not-for-profit organizations. (See pp. 25 and 26.)

The Department of Health, Education, and Welfare and the Department of Transportation are developing interim guidelines for issuance. (See p. 24.)

The National Aeronautics and Space Administration (NASA) says that, as an interim measure, it will caution buying personnel to consider the tax-exempt posture of contractors when negotiating fees with not-for-profit organizations. (See p. 26.)

DOD believes that its guidelines are adequate, that they have generally been followed by procurement activities, and that a study by OMB would not prove to be productive in appreciably changing fee rates to not-for-profit organizations. (See p. 27.)

The Agricultural Research Service and the Agency for International Development recognize the need for guidelines but are awaiting the results of the study by OMB. (See p. 25.)

OMB believes that the legislative charter of the Commission on Government Procurement would include any study of contractor fees. Therefore,

although OMB would work with the Commission and the affected agencies, OMB feels that it would be premature to take the leadership. (See p. 28.)

GAO believes that OMB is the appropriate agency to assume the responsibility for ensuring that the procurement regulations of all agencies reflect a single overall Government policy for determining fees to be paid to the tax-exempt organizations. It is particularly suited to this task because it is a permanent organization (as contrasted with the Commission on Federal Procurement), has overall management and coordination functions within the executive branch, and has experience in procurement matters. (See p. 32.)

GAO's defense profit study report of March 17, 1971 (B-159896), recommended that OMB take the lead in interagency development of uniform Government-wide guidelines for determining profit objectives for negotiating Government contracts that will emphasize consideration of the total amount of contractor capital required when appropriate, where effective price competition is lacking. Such an interagency study could incorporate the development of a policy governing negotiation of fees to not-for-profit organizations.

MATTERS FOR CONSIDERATION BY THE CONGRESS

GAO is bringing this matter to the attention of the Congress in view of the need for a Government-wide policy governing the negotiation of fees to not-for-profit and commercial organizations, which recognizes the tax posture of each type of organization.

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ABBREVIATIONS

AEC	Atomic Energy Commission
ASPR	Armed Services Procurement Regulation
CPFF	cost-plus-fixed-fee
DOD	Department of Defense
GAO	General Accounting Office
GSA	General Services Administration
HEW	Department of Health, Education, and Welfare
NASA	National Aeronautics and Space Administration
NIH	National Institutes of Health
OMB	Office of Management and Budget

GLOSSARY

The terms "not-for-profit" and "nonprofit" are used interchangeably in this report to identify a scientific organization that (1) performs research for the Federal Government, (2) is exempt from paying Federal income taxes on its

Government work under section 501(c)(3) of the Internal Revenue Code, and (3) operates under a not-for-profit corporate charter.

A nonsponsored not-for-profit organization--as opposed to a Government-sponsored nonprofit organization--is defined for purposes of this report as one for which no Government agency has assumed responsibility to provide sufficient work and revenues to ensure retention of acquired capabilities to meet Government needs.

A commercial organization is defined for purposes of this report as one that (1) performs research for the Federal Government, (2) operates under a corporate charter for profit-making purposes, and (3) pays Federal income taxes on profits.

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CHAPTER 1

INTRODUCTION

In 1962 the President sent a report to the Congress entitled "Government Contracting for Research and Development" (the Bell Report). The report stated that it had been the practice of Government agencies in contracting for research and development with not-for-profit organizations, other than universities, to cover all allowable costs and also to provide a fee.

The reason for paying a fee to not-for-profit organizations is, according to the report, quite different from the reason for paying a fee to profit-making contractors: the profit-making contractor is engaged in business for profit and this profit and the return to shareholders and investors can only come from the fee. Although there are no shareholders in not-for-profit organizations, the Bell Report found two sound reasons to justify payment of a "development" or "general support" allowance or fee to such organizations:

- To provide some degree of operational stability and flexibility to organizations otherwise bound to the precise limitations of cost financing of specific tasks, the allowance to be used to even out the variations in income resulting from variations in the level of contract work.
- To conduct some independent, self-initiated research in order to obtain and hold highly competent scientists and engineers.

In February 1969 the General Accounting Office reported to the Congress¹ on the needs of Government-sponsored non-profit organizations for fees. For comparison purposes, we also obtained information on selected nonsponsored not-for-

¹"Need for Improved Guidelines in Contracting for Research with Government-Sponsored Nonprofit Contractors," B-146810.

profit research institutes. The nonsponsored not-for-profits generally took the position that, because they compete for Government and commercial contracts with private industry, they should not be compared with the sponsored not-for-profits. This led to our review of the Government's practices in awarding fees to nonsponsored organizations.

The objectives of our review were to evaluate existing guidelines for awarding of fees to nonsponsored not-for-profit organizations on cost-plus-fixed-fee (CPFF) contracts for research and development, including their implementation by agencies of the Government, and to compare tax-exempt fee payments awarded to such not-for-profit organizations on Government research work with fee payments awarded to taxpaying commercial organizations, with whom the not-for-profits compete. Our review did not include nonprofit educational institutions that do not usually receive fees on research and development contracts.

For the review, we selected three of the larger nonsponsored not-for-profit research institutes. These three were chosen because their clients include practically all departments of the Government and because they are generally in competition with universities and other not-for-profit organizations, both sponsored and nonsponsored, as well as with commercial organizations, for the award of Government research projects.

Due to the confidential nature of the fee data included in this report, the names of the research institutes are not shown. They are called institutes A, B, and C. Their identities were made known to the heads of Government agencies in letters transmitting draft copies of the report for their review and comment. The president of each of the research institutes has been informed of the designation of his institute.

Institute A performs about 70 percent of its research for the Federal Government, a large portion under CPFF contracts. It uses its fees from Government research contracts primarily to further its growth and development, including independent research, and to cover expenses which are not reimbursed under existing Government procurement regulations.

Institute B engages in many different kinds of activities, a major one being research. We obtained contract and fee information at one research location which accounts for more than one third of institute B's total research volume. About two thirds of the research revenue at this location comes from the Federal Government.

Institute C performs about 75 percent of its research for local, State, and Federal Governments, and the remainder for industrial organizations. Its fee income is used substantially for growth, independent research, and costs which are not reimbursed under Government contracts.

The three organizations do not pay any Federal income taxes on fees earned on Government work but, in some instances, pay taxes on earnings from sales to commercial clients where the research is not of benefit to the general public.

According to figures published by the National Science Foundation, in fiscal year 1969 Government agencies obligated approximately \$260 million for basic and applied research with not-for-profit institutions, other than colleges and universities and sponsored nonprofits. The three non-sponsored not-for-profit research institutes covered in our review reported combined revenues from Government agencies of approximately \$95 million in calendar year 1968.

A total of 14 Government procurement offices, eight civil and six DOD, were included in the review.

CHAPTER 2

NEED FOR GOVERNMENT-WIDE GUIDELINES

AND IMPROVED AGENCY PRACTICES

TO ENSURE ADEQUATE CONSIDERATION OF CONTRACTORS'

TAX-EXEMPT STATUS

In many instances, nonsponsored not-for-profit organizations which pay no Federal income taxes on Government work are allowed approximately the same rate of fee on estimated costs that commercial profit-making organizations are allowed for doing similar work. Most agencies of the Federal Government, when determining fee payments on research contracts, had not given adequate recognition to the tax-exempt status of these not-for-profit research institutes. In our opinion, an appropriate adjustment in fees is necessary if agencies are to contract with these tax-exempt organizations in a manner which treats them on an equitable basis with their commercial competitors.

CIVIL AGENCY FEE RATES TO NONSPONSORED NOT-FOR-PROFITS COMPARABLE TO COMMERCIAL FEE RATES

On the basis of our analysis of 108 contracts, totaling about \$9.9 million, awarded by six selected civil agency procurement offices to the three nonsponsored not-for-profit organizations during the period 1965 through 1968, we found that the composite weighted average rate of fees paid to these not-for-profit institutes was about 7.1 percent. At these same six procurement offices, we made an analysis of 50 similar contracts awarded to commercial organizations during the same period, which showed that the composite weighted average rate of fee was about 7.7 percent. (See app. I.)

Our comparison of 1965-68 CPFF rates paid to each of the three nonsponsored not-for-profit research institutes with rates paid to commercial organizations for similar work follows.

<u>Organization</u>	<u>CPFF contracts</u>		Composite weighted average fee (percent)
	<u>Number</u>	<u>Amount (millions)</u>	
Institute A	68	\$7.2	7.3
Institute B	21	1.2	6.6
Institute C	<u>19</u>	<u>1.5</u>	<u>6.7</u>
Three institutes	<u>108</u>	<u>9.9</u>	<u>7.1</u>
Commercial	<u>50</u>	<u>\$8.1</u>	<u>7.7</u>

In our opinion, a difference of 0.6 of a percentage point does not adequately provide for the distinction in tax status between the two different forms of corporate organization.

We believe that the failure of the procurement guidelines used by most civil agencies to provide for an appropriate adjustment to fee objectives in recognition of the tax-exempt status of nonprofit organizations is the principal reason that individual procurement centers have paid fees to these organizations that are almost as high as fees paid to commercial organizations for research considered to be comparable by contracting officials.

Procurement regulations of most civil agencies do not distinguish between the exempt nonprofits and taxpaying commercial organizations

The civil agencies that follow the Federal Procurement Regulations (this excludes NASA and AEC) are to take the following nine profit factors into consideration in arriving at a fee objective for negotiation purposes.

1. Effect of competition
2. Degree of risk
3. Nature of work to be performed
4. Extent of Government assistance
5. Extent of contractor's investment
6. Character of contractor's business

7. Contractor's performance
8. Subcontracting
9. Unrealistic estimates

The NASA Procurement Regulations contain the same nine profit factors, and incorporate a 10th factor--cost reduction program accomplishments.

These procurement regulations merely provide narrative guidelines for the contract negotiator through the use of supplemental instructions for each profit factor, and they make no distinction between nonprofit organizations which are tax exempt and commercial organizations.

The guidelines in the AEC procurement instructions emphasize the amount of risk involved as a profit consideration and then list 10 other factors to be taken into account. These are substantially the same as those in the Federal Procurement Regulations. The AEC procurement instructions, however, provide additional fee guidelines to the negotiator for nonprofit organizations by requiring at least a 25-percent reduction in the maximum allowable fee as calculated for commercial organizations. This is to compensate for the tax posture of the nonprofit organizations.

While making our analyses at the various civil agency procurement offices, we discussed our findings with their contracting officials. In general, officials of the agencies, other than AEC, have stated that their regulations do not require them to negotiate fee rates to nonprofit organizations differently from fee rates to commercial organizations. These officials have said that they believe that not-for-profit organizations have a competitive advantage over commercial organizations because they receive tax-exempt fees comparable in amount to the taxable fees being paid to commercial organizations, and thus provide a higher aftertax rate of return. Examples of their comments follow.

Federal Highway Administration

Contracting officials of the Federal Highway Administration have stated that the Federal Procurement Regulations do not contain specific guidelines for development of fee payments to nonprofits. Because there is no specific limitation

on fee payments to nonprofits, the chief contracting officer has informed us that the independent nonprofits press for, and often get, fees from other Government agencies that are as high as fees paid by the Federal Highway Administration to commercial organizations. Our schedule in appendix I shows that some agencies have awarded fees to nonprofits that exceed the rate of fees that the Federal Highway Administration has awarded to commercial organizations.

National Institutes of Health

We estimate that on the basis of a sample of the National Institutes of Health (NIH) contracts and discussions with contracting officials, NIH has paid commercial organizations about 7.5 percent on CPFF research contracts for calendar years 1965 through 1968. For the same period, NIH paid fees averaging about 7.6 percent on CPFF contracts awarded to the three nonsponsored not-for-profit organizations on tax-exempt Government work.

Officials of NIH Research Contracts Section have told us that one of these not-for-profits has been receiving a fee of almost 8 percent for CPFF work since August 1958. NIH established the 8-percent rate on the basis of evidence submitted by the organization that certain DOD and AEC contracts had fee rates of 8 percent or higher. After the rate was established at 8 percent, NIH was unable to negotiate significant reductions in this rate because the Federal Procurement Regulations did not distinguish between nonprofit and commercial organizations. Consequently, NIH paid the rate of almost 8 percent through 1968--a period of over 10 years.

NASA Ames Research Center

The Ames Research Center paid the three nonsponsored not-for-profits an average CPFF fee rate of about 6.3 percent for the period 1965 through 1968. On the basis of discussions with NASA officials and a sample of Ames contracts, we estimated that Ames had paid about this same average fee rate to commercial organizations for research and development on a CPFF basis.

On February 20, 1968, Ames officials advised NASA headquarters by letter that fees awarded to nonprofit organizations were high in comparison to fees awarded to commercial organizations. They wrote:

"One comment received from our contract administration staff has to do with our concern of long standing, regarding fees demanded by the so-called Nonprofit Institutions. This particular comment extrapolated a 6 to 8% range for fees paid to a nonprofit institution, as roughly comparable to 14 to 15% fees for a tax-paying commercial firm. Commercial fees of such magnitude would require NASA Headquarters approval. This comment is perhaps outside the reference letter, but deserves to be kept in mind for high-level consideration as a separate study."

We were informed that procurement headquarters subsequently conducted a review of NASA procurement regulations and concluded that further study was not required. NASA procurement regulations still do not recognize that the proceeds of a contract with a nonprofit organization are not subject to Federal income taxes.

AEC fee policies give recognition to
contractors' tax posture

The guidelines in the AEC procurement instructions emphasize several factors as profit considerations, such as amount of risk involved, investment in facilities, and working capital supplied by the contractor. Regarding contracts with not-for-profit organizations, the AEC procurement instructions also provide:

In order to assure consideration of the tax posture of not-for-profit organizations during fee negotiation, the fee shall be calculated as for a contract with a commercial concern and then reduced at least 25%. However, depending on the circumstances, field office managers are permitted to pay a fee somewhere between this amount and the fee allowable if it were a commercial concern provided that the contract files are documented to specifically state the reason or reasons in each case.

Generally AEC expects that the fee negotiated for a not-for-profit contractor would be at least 25 percent lower than the maximum fee allowable for a commercial contractor.

AEC officials have informed us that the fee schedules which set the ceilings on AEC fees are not made known to contractors. A general provision of the AEC fee policy is that there is no obligation to negotiate a fee below the amount determined to be fair and reasonable. If the contractor proposes a fee lower than the amount so determined to be fair and reasonable, however, such fees as proposed by the contractor are accepted.

AEC officials advised us that, prior to the development of the AEC fee guidelines for nonprofit organizations in November 1963, AEC had paid institute A fee rates averaging 9 percent and that, subsequent to the development of the guidelines, the average rate had been reduced to about 7.4 percent. Our sample of AEC contracts with institute A for the periods involved verified that AEC's recognition of the tax posture of nonprofit organizations in determining fees had achieved the substantial reduction discussed above.

Our review showed that the spread between the maximum allowable rate and the rate actually being paid institute A was less than the spread between the maximum allowable rate and the rate actually paid on the commercial contracts sampled. For 24 new CPFF research contracts awarded by AEC to institute A for the period 1965 through 1968, the maximum allowable fee rate averaged 7.47 percent and the average negotiated rate was 7.39 percent. Our sample of CPFF research contracts awarded to commercial organizations by AEC for dollar amounts comparable to the 24 contracts awarded to institute A showed an average maximum allowable fee rate of 9.8 percent and an average negotiated rate of 8.7 percent.

Thus, although the maximum allowable fee rate authorized under the AEC fee guidelines for payment to institute A was about 25 percent less than the maximum allowable for commercial research contracts (7.47 percent compared with 9.8 percent), there was about a 15-percent difference in the rates actually negotiated (7.39 percent compared with 8.7 percent).

We concluded from our examination of AEC contracts with nonsponsored not-for-profit institute A that, for this contractor, implementation of AEC's policy of giving consideration to the tax posture of not-for-profit contractors resulted in the negotiation of reduced fees.

DOD FEE POLICY RECOGNIZES
TAX POSTURE BUT OBJECTIVE
OF POLICY IS NOT FULLY ACHIEVED

In December 1964 an Armed Services Procurement Regulation (ASPR) Subcommittee began an extensive review of DOD's fee payment practices under contracts with nonprofit organizations. The Subcommittee's study, completed in 1966, showed that the range of fee rates negotiated under weighted guidelines of ASPR with commercial research and development contractors averaged from 6 to 10 percent, having a median of 8 percent. Fee rates for contracts with nonsponsored not-for-profit organizations, with a few exceptions, were not negotiated using the weighted guidelines; these fee rates ranged from 5 to 7 percent, having a median of 6 percent.

The study report stated that there was strong evidence that a reduction fixed at approximately 3 percentage fee points would appropriately adjust for the difference in retained income that nonsponsored not-for-profit contractors obtain because of their tax exemption. The ASPR Subcommittee concluded that the range of 5 to 7 percent for nonsponsored not-for-profit organizations was too narrow and should begin at 3 percent to result in a wider range of 3 to 7 percent, having a median of 5 percent. This would provide for a 3 percentage point average spread between the nonprofit and commercial medians rather than the 2 percentage point spread then existing.

In a memorandum dated June 15, 1966, to the Chairman, ASPR Committee, the Subcommittee recommended that, for contracts with nonsponsored not-for-profit organizations where fees are involved, the weighted guidelines of ASPR be applied, adjusted by a factor of minus 3 percentage points where the proceeds of the contract are not subject to Federal income taxation. For sponsored nonprofit organizations, an additional reduction of 1 to 2 percentage points was recommended to reflect their lesser degree of risk.

In December 1966 the ASPR Committee issued Defense Procurement Circular 50. This circular established as DOD policy the use of the weighted guidelines method, as modified, for arriving at fee objectives in contracts with nonprofit organizations. One of the modifications required by Circular 50 is the assignment of a special factor of minus 3 percentage points in all cases where fees of nonprofits are involved.

In determining the prenegotiation fee objective under the ASPR weighted guidelines, profit weightings are assigned for (1) contractor's input to total performance (including factors for materials, engineering and manufacturing labor, and overhead), (2) contractor's assumption of contract cost risk (type of contract), (3) contractor's record of performance, (4) selected factors, such as the source of resources used and any special achievement required, and (5) special profit considerations for the development of military items without Government assistance or for outstanding sales efforts in developing foreign markets for military items. After the weightings are assigned, a

composite rate is obtained and the 3 percentage point reduction required by Circular 50 is made from this composite rate.

During 1967 and 1968 DOD organizations awarded 356 new CPFF contracts to the three nonsponsored not-for-profit organizations. The weighted average rate of fee on these contracts was 6.2 percent.

We made a tabulation of 352⁽¹⁾ of these contracts with a valuation of \$52.8 million. We found that the weighted average rate of fees ranged from nearly 4 percent to 8.5 percent, in contrast to the recommended range of 3 to 7 percent. More than 90 percent of new contract awards for 1967 and 1968 were in excess of the recommended average of 5 percent, as shown below.

Fee rate range (percent)	Number of awards	Percent of total awards	Negotiated amount in- cluding fee (thousands)	Percent of total amount	Weighted average rate within range (percent)
3.5 to 4.4	3	0.9	\$ 1,917	3.6	3.9
4.5 to 5.4	25	7.1	5,219	9.9	5.0
5.5 to 6.4	168	47.7	25,508	48.3	5.9
6.5 to 7.4	118	33.5	16,597	31.4	6.9
7.5 to 8.4	37	10.5	3,556	6.7	7.8
8.5 to 9.4	<u>1</u>	<u>0.3</u>	<u>50</u>	<u>0.1</u>	8.5
Total	<u>352</u>	<u>100.0</u>	<u>\$52,847</u>	<u>100.0</u>	

¹Four contracts awarded during this period were not included because they were nonrepresentative.

Comparison of DOD not-for-profit rates with commercial rates

We obtained data at four DOD procurement centers contracting with the three nonsponsored not-for-profits for use in comparing fee rates paid to these organizations with rates paid to commercial organizations. On 129 contracts in the amount of \$24.5 million awarded to the three not-for-profit institutes in 1967 and 1968, the composite weighted average rate of fee allowed was 6.3 percent. (The overall DOD rate is 6.2 percent.) On 77 CPFF contracts with a value of \$11 million awarded to commercial organizations during 1967 and 1968 by the four selected DOD activities, the composite weighted average rate of fee negotiated was 7.5 percent (see app. II).

Although the spread of 1.2 percentage points between not-for-profit and commercial fee rates was greater on DOD contracts than the 0.6 percentage point spread on contracts awarded by civil agencies (see p. 9), it was less than half of the 3 percentage point spread called for by the ASPR Subcommittee.

The composite weighted average rates of fee paid to each of the three institutes by these four DOD procurement activities in calendar years 1967 and 1968, compared with the average rate paid to commercial organizations by the four procurement offices on contracts requiring work of a comparable nature follow.

<u>Organization</u>	<u>CPFF contracts</u>		Composite weighted average fee (percent)
	<u>Number</u>	<u>Amount (millions)</u>	
Institute A	73	\$18.6	6.4
Institute B	34	4.0	5.9
Institute C	<u>22</u>	<u>1.9</u>	<u>6.2</u>
Three institutes	<u>129</u>	<u>24.5</u>	<u>6.3</u>
Commercial	<u>77</u>	<u>\$11.0</u>	<u>7.5</u>

We found that, for many contracts, the weighted guidelines were not used by contract negotiators in developing fee objectives. For example, the Army Research Office, Arlington, and the Office of Naval Research usually did not use the ASPR weighted guidelines for contract awards in amounts of less than \$100,000 and \$50,000, respectively. Officials of these procurement offices explained that the guidelines were not used for smaller procurements because, with staffing shortages, it was easier to continue to use an established or historical rate.

Because research contracts awarded to nonprofit research institutes generally are for scientific studies which do not require the delivery of hardware, they are frequently for amounts less than \$50,000. For example, these two procurement offices had used the weighted guidelines for only six of 20 procurements made during 1967 and 1968 from one of the three nonsponsored not-for-profit organizations covered in our review. The Army used the guidelines for three of eight procurements and the Navy for three of 12 procurements. Where the guidelines were not used, Army Research Office procurement officials stated that they had relied on a historical fee average of around 7 percent, whereas Office of Naval Research officials stated that they had used a historical fee average of about 6 percent.

In commenting on our draft report, DOD submitted to us a listing of 25 contracts exceeding \$200,000 awarded to research institute A during 1967 and 1968. This listing was for the purpose of showing that, in computing the fee objective for these contracts, the guidelines published in Circular 50 were followed and that the weighted guidelines method was used, including the special factor of minus 3 percentage points.

Although it is likely that contract negotiators use the weighted guidelines for the larger procurements, which probably represent a major share of the dollar volume of the procurement offices' contracts with the three institutes, it is apparent that such use had little effect in achieving a 3 percentage point spread. The overall rate of fee (see p. 17) negotiated by the four procurement offices

for the three institutes was only 1.2 percentage points less than the average fee allowed commercial organizations.

Comparison of DOD fee rates before
and after Defense Procurement Circular 50

The issuance of Circular 50 in December 1966, implementing the recommendations of the ASPR Subcommittee, did not result in any significant change in the average rate of fee paid by DOD to nonsponsored nonprofit organizations.

Our analysis of fees paid by DOD to the three nonsponsored not-for-profit organizations during 1965 and 1966 on 241 CPFF contracts with a value of \$38.5 million showed a composite weighted average rate of fee of 6.2 percent and a fee range of 5 to 7 percent. After issuance of Circular 50, the composite weighted average of fee rates for 352 contracts awarded in 1967 and 1968 was also 6.2 percent, having a fee range of 4 to 8.5 percent. (See app. III.)

In 1967 and 1968 the average rate of 6.2 percent paid institute A by DOD procurement activities was only slightly less than the 6.5 percent paid institute A by these offices in 1965 and 1966.

We found that institute B, subsequent to the issuance of Circular 50, continued a policy of proposing and negotiating fee rates of about 6 percent on substantially all CPFF procurement with Government agencies. The only notable exception to the 6-percent policy appeared to be for an annually renewable contract which was in effect many years before Circular 50 and included a descending fee rate schedule.

Our test of 103 CPFF contracts with a value of about \$10 million awarded by DOD to institute C during 1965 and 1966 showed that the rate of fees paid ranged from 5 to 7 percent and that the composite weighted average rate was 6 percent. Fee rates for 105 CPFF contracts with a value of about \$8.5 million awarded by DOD to institute C during 1967 and 1968 showed that fees ranged from about 5.5 to 8.5 percent, compared with the ASPR Subcommittee's recommended range of 3 to 7 percent. Also the weighted average rate for the 105 contracts was 6.4 percent, compared with

(1) the ASPR Subcommittee's recommended 5 percent and (2) the institute's pre-Circular 50 average of 6 percent.

DOD disagreed with our test findings because we had included 1967 statistics. According to DOD, the first applications of the new policy stated in Defense Procurement Circular 50 were not made until May 1967. Therefore DOD believes that statistics which included the entire year could not be representative of the effect of the policy change. We found, however, that deletion of 1967 statistics from our test had practically no effect on the overall results.

Ineffectiveness of Defense Procurement Circular 50

As shown in the previous sections of this chapter, Circular 50 neither has produced the ASPR Subcommittee's desired effect of reducing the average fee rate paid to nonsponsored not-for-profits from 6 to 5 percent, nor has it achieved the 3 percentage point spread between the fee rates negotiated with nonsponsored not-for-profit and commercial organizations. Our analysis showed that, subsequent to the issuance of the circular, the average fee rate negotiated on CPFF contracts awarded by DOD to not-for-profit organizations stayed about the same.

During our review we discussed this matter with the Chairman of the special ASPR Subcommittee which conducted the study leading to the circular. He stated that the minus 3 percentage point factor was related to the tax differential that nonprofit organizations enjoy. The Chairman stated also that the provisions of Circular 50 were intended to apply to all nonprofit contractors even though much of the impetus for the Subcommittee's study came from a dissatisfaction expressed by a congressional committee with the amount of fees that were being paid to Government-sponsored nonprofit organizations.

DOD, in commenting on a draft of this report, stated that we had not accurately portrayed the policy published in Circular 50--that there was nothing in its policy to the effect that fees to nonprofit organizations were to be less than fees to commercial organizations or that the

median fee for nonprofit organizations should be 5 percent.

DOD further informed us that we had attached too much weight to the position of the special ASPR Subcommittee which studied the application of weighted guidelines to not-for-profit organizations and that its study was just one consideration in the formulation of the policy adopted. The three not-for-profit institutions, in commenting on our draft report, were also critical of our findings concerning Circular 50, principally for the same reasons expressed by DOD.

Although the written policy does not specifically state that fees to nonprofit organizations are to be less than fees to commercial organizations, application of a minus 3 percentage point adjustment in arriving at the fee objective for nonprofits would have such a result, all other factors being equal. The ASPR Subcommittee stated in its study report that, without such an adjustment, it believed contracting officers would be constrained to pay nonprofit contractors the same fees they had paid in the past.

The study by the ASPR Subcommittee was in great depth and was conducted over an extended period of time. The results of this study and the underlying reasoning for arriving at the minus 3 percentage point adjustment were spelled out in the Subcommittee's report to the Chairman of the ASPR Committee. The minus 3 percentage point adjustment proposed by the Subcommittee was specifically prescribed in Circular 50. It thus seems likely that the reasoning in the Subcommittee study was the basis for the policy change.

It appears to us that the intent was to achieve a spread between fees paid to nonprofit organizations and commercial organizations. Because there is no indication that commercial fees would be raised, the intent must have been to adjust nonprofit fees downward, as suggested by the language in the ASPR Subcommittee report. Although we recognize that the weighted guidelines are to be used in computing prenegotiation objectives, we believe that it was intended that the actual negotiated rates were meant to

similarly reflect a spread of about 3 percentage points between not-for-profit and commercial organizations. To interpret the provisions of ASPR otherwise would defeat the purpose of issuing Defense Procurement Circular 50.

CHAPTER 3

AGENCY AND CONTRACTOR COMMENTS AND OUR EVALUATION

We submitted a draft of this report for comment to the agencies and contractors included in our review. In the draft we stated that, in our opinion, regulations followed by Government agencies had not made an adequate distinction between not-for-profit and commercial organizations in the payment of fees and this resulted in fee payments to not-for-profits in excess of rates that would give proper recognition to their tax-exempt status.

We proposed in the draft report that the Director, Office of Management and Budget, take the lead in interagency development of uniform Government-wide guidelines governing the negotiation of fees to not-for-profit organizations. We stated that these guidelines should establish firm, equitable criteria for use by all departments and agencies of the Government in establishing fee payments which would be fair to both not-for-profit and commercial organizations, giving consideration to the tax posture of each. Pending the development of uniform Government-wide guidelines, we suggested that each agency reevaluate its current policy and take steps necessary to ensure that fee payments are adjusted to adequately recognize the tax-free status of not-for-profit organizations.

We received comments on the draft report from the heads of Government agencies and from each of the three research institutes. The earlier chapters of this report have been revised to incorporate appropriate portions of their replies, and comments of a broader nature are summarized and evaluated in this chapter. The agency replies are included in this report as appendixes IV through XII. We have not included the replies of the institutions so as to not disclose the identities of the organizations.

CIVIL AGENCIES USING
FEDERAL PROCUREMENT REGULATIONS
GENERALLY CONCUR IN NEED FOR GUIDELINES

The Department of Health, Education, and Welfare (HEW) concurred that OMB should take the lead in interagency development of guidelines governing the negotiation of fees with not-for-profit organizations. (See app. IV.) Regarding such fees, HEW would welcome the establishment of uniform Government-wide criteria which would go beyond consideration of the different tax postures of not-for-profit and commercial organizations and take into account organic differences between such organizations and the fundamental purposes to be served by fees.

HEW informed us also that it has recently completed a comprehensive study of fees which confirmed our findings that there is little difference between the rates of fixed fee paid to commercial concerns and those awarded to not-for-profit organizations and that adequate recognition is not being given to the tax-free status of not-for-profit organizations. HEW, pending the development of Government-wide guidelines, is reevaluating its current policies governing the negotiation of fees and is in the process of developing separate fee guidelines applicable to not-for-profit and commercial organizations, respectively, which will give consideration to differences between the nature of such organizations.

The Department of Transportation also concurred that OMB should initiate the development of uniform Government-wide guidelines. (See app. V.) In the meantime, the Department expects to issue a procurement regulation on the negotiation of fees with tax-exempt institutions.¹

¹The Department subsequently published a proposed revision to its procurement regulation which would require that consideration must be given to the tax posture of an organization in determining the fee or profit. Any proposed fee to a not-for-profit organization in excess of 5 percent of the estimated cost of the contract, exclusive of fee, would require approval by the Director, Office of Installations and Logistics, Office of the Secretary of Transportation (Federal Register, March 17, 1971).

The Agricultural Research Service of the Department of Agriculture saw no objection to the conclusions expressed in our report and stated that fee-setting guidelines which were more extensive and specific than those presently in the Federal Procurement Regulations would be of assistance in standardizing the fees paid under CPFF contracts. (See app. VI.)

The Agency for International Development in the Department of State informed us that its fee guidelines for the use of contracting officers contained no guidance regarding fees to be paid to not-for-profit organizations. (See app. VII.) The agency made a review of fees paid, which confirmed our broader findings, and believes that it should reevaluate its current policy. The agency, however, does not believe that it should, on its own, try to define a standard regarding what constitutes adequate recognition of the tax-free status of not-for-profit organizations and plans to await the results of the study by OMB.

Several of these agencies, although concurring in the need for establishing some uniformity in fee guidelines, pointed out that there were factors of cost which must be considered in conjunction with the tax status. So that due weight can be given to these other factors in special situations, they believe that the guidelines should not require that fees fall within a fixed range.

GENERAL SERVICES ADMINISTRATION TO
CONVENE INTERAGENCY TASK GROUP

The General Services Administration (GSA) fully agreed that, in view of their exemption from Federal income taxes, not-for-profit organizations should not receive as proportionately large fees under cost-reimbursement-type contracts as commercial organizations. (See app. VIII.) GSA stated that the promulgation of Government-wide guidelines by OMB or, in the alternative, by GSA and DOD through the Federal Procurement Regulations and ASPR certainly would be desirable. In view of its responsibility for issuing Government-wide contract policies and procedures, GSA favors the latter arrangement.

In any event, GSA said that it planned to convene an interagency task group to develop an appropriate temporary Federal Procurement Regulation which would provide uniform civilian agency adherence to our proposal that agencies should take the steps necessary to adjust fee payments in recognition of the tax-free status of not-for-profit organizations. The task group was still in the process of formation in August 1971.

NASA WOULD PARTICIPATE IN
DETERMINATION OF NEED FOR GUIDELINES

NASA informed us that it would be glad to meet with other agencies to determine if Government-wide fee guidelines were needed and, if they were, would expect them to be structured in such a fashion as to allow individual contracting officers to consider each case in its proper perspective. (See app. IX.)

As an interim step, NASA reported that it was cautioning its contracting officers to consider the tax-exempt posture of contractors when negotiating fees with not-for-profit organizations. NASA pointed out it did not necessarily believe that tax-exempt status was an overriding factor when determining fees, or that there should be a preestablished fee limitation. Rather, it believed that the tax-exempt status should be considered with other factors to arrive at a reasonable fee commensurate with the services received.

AEC FAVORS A GOVERNMENT-WIDE POLICY
BUT QUESTIONS NEED FOR UNIFORMITY

We have been advised by AEC that it believes that there should be a Government-wide policy that requires all agencies to give appropriate consideration in their fee policies to the tax posture of each organization. It does not believe, however, that the policy should spell out specific guidelines for making a distinction between not-for-profit and profit-making organizations to be uniformly applied by all agencies. (See app. X.)

AEC has pointed out that the present overall fee policies of the various agencies generally recognize that there are profit factors other than tax status which are important and must be considered. In AEC's opinion, it would be difficult to develop a viable uniform Government-wide policy for just one of the profit factors.

AEC takes the position that the problems noted in our report could be corrected by better execution and enforcement where an agency has a policy requiring consideration of the tax position of the non-profit and by giving recognition to the not-for-profit status in the regulations of other agencies. As long as the executive agencies make an adequate distinction between commercial and not-for-profit organizations in their fee policies and practices, AEC feels that the objectives we are seeking will be accomplished.

DOD BELIEVES OMB STUDY WOULD NOT
PROVE TO BE PRODUCTIVE

In the opinion of DOD, its guidelines on fees to not-for-profits are adequate and have generally been followed by procurement activities. DOD states that its policy in establishing the guidelines was not to reduce fees. Therefore, although it has no objection to OMB pursuing a study in this area, in DOD's opinion, a study would not be productive in appreciably changing fee rates to not-for-profit organizations. (See app. XI.)

We expressed in the preceding chapter of this report that we believe that the intent of DOD's comprehensive study and subsequent regulation could not be logically interpreted in any way other than an effort to effect a reduction of

fees to not-for-profit organizations in recognition of their tax-exempt status. We therefore believe that an interagency study under OMB's guidance, such as we had suggested, would provide a reasonable means for resolving the difference of opinion.

OMB TO AWAIT ACTION BY COMMISSION ON GOVERNMENT PROCUREMENT

OMB has pointed out that a broad legislative charter for the comprehensive review of Federal procurement has been granted to the Commission on Government Procurement, along with the obligation to report findings and recommendations to the Congress. It believes that cost contract and non-profit contractor fees are among the subjects scheduled for review by a Commission study group. OMB states that, whereas it could work with the Commission and affected agencies to explore the feasibility of developing the suggested guidelines, it would be premature for OMB to take the leadership in developing uniform guidelines prior to the completion of any pertinent Commission review. (See app. XII.)

CONTRACTOR COMMENTS

Only one of the three research institutes commented on our proposal that OMB take the lead in interagency development of uniform Government-wide guidelines, and none of them acknowledged any need for agencies to adjust their fee payments to recognize the tax-free status of not-for-profit organizations.

The institute that commented on our proposal for developing guidelines stated that uniformity, when dealing with Government agencies on procurement matters, was highly desirable. It went on to say that uniformity should not be limited to negotiation of fees--that divergent cost principles between agencies was a major factor in the lack of consistency among agencies and a continuing source of problems.

Two of the institutes pointed out that an adjustment of fees, taking into consideration the tax-free status of not-for-profit organizations, would defeat the intent of Congress in granting them exemption from Federal income taxes. They contend that the Congress would not have granted not-for-profit organizations tax-exempt status if the intention had

been to give them and commercial organizations identical financial treatment. The institutes did not identify the basis for their conclusion concerning congressional intent.

Our review was not directed to ascertaining the reasons for, or the advisability of, granting tax-exempt status to not-for-profit organizations, but we did review legislative background material we thought to be applicable. We could not locate any clear intent on the part of the Congress other than the stipulation that none of the net earnings of the tax-exempt organizations should inure to the benefit of any private individual. We found no indication of congressional consideration of the level of fees that Government agencies should pay the not-for-profits or any indication of an intention to allow these organizations to earn a higher effective rate on Government contracts than would be earned by commercial organizations doing the same work.

In our opinion, this is what occurs when not-for-profit organizations, which can retain the fees received on Government contracts, are allowed about the same fees as commercial tax-paying organizations, which can be required to return to the Government in taxes up to about one half of the fees earned. We also found no indication that the Congress intended to give the not-for-profit organizations a competitive advantage when dealing with Government agencies, such as that which results from their ability to retain and use a higher percentage of earnings to improve physical plant and technical capabilities.

The institutes commented in various ways that our study was incomplete. One institute, for example, stated that our findings appeared to be based on a limited review of negotiated fees which did not give sufficient consideration to important related factors, such as cost elements affecting fee objectives, net realized fee and its utilization, and return on investment. This institute suggested that a valid comparison of fees negotiated with nonsponsored not-for-profit organizations and commercial organizations could not be made unless a review was made of the scope and cost elements of each contract.

Another institute complained that we did not evaluate the reasonableness of profits earned but that, at the same

time, we implied that fees should be adjusted downward. This institute stated that, before recommending that fees be reduced, we should evaluate the level of fees reasonably required to sustain a viable and healthy not-for-profit organization.

Our review did not involve evaluation of the reasonableness of fees negotiated on individual contracts or of each cost element included in contract negotiations. Instead, the review was essentially one of comparison between fees paid to not-for-profit and commercial organizations that were reported to us by the procurement agencies as doing the same type of work. Our primary objective was to determine whether adequate recognition was being given in negotiating fee rates to offset the competitive advantage of tax-exempt organizations.

We are not trying in any way to minimize the importance of other elements of costs or other factors involved in the negotiation of fees to both not-for-profit or commercial contractors. Our recent report to the Congress on our defense profit study (B-159896, March 17, 1971) points out the importance of considering capital requirements as well as such other factors as risk, complexity of the work, and other management and performance factors.

We did not attempt to compare the fees or profits earned by the not-for-profit organizations with those earned by taxpaying commercial organizations. For both types of organizations, the difference between the rate of fee or profit awarded and the rate actually earned represents costs incurred that are not authorized for reimbursement under Government procurement regulations. If the not-for-profit organizations incur a higher rate of these "unallowable costs" than the commercial taxpaying organizations, their earnings would be reduced accordingly.

In view of the fact that the types of unallowable costs are the same for both types of organizations, we believe that, if there is actually any difference in the degree of incurrence, it is due principally to management prerogative. For example, the extent of travel costs above those authorized by procurement regulations is a matter of management decision.

CHAPTER 4

CONCLUSIONS AND RECOMMENDATION

At least two Government agencies, DOD and AEC, have recognized the competitive advantage of not-for-profit organizations and have required in their procurement regulations that consideration be given to the tax-exempt status of these organizations when negotiating fees to be paid on research contracts. Other agencies, in commenting on our draft report, have indicated that there is a need for guidelines to govern the negotiation of fees with not-for-profit organizations.

We believe that GSA's interim plan to convene an interagency task group to develop a temporary Federal Procurement Regulation, in accordance with its responsibility for promulgating Government-wide contract policies and procedures, is desirable. The guidance which is established in the temporary Federal Procurement Regulation and which is provided for in ASPR and in the AEC and NASA procurement regulations should, of course, be compatible, even though there may be differences in implementation which must be recognized.

We think that it is important that contractors dealing with various agencies having different procurement regulations can expect, and should receive, uniform treatment in establishing their fees. It is our opinion that this uniformity can best be achieved by having one agency responsible for ensuring that all Government procurement regulations reflect a single overall Government policy.

In our opinion, OMB would be the appropriate agency to assume this responsibility. It is a permanent organization with overall management and coordination functions within the executive branch of the Government and has experience in procurement matters.

In our report to the Congress on our defense industry profit study (B-159896, March 17, 1971), we recommended that OMB take the lead in interagency development of uniform Government-wide guidelines for determining profit objectives

for negotiating Government contracts that will emphasize consideration of the total amount of contractor capital required when appropriate, where effective price competition is lacking. In our opinion, the development of a policy of contract management to govern all Government agencies in determining fees to be paid to tax-exempt organizations that compete with commercial organizations for Government contracts is a logical extension of the task included in the profit study recommendation.

It seems reasonable, of course, that OMB would closely coordinate its work on these matters with that of the Commission on Federal Procurement and that OMB should have the prerogative of accepting the Commission's findings where appropriate.

RECOMMENDATION

We therefore recommend that the Director, Office of Management and Budget, head an interagency study leading to the development of a Government-wide policy governing the negotiation of fees to not-for-profit and commercial organizations and giving consideration to the tax posture of each type of organization.

CHAPTER 5

SCOPE OF REVIEW

Our review was conducted at three nonsponsored not-for-profit research institutes and at 14 Government procurement offices engaged in the acquisition of research from commercial and not-for-profit organizations. These offices represented eight civilian agencies and six DOD activities, as follows:

Civil agencies

Department of State
Agency for International Development
Washington, D.C.

Department of Agriculture
Agricultural Research Service
Hyattsville, Maryland

Department of Health, Education, and Welfare
Public Health Service
National Institutes of Health
Bethesda, Maryland

Office of Education
Washington, D.C.

Department of Transportation
Federal Aviation Administration
Washington, D.C.

Federal Highway Administration
Washington, D.C.

Atomic Energy Commission
San Francisco Operations Office
Berkeley, California

National Aeronautics and Space Administration
Ames Research Center
Moffett Field, California

Department of Defense

Air Force Aeronautical Systems Division
Dayton, Ohio

Army Research Office
Arlington, Virginia

Defense Nuclear Agency
Arlington, Virginia

Naval Supply Center
Oakland, California

Office of Civil Defense
Washington, D.C.

Office of Naval Research
Washington, D.C.

We reviewed contractual data for 1,032 prime CPFF research contracts, totaling about \$134.3 million, that were awarded over a period of 4 years (1965 through 1968) to the three selected not-for-profit research institutes. Negotiation files were reviewed at the 14 Government procurement offices for 225 of these contracts, totaling about \$46.5 million.

At 10 procurement offices we extended our review beyond the narrative support in the contract files and discussed with Government contracting officials their rationale for the fees that were negotiated with not-for-profit organizations. In addition, we developed data on fees paid to commercial organizations by these same 10 procurement offices and compared these rates with nonsponsored not-for-profit rates.

Our review did not include an evaluation of the reasonableness of profit ranges prescribed in Government regulations for payment to either commercial or nonprofit organizations, or of the profits or fees actually paid. We did, however, include a comparison of fees paid to nonsponsored not-for-profits in relation to profit rates allowed commercial organizations. We relied on the advice of agency

contracting officials that contracts used in both samples were for research which was of a comparable nature and that no fee differential between the two types of organizations could have been caused by a higher level of technical input on the part of either party.

APPENDIXES

COMPARISON OF WEIGHTED AVERAGE FEE RATES
 NEGOTIATED BY SELECTED CIVIL AGENCIES WITH
 THREE NONSPONSORED NOT-FOR-PROFIT INSTITUTES AND
 COMMERCIAL ORGANIZATIONS

Civil agency/ not-for-profit institutes	Composite weighted average fee rates 1965-68		
	Not-for-profit institutes (percent)	Commercial organizations (percent)	Variance (percent)
FEDERAL AVIATION ADMINISTRATION:			
Institute A	6.2		1.6
Institute B	6.0	7.8	1.8
Institute C	6.0		1.8
FEDERAL HIGHWAY ADMINISTRATION:			
Institute A	6.5		1.3
Institute B	6.0	7.8	1.8
Institute C	6.0		1.8
NATIONAL INSTITUTES OF HEALTH:			
Institute A	7.9		(0.4)
Institute B	7.4	7.5	0.1
Institute C	7.0		0.5
AGRICULTURAL RESEARCH SERVICE:			
Institute A	8.0	8.1	0.1
Institute B	6.0		2.1
ATOMIC ENERGY COMMISSION SAN FRANCISCO OFFICE:			
Institute A	7.4	8.7	1.3
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION-- AMES RESEARCH CENTER:			
Institute A	6.4		0.0
Institute B	6.1	6.4	0.3
Institute C	5.9		0.5
COMPOSITE RATES:			
Institute A	7.3		0.4
Institute B	6.6	7.7	1.1
Institute C	<u>6.7</u>	---	<u>1.0</u>
Three not-for-profits	<u>7.1</u>	<u>7.7</u>	<u>0.6</u>

APPENDIX II

COMPARISON OF WEIGHTED AVERAGE FEE RATES
 NEGOTIATED BY SELECTED DOD ORGANIZATIONS WITH
 THREE NONSPONSORED NOT-FOR-PROFIT INSTITUTES
 AND COMMERCIAL ORGANIZATIONS

Defense activity/ not-for-profit <u>institutes</u>	Composite weighted average fee rates 1967 and 1968		
	Not-for-profit institutes (percent)	Commercial organizations (percent)	Variance (percent)
DEFENSE NUCLEAR AGENCY:			
Institute A	6.0		2.2
Institute B	5.9	8.2	2.3
Institute C	7.1		1.1
OFFICE OF NAVAL RESEARCH:			
Institute A	6.0		2.0
Institute B	5.9	8.0	2.1
Institute C	6.0		2.0
ARMY RESEARCH OFFICE:			
Institute A	7.0		1.4
Institute B	6.0	8.4	2.4
Institute C	6.9		1.5
AIR FORCE AERO- NAUTICAL SYS- TEMS DIVISION:			
Institute A	5.9		1.3
Institute B	5.9	7.2	1.3
Institute C	5.9		1.3
COMPOSITE RATES:			
Institute A	6.4		1.1
Institute B	5.9	7.5	1.6
Institute C	<u>6.2</u>	—	<u>1.3</u>
Three not- for-profits	<u>6.3</u>	<u>7.5</u>	<u>1.2</u>

COMPARISON OF WEIGHTED AVERAGE FEE RATES

NEGOTIATED BY DOD

WITH THREE NONSPONSORED NOT-FOR-PROFIT INSTITUTES

BEFORE AND AFTER ISSUANCE OF

DEFENSE PROCUREMENT CIRCULAR 50

ON DECEMBER 30, 1966

	<u>1965 and 1966 Contracts</u>		
	<u>Number</u>	<u>Value (millions)</u>	<u>Composite weighted average rate (percent)</u>
Institute A	44	\$16.5	6.5
Institute B	94	12.0	6.0
Institute C	<u>103</u>	<u>10.0</u>	<u>6.0</u>
	<u>241</u>	<u>\$38.5</u>	<u>6.2</u>
Range			<u>5-7</u>
	<u>1967 and 1968 Contracts</u>		
	<u>Number</u>	<u>Value (millions)</u>	<u>Composite weighted average rate (percent)</u>
Institute A	174	\$33.2	6.2
Institute B	73	11.2	5.9
Institute C	<u>105</u>	<u>8.5</u>	<u>6.4</u>
	<u>352</u>	<u>\$52.9</u>	<u>6.2</u>
Range			<u>4-8.5</u>

APPENDIX IV



DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D.C. 20201

OFFICE OF THE SECRETARY

NOV 27 1970


Mr. Philip Charam
Associate Director, Civil Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Charam:

The Secretary has asked that I reply to the draft report of the General Accounting Office on its review of fees paid nonsponsored not-for-profit organizations by various agencies of the government. Enclosed are the Department's comments on the findings and recommendations in your report.

We appreciate the opportunity to review and comment on your draft report.

Sincerely yours,


James B. Cardwell
Assistant Secretary, Comptroller

Enclosure

COMMENTS ON DRAFT REPORT OF
THE GENERAL ACCOUNTING OFFICE, ENTITLED
REVIEW OF FEES PAID NONSPONSORED NOT-FOR-PROFIT ORGANIZATIONS
BY VARIOUS AGENCIES OF THE GOVERNMENT

GAO Recommendation: That the Director, Office of Management and Budget, take the lead in interagency development of uniform Government-wide guidelines governing the negotiation of fees to not-for-profit organizations. These guidelines should establish firm, equitable criteria for use by all departments and agencies of the Government in establishing fee payments which will be fair to both not-for-profit and commercial organizations, giving consideration to the tax posture of each type of organization.

HEW Comment: We concur in the recommendation that the Office of Management and Budget take the lead in interagency development of guidelines governing the negotiation of fees with not-for-profit organizations. We particularly welcome the establishment of uniform Government-wide criteria regarding such fees which clearly distinguish between the commercial or nonprofit nature of the contracting organization.

Existing guidelines governing fees, as prescribed in Section 1-3.808 of the Federal Procurement Regulations and Section 3.808 of the Armed Services Procurement Regulation, do not adequately address the distinction between types of organization. We feel, however, that the recommended guidelines should go beyond consideration of the different tax postures of not-for-profit and commercial organizations and should take into account organic differences between such organizations and the fundamental purposes to be served by fees. We further believe that a single set of guidelines may be appropriate to cover both sponsored and nonsponsored nonprofit organizations. In this regard, we question the contention made by nonsponsored not-for-profits, as reported on page 8 of the draft report, that "they should not be compared with the sponsored not-for-profit." The reasons given for the nonsponsored organizations' requirement for fees; i.e., "for working capital, financial stability reserves, acquisition of facilities, and expansion of facilities," are substantially identical to the purposes for which fees were expected to be applied as recommended in the Bell Report and as discussed in the Comptroller General's Report on "Need for Improved Guidelines in Contracting for Research with Government-Sponsored Nonprofit Contractors" (B-146810, February 10, 1969).

GAO Recommendation: Pending the development of uniform Government-wide guidelines governing fees to not-for-profit organizations, each individual agency should reevaluate its current policy and take steps necessary to assure that fee payments are adjusted to adequately recognize the tax-free status of not-for-profit organizations.

APPENDIX IV

HEW Comment: We concur in this recommendation and are in the process of taking steps to implement it. As a first step, the Department of Health, Education, and Welfare has recently completed a comprehensive study of fees awarded under CPFF contracts by operating agencies throughout the Department. The results of this study confirms the Comptroller General's finding that there is little difference between the rates of fixed fee paid to commercial concerns and those awarded to nonprofit organizations, and that adequate recognition is not being given to the tax-free status of not-for-profit organizations. Based on statistics for Fiscal Year 1969, the Department-wide weighted average of fee rates for commercial contractors was 6.4%, which compares favorably to the average rate of 7.5% with respect to fees paid commercial organizations Government-wide as estimated in the Comptroller General's report. For the same year, however, the weighted average rate of fees paid to nonprofit organizations throughout the Department was 5.9%. These statistics reveal that while the average fee rate negotiated with nonprofit organization is less than that negotiated with commercial contractors, the difference is not significant. To effectuate the Comptroller General's recommendation, this Department is reevaluating its current policies governing the negotiation of fees and is in the process of developing separate fee guidelines applicable to nonprofit and commercial organizations, respectively, which will give consideration to differences between nature of such organizations.

Other Considerations in the Development of Government-wide Guidelines.

It should be noted that approximately two-thirds of the CPFF contracts awarded by the Department of Health, Education, and Welfare involve amounts under \$100,000, a level below which many components of the Department of Defense do not even bother to employ the ASPR weighted guideline system of fee determination. Consequently, the comparatively low average dollar value of HEW's CPFF transactions may preclude the attainment of the suggested 3% spread between average fees paid to commercial and nonprofit organizations. The use of ASPR type weighted guidelines would appear to be uneconomical for individual low dollar procurements, since the cost of detailed evaluations and prolonged negotiations may outweigh possible savings in fees. In addition, negotiating fees at the low end of the 3% to 7% range becomes particularly difficult when low dollar procurements are involved, regardless of the commercial or nonprofit nature of the contracting organization.

An additional consideration, which may be peculiar to this Department, is that the preponderance of HEW's support to nonprofit concerns is made by means other than CPFF contracts; i.e., principally by grants. Since one of the purported purposes fees fulfill for nonprofit organizations, whether sponsored or nonsponsored, is the support of independent, self-initiated research conducted by the recipient, it may be appropriate to examine the broader question of whether the award of grants to nonprofit organizations adequately recompenses them for independent research and should preclude

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or limit the payment of fees on contract work performed by such organizations. A further area to be considered may be the propriety of fees paid to nonprofit organizations under CPFF contracts being employed by such organizations to cover the requirement for sharing in the cost of research projects supported by Federal grants.

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APPENDIX V



OFFICE OF THE SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

ASSISTANT SECRETARY
FOR ADMINISTRATION

November 4, 1970

Mr. Richard W. Kelley
Assistant Director
Civil Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Kelley:

This is in reply to Mr. Sacks' letter of August 26, 1970, which forwarded for comment the General Accounting Office (GAO) draft report to Congress entitled "Review of Fees Paid Nonsponsored Not-for-Profit Organizations by Various Agencies of the Government."

GAO recommends that the Director, Office of Management and Budget, take the lead in interagency development of uniform Government-wide guidelines governing the negotiation of fees to not-for-profit organizations. GAO further recommends that pending the development of uniform Government-wide guidelines, each individual agency reevaluate its current policy and take steps necessary to assure that fee payments are adjusted to adequately recognize the tax-free status of not-for-profit organizations.

The Department concurs in the recommendation that the Director, Office of Management and Budget, initiate the development of uniform Government-wide guidelines. We expect to issue a Department of Transportation Procurement Regulation on the negotiation of fees with tax-exempt institutions, providing guidelines which will implement your second recommendation.

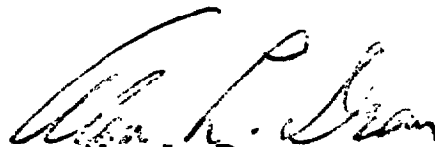
The draft report on page 24 contains comments attributed to Federal Highway Administration contracting officials. The language used in the report should be clarified to more accurately express the views of these officials. We suggest the paragraph in question be reworded as follows (added or revised wording underscored):

"Federal Highway Administration

Contracting officials of the Federal Highway Administration stated that the Federal Procurement Regulations contain guidelines for fee payments to profit-making organizations but do not contain specific guidelines for development of fee payments to nonprofits. Because the Federal Procurement Regulations contain no directions specifically limiting fee payments to nonprofits, the chief contracting officer informed us that the independent nonprofits press for and sometimes get fees from other Government agencies that are as high as fees paid by the Federal Highway Administration to commercial organizations."

We appreciate the opportunity to comment on the draft report.

Sincerely,



Alan L. Dean

APPENDIX VI

UNITED STATES DEPARTMENT OF AGRICULTURE
AGRICULTURAL RESEARCH SERVICE
WASHINGTON, D.C. 20250

OFFICE OF ADMINISTRATOR

NOV 27 1970

Mr. Bernard Sacks
Associate Director, Civil Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Sacks:

This is in reply to your letter of August 26, 1970, on fees paid non-sponsored not-for-profit organizations by various agencies of the Government and the proposed draft to be submitted to the Congress. Our comments are based on actual on-site negotiation experience with our contractors.

Agricultural Research Service research contracts are authorized under the Research and Marketing Act of 1946, as amended, and the work to be performed must be carried out more effectively, more rapidly, or at less cost, than if performed by the Department. The proposed work must be coordinated with, and supplemental to, current ARS research work. ARS does not sponsor any contractors to provide sufficient work and revenues to insure retention of acquired capabilities to meet Government needs.

Contracts negotiated by ARS involving a fee are for basic and/or applied agricultural research and not the delivery of hardware, and are usually for amounts less than \$50,000. Most of these contracts are with universities or nonsponsored not-for-profit organizations and not tax-paying commercial organizations. While the Research and Marketing Act of 1946, as amended, exempts USDA from obtaining formal competition, it is Agency policy to obtain comparative costs. Selection of contractor is based upon evaluation of qualifications, understanding of problem area and the approach to solving the problem, and total cost for the complete project.

A positive effort is made to negotiate the lowest possible fee; however, of equal importance is that proper consideration be given to the total cost of the work. The best interest of the Government cannot be served if procedure requires contract negotiation with an organization whose fixed fee fell within the range recommended in your report but whose total cost for the work exceeded another highly qualified organization which requires a higher fee. In practice, educational institutions, profit-making, and not-for-profit organizations are in competition. ARS strives for the best possible contract in the interest of the Government regardless of the type of organization of the prospective contractor.

It is the policy of ARS to negotiate each budget item and obtain the lowest fee acceptable to the contractor for the particular proposed work regardless of whether the contractor is a not-for-profit or commercial organization. We do not rely solely on past historical facts for the lowest possible fee acceptable to the contractor. Our experience with prospective contractors, particularly the three mentioned in the report, indicates that they are very adamant to negotiating a fee lower than their stated rate. In many instances they would rather forfeit the proposed contract than accept a lower fee.

These contractors have willingly indicated to us at times that they negotiate lower fees with other Government agencies due to the number and large dollar amounts of such contracts. In many of our contracts with these organizations, there is a cost-sharing factor which is taken into consideration in the total negotiation of the contract.

Another factor affecting the fee is the indirect cost factor. Here again we strive to negotiate the lowest fixed dollar value indirect cost, lower than the current DCAA percentage rate if possible. Our contracts are for extended periods up to four years and do not provide for a provisional increase in the event the contractor's indirect costs are increased. The contractors usually insist that this factor be considered in negotiating the fee.

We have no objections to the conclusions expressed in the report. Fee setting guidelines which are more extensive and specific than those presently in the Federal Procurement Regulations would be of assistance in standardizing the fees paid under the cost-plus-fixed-fee contracts.

The report concludes that it would be equitable to reduce the fee paid to not-for-profit organization by 3 to 7 percent to offset the taxes commercial organizations pay. We do not disagree with this judgment, assuming that it is based on conclusion that fees paid to both types of organizations are subject to the same criteria. We strongly recommend that this area be carefully examined in developing fee-setting guidelines. It may be found that the same criteria are not applicable and that two sets of guidelines will be required to achieve equitable treatment.

Sincerely,



T. W. Edminster
Acting Administrator

APPENDIX VII

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

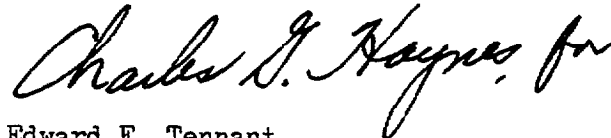
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Mr. Oye V. Stovall
Director, International Division
United States General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Stovall:

We have carefully reviewed your report of August 26, 1970, concerning fees paid non-sponsored, not-for-profit organizations by various agencies of the Government. We are pleased to transmit a memorandum dated October 21, 1970 from Patrick M. O'Leary which constitutes the Agency's consolidated response to the draft report.

Sincerely yours,



Edward F. Tennant
Auditor General

Enclosure: a/s

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APPENDIX VII

assure that Agency fee payments adequately recognize the tax-free status of not-for-profit organizations. As a reading of subject report will make amply clear, there is no hard and fast rule as to what constitutes "adequate recognition" of the tax-free status of not-for-profit organizations. We believe the Agency would be ill-advised to commit itself to measuring up to a standard which is yet to be defined. We note that the recommendation on page 34 of the draft report, concerning setting uniform Government-wide guidelines has been made to the Director, Office of Management and Budget (OMB); we will await OMB's comment with interest.

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UNITED STATES OF AMERICA
GENERAL SERVICES ADMINISTRATION
WASHINGTON, D.C. 20405



OCT 16 1970

Honorable Elmer B. Staats
Comptroller General of the
• United States
General Accounting Office
Washington, D. C. 20548

Dear Mr. Staats:

This is in reply to your letter of August 26, 1970, which requested our views and comments on the accompanying copy of a draft of a proposed report to the Congress on your review of fees paid by Government agencies under research contracts to nonsponsored not-for-profit organizations.

We agree fully with the proposition that not-for-profit organizations should not receive as proportionately large fees under cost reimbursement type contracts as commercial organizations, in view of the exemption of the former from Federal income taxes.

The promulgation of uniform Government-wide guidelines by the Office of Management and Budget, as you recommend, or, in the alternative, by the General Services Administration and the Department of Defense through the Federal Procurement Regulations and the Armed Services Procurement Regulation, certainly would be desirable. In view of GSA's responsibility for issuing Government-wide contract policies and procedures, we would favor the latter arrangement.

In any event, we propose to convene an interagency task group to develop an appropriate temporary Federal Procurement Regulation which would provide uniform civilian agency adherence to your recommendation that such agencies take steps necessary to adjust fee payments in recognition of the tax-free status of not-for-profit organizations.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Rod Kuehn', written in a cursive style.

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Keep Freedom in Your Future With U.S. Savings Bonds

APPENDIX IX



NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
WASHINGTON, D C. 20546

REPLY TO
ATTN OF: KDP-2

NOV 20 1970

Mr. Lloyd G. Smith
Associate Director, Civil Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Smith:

This is in response to the GAO draft report on Review of Fees Paid Non-sponsored Not-For-Profit Organizations by Various Agencies of the Government.

Although we do not necessarily agree with the conclusions reached in your draft report, for reasons stated in the attached comments, we would be pleased to meet with other agencies to determine if Government-wide fee guidelines are needed.

As an interim step, we will caution NASA contracting officers to consider the tax exempt posture of contractors in the overall fee guidelines of NASA Procurement Regulation 3.808 when negotiating fees with not-for-profit organizations.

Sincerely yours,

Richard C. McCurdy
for Richard C. McCurdy
Associate Administrator
for Organization and Management

Attachment
a/s

NASA COMMENTS ON GAO DRAFT REPORT
ON REVIEW OF FEES PAID
NONSPONSORED NOT-FOR-PROFIT ORGANIZATIONS
BY VARIOUS AGENCIES OF THE GOVERNMENT

GAO has concluded that: (1) DOD and other agencies have not given sufficient attention to the tax posture of not-for-profit organizations in negotiating rates of fee for research and development contracts, which resulted in excessive fee payments, (2) existing regulations of such agencies are not consistent for payment of fees to not-for-profit research organizations, (3) where guidelines are in existence, they are not uniformly applied, and (4) agency regulations do not make adequate distinction between not-for-profit and commercial organizations in the payment of fees.

GAO has made the following recommendations:

1. That the Director, Office of Management and Budget, take the lead in interagency development of uniform Government-wide guidelines governing the negotiation of fees to not-for-profit organizations. These guidelines should establish firm, equitable criteria for use by all departments and agencies of the Government in establishing fee payments which will be fair to both not-for-profit and commercial organizations, giving consideration to the tax posture of each type of organization.

2. That, pending the development of uniform Government-wide guidelines, each individual agency reevaluate its current policy and take steps necessary to assure that fee payments are adjusted to adequately recognize the tax-free status of not-for-profit organizations.

Before commenting on the GAO recommendations, it is necessary to clarify one portion of the draft report that is misleading and not completely factual.^[1] On Page 26, GAO quotes a portion of an Ames Research Center letter, dated February 20, 1968, to NASA Headquarters and implies that action should have been taken at NASA Headquarters but was not.

The letter in question was the result of an inquiry from the Director of Procurement on February 1, 1968 to all NASA Centers, on a different subject, asking for comments and suggestions regarding problem areas encountered in drafting contracts with nonprofit scientific and educational institutions. The Ames comment was of a general nature and not to a specific Ames contract. Rather, it was based on a U. S. Army Audit Agency Report SF-65-526, issued 3-1/2 years earlier on September 11, 1964, entitled "Comprehensive Report on Government Contract Operations for the 18 Months Period Ending December 31, 1963". The audit report was the result of an overall review of financial operations and related management procedures and practices of ^[2]

GAO notes:

1. The report has been modified (see p. 12) to clarify this matter.
2. The name of the contractor has been deleted.

APPENDIX IX

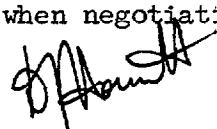
As presented in the draft report, GAO has taken the Ames comment out of its proper perspective because they failed to complete the Ames suggestion, which read: "This comment is perhaps outside the intent of reference letter, but deserves to be kept in mind for high-level consideration as a separate study" (underscore added).

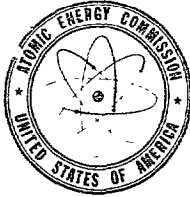
A reply to the Ames letter was not expected, but Headquarters Procurement Office did promptly review the NASA Procurement Regulations and determined that a revision to the regulations was not required. The policy and procedures for determining a reasonable fee are necessarily broad to encompass the great number of factors to be considered and the multitude of contractual situations which arise. Because of this, we considered and still consider, the NASA Procurement Regulation 3.808 proper. Accordingly, that part of Page 26 of the draft report that pertains to NASA should not be included in the final report.

With regard to GAO's recommendations, we would be glad to meet to determine if Government-wide fee guidelines are needed. If these guidelines are needed, we would expect them to be structured in such a fashion as to allow individual contracting officers to consider their instant case in its proper perspective.

GAO has concluded in connection with the second recommendation that, because nonsponsored not-for-profit organizations are tax exempt, fees paid for contracts with these organizations should be limited. Although we appreciate the GAO concern, we do not necessarily believe that the subject of tax exemption is the overriding factor when determining fees nor do we believe that there should be a preestablished fee limitation on these contracts. NASA's basic position is to pay a reasonable fee commensurate with the services received. We agree that the tax exempt status of not-for-profit organizations is one factor that should be considered by contracting officers when negotiating fees. The need for payment in excess of cost and the uses to which such payments would be put are other factors to be considered. Further, the weighting placed on the tax exemption element will likely differ from contract to contract when placed in perspective with other fee factors such as those contained in the NASA Procurement Regulation 3.808. Because of this, it is difficult for us to understand how GAO concludes that the average fee paid to not-for-profit organizations (6.1% of cost on NASA contracts reviewed) should have averaged 5% to be considered reasonable. In no way could we support the position that fees paid to not-for-profit organizations should be at an average of 5%, or any other set percentage, in order to be considered reasonable.

As a current action, we will caution NASA buying personnel to consider the tax exempt posture of contractors in the overall fee guidelines of PR 3.808 when negotiating fees with not-for-profit organizations.


D. J. Harnett
Assistant Administrator for
Industry Affairs and Technology Utilization



UNITED STATES
ATOMIC ENERGY COMMISSION
WASHINGTON, D. C. 20545

JAN 15 1971

Mr. Lloyd G. Smith
Associate Director
Civil Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Smith:

This is in response to your letter of August 26, 1970, requesting our comments on the draft of a report of GAO's review of fees paid to non-sponsored not-for-profit organizations.

It is our understanding that as a result of discussions held between members of our respective staffs, GAO intends to revise those sections of the report dealing with the AEC to indicate that AEC is implementing its policy of giving consideration to the tax posture of not-for-profit contractors by making reductions when negotiating fees with such organizations. We also understand that there will be a number of revisions in the findings concerning the average fees paid to Institute A and commercial organizations by the AEC, which support the report's overall finding concerning the AEC's implementation of its policy in this area.

The report recommends that uniform Government-wide guidelines be developed for the negotiation of fees with nonsponsored not-for-profit organizations. This recommendation is apparently based on two points: (1) GAO's opinion that in order to provide that not-for-profit and commercial profit making organizations are treated equitably, Government agencies, when determining fee payments on Government contracts, should make an appropriate adjustment in the fees paid to not-for-profit organizations because they pay no Federal income taxes; and (2) the report's findings that the Department of Defense policies concerning fee for not-for-profit contractors are not achieving their intent, and on the fact that civilian agencies (other than the AEC) do not make a distinction between tax-exempt organizations and commercial organizations in their fee policies. We understand that GAO envisions that the proposed guidelines would be essentially concerned with providing a uniform not-for-profit adjustment factor (similar to

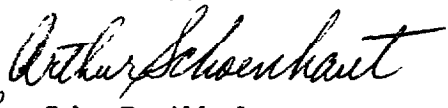
APPENDIX X

Mr. Lloyd G. Smith
the 25% factor and the 3% weighted guidelines factor used by AEC and DOD, respectively) or some other uniform adjustment technique, and with providing guidelines for the application of this factor or technique to not-for-profit contractors.

We believe that there should be a Government-wide policy that requires all agencies to give appropriate consideration in their fee policies to the tax posture of each organization. However, we do not believe there is a need for a uniform Government-wide fee policy which spells out specific guidelines for making a distinction between not-for-profit and profit making organizations. It appears to us that the problems noted in the last paragraph of page 4. of the draft report could be corrected by better execution and enforcement in the case of the agency which has a policy and by modification of the regulations of the other agencies to give recognition to not-for-profit status. It would seem that as long as the executive agencies make an adequate distinction between commercial and not-for-profit organizations in their fee policies and practices, the objectives being sought by GAO would be accomplished.

We also believe the development of detailed guidelines for not-for-profit organizations could have a serious disruptive effect on the existing overall fee policies of the various executive agencies. It appears that GAO is recommending, in effect, that the OMB examine only one of the factors that must be considered when calculating and negotiating a fee, i.e., the not-for-profit factor. The present overall fee policies of the various agencies recognize that there are other factors which are important and which must be considered in the negotiation of fees with both not-for-profit and commercial organizations, such as complexity of the work, risk, and the contractor's capital investment. However, there are some major differences in the overall fee policies of the various agencies. The DOD utilizes the weighted guidelines approach to determining fees. The AEC uses factors such as complexity of the work and capital investment, but the target fee arrived at using these factors cannot be in excess of established declining fee curves based upon estimated costs. The other civilian agencies such as NASA use narrative factors. Since these three approaches are so different, it would be extremely difficult to develop a viable uniform Government-wide fee policy for just one of the factors that must be considered, that would not seriously disrupt the various agencies fee policies, unless all the agencies were required to adopt the same basic overall approach to fee determination. The only practical manner in which an examination could or should be made of fee policy is an examination of all the major elements involved in the determination of fees.

Sincerely,


for John P. Abbadessa
Controller



ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

6 NOV 1970

INSTALLATIONS AND LOGISTICS

Mr. C. M. Bailey
Director, Defense Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Bailey:

This is in response to your letter of 26 August 1970 transmitting for comment GAO draft report titled, "Review of Fees Paid Nonsponsored Not-For-Profit Organizations by Various Agencies of the Government" (OSD Case #3170).

GAO has examined into the policies and practices followed by Government agencies in the payment of fees to nonsponsored not-for-profit organizations at six defense and eight civil agency procurement activities. The examination was focused on cost-plus-fixed-fee contracts awarded to three large not-for-profit research institutes.

The report concludes that these not-for-profit organizations receive approximately the same rate of fees that commercial profit making organizations receive for doing similar work. It is estimated that the total fee at these three institutes could have been reduced by \$594,000 if the Department of Defense (DoD) had achieved a fee rate of five percent. In GAO's opinion, the failure of DoD guidelines to achieve their intended reduction in fees to not-for-profit organizations are the principal reasons that these fees are comparable to those being paid to commercial organizations. Your report recommends that the Director, Office of Management and Budget take the lead in interagency development of uniform Government-wide guidelines governing the negotiation of fees to not-for-profit organizations. Further, pending the development of these guidelines, the report recommends that each agency take steps necessary to adjust fee payments in recognition of the tax-free status of not-for-profit organizations.

APPENDIX XI

We have reviewed this matter, and in our opinion the DoD guidelines on this matter are adequate and procurement activities generally have followed these guidelines in determining the profit objective. The report conclusion that the DoD guidelines were established to reduce fees to not-for-profit organizations misinterprets our policy. Therefore, though we have no objection to the Office of Management and Budget pursuing a study in this area, we are of the opinion that it would not prove to be productive in appreciably changing fee rates to not-for-profit organizations.

We believe that your discussion of the background leading to the publication of our policy in Defense Procurement Circular (DPC) #50 providing for the application of the weighted guidelines to nonprofit organizations does not accurately portray the policy and its development. Your report attaches heavy weight to a special Armed Services Procurement Regulation (ASPR) Subcommittee that considered this subject and recommended the application of the weighted guidelines to nonprofit organizations, subject to minus three percentage points (weighting factor) in recognition of the different status that a nonprofit has as related to a commercial tax bearing organization. The Subcommittee report to the ASPR Committee had suggested that a three percentage point reduction of the weighted guidelines would seemingly adjust fees to a range of three - seven percent with a median of five percent.

Based on the files of the Subcommittee action, the GAO report states, page 3, "The Department of Defense (DoD) revised its procurement regulations in December 1966 to effect a three percentage point spread between not-for-profit and commercial fees." The report further states, "Fees objectives...were to be adjusted by...-3 percent where the proceeds of the contract were not subject to Federal income taxation." GAO found that "...the recommended spread of three percentage points was not being achieved." This misinterpretation of DoD policy in your draft report should be corrected.

Prior to the issuance of DPC #50 dated 30 December 1966, the use of the weighted guidelines for determining the Government's profit objective was not required for negotiating with nonprofit organizations. DPC #50 had several purposes, one of which was to provide for the use of weighted guidelines in determining the Government's profit objective when

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negotiating with nonprofit organizations. Another was to provide necessary adjustment factors to recognize the nonprofit status of such organizations. These purposes are clearly set forth in the published regulation quoted below:

ASPR 3-808.4 "(f) The weighted guidelines method was designed for arriving at profit or fee objectives for other than nonprofit organizations. However, if appropriate adjustments are made to reflect differences between profit and nonprofit organizations, the weighted guidelines method can be used as a basis for arriving at fee objectives for nonprofit organizations. Therefore, the policy of the Department of Defense is to use the weighted guidelines method, as modified in (2) below, to establish fee objectives which will stimulate efficient contract performance and attract the best capabilities of nonprofit organizations to defense oriented activities. The modifications should not be applied as deductions against historical fee levels, but rather, to the fee objective for such a contract as calculated under the weighted guidelines method." (Underlining added)

There is nothing in the DoD published policy to the effect that fees to nonprofit organizations are to be less than fees paid to commercial organizations. Nor is there anything in the published policy that states that the median fee for nonprofit organizations shall be five percent as indicated on pages 3, 4, 16, and 31 of the draft report. Hence, your conclusion on page 19 that DPC #50 had not reduced the fee rates to nonprofit is not an accurate analysis -- that was not the DoD objective. To the contrary, the DoD policy specifically provides (ASPR part quoted above) that the modifications to adjust the weighted guidelines for use in contract awards with nonprofits should not be applied as deductions against historical fee levels.

Perhaps you may have been somewhat misled during your review by the operation of the ASPR Committee. It is the practice of the ASPR Committee to designate special Subcommittees to study and assist in the development of policy. However, the ASPR Committee considers and appraises many views (both inside and outside the Government) in formulating a specific policy. Differing views and conflicting opinions are frequently found in the files of the ASPR Committee's deliberations. The ASPR Committee, in considering this policy, examined the Subcommittee's study, solicited

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other comments, deliberated at length on the issues involved, and formulated the policy which was eventually promulgated.

The GAO report is predicated on a review of contracts awarded during CYs 1967 and 1968. Though the DoD policy was issued on 30 December 1966, printing, reproduction, distribution, implementation and application were some months in the accomplishment. From our examination of significant contract actions awarded to these three research institutes, it appears that the first applications of the new policy occurred in May 1967. Therefore, the use of CY 1967 statistics as a representation of the after effect of the policy change would not be truly reflective since the first four to five months of CY 1967 were taken up with the general distribution and implementation of the new policy.

The draft report concludes on page 4 that DoD guidelines failed to achieve their intended purpose, to wit: a reduction in fees to nonprofit organizations. As we previously stated, that was not the intended purpose of our policy. In actual fact, a review of major contract awards indicates that the specific intent of our policy is being achieved. The specific intent was to require the application of the weighted guidelines with an adjustment factor of minus three percentage points for determining the profit objective under contracts to be awarded to nonsponsored nonprofits. Since the implementation and the application of our policy occurred toward mid-CY 1967, a review of contract awards for the period 1 July 1967 through 30 June 1969 (FY 1968 and 1969) would be a pertinent period to examine for determining whether our policy was implemented by procurement activities.

We have reviewed contract actions exceeding \$200,000 awarded to the three research institutes noted in the GAO report during that two-year period and have found, with no significant exception, that our guidelines published in DPC #50 have been followed. As an example, listed below are CPFF contracts exceeding \$200,000 awarded during FY 1968 and 1969 to Institute A (estimated cost \$13.4 million - fee \$816 thousand). You will note that procurement activities applied the weighted guidelines method, including the special minus factor of three percentage points, in arriving at the Government's profit objective.

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Institute A - Fiscal Years 1968 and 1969 *

<u>Contract Number</u>	<u>Contracting Officer Fee Objective %</u>	<u>Special Factor %</u>	<u>Net Fee Objective %</u>	<u>Contractor Fee Requested %</u>	<u>Negotiated Fee %</u>
A 0099	10.4	(-3.0)	7.4	7.0	7.0
A 0373	8.5	(-3.0)	5.5	7.5	6.0
A 0497	9.3	(-3.0)	6.3	6.3	6.3
A 0684	10.5	(-3.0)	7.5	8.0	7.5
A 1224	8.9	(-3.0)	5.9	8.0	6.3
A 0006	9.0	(-3.0)	6.0	8.0	6.0
A 1261	9.8	(-3.0)	6.8	7.0	6.7
A 0040	7.8	(-3.0)	4.8	7.2	5.0
AF 0156	10.0	(-3.0)	7.0	8.3	7.4
AF 0286	5.9	(-3.0)	2.9	4.0	3.0
AF 1359	7.2	(-3.0)	4.2	7.0	5.0
N 0299	8.7	0	8.7	8.0	8.0
A 0917	9.0	(-3.0)	6.0	6.0	5.1
A 0918	9.0	(-3.0)	6.0	6.5	6.0
A 0919	9.1	(-3.0)	6.1	6.5	6.0
A 0200	9.9	(-3.0)	6.9	7.0	6.5
A 0194	8.0	(-3.0)	5.0	5.0	5.0
A 1703	9.6	(-3.0)	6.6	7.0	6.5
A 2097	9.7	(-3.0)	6.7	7.5	6.7
A 0004	9.4	(-3.0)	6.4	7.5	6.5
A 0004 Mod	9.8	(-3.0)	6.8	8.0	6.8
A 0009	9.6	(-3.0)	6.6	7.3	6.7
A 1261	10.0	(-3.0)	7.0	8.0	7.3
AF 0127	9.0	(-3.0)	6.0	7.0	6.4
AF 0286	8.3	(-3.0)	5.3	7.6	6.0

It is our conclusion that from an examination of major contract actions, DoD contracting officials did apply the policy as promulgated in DPC #50 to nonsponsored nonprofit organizations in the manner intended. Thus, we do not concur with your conclusion that there was a failure in the use

* Source: DoD Profit Reporting System **BEST DOCUMENT AVAILABLE**

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of the DoD guidelines. Though we do not object to your recommendation concerning a study by the Office of Management and Budget, it would be in our opinion unnecessary and of no appreciable benefit to the DoD.

We appreciate this opportunity to comment on your report.

Sincerely,

A handwritten signature in black ink, appearing to read "Barry Shillito". The signature is written in a cursive style with a prominent flourish at the beginning.

BARRY J. SHILLITO
Assistant Secretary of Defense
(Installations and Logistics)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

NOV 25 1970

Mr. A. T. Samuelson
Director, Civil Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Samuelson:

We appreciate the opportunity afforded by your letter of August 26, 1970, to review and comment on the draft GAO report, dated August 1970, "Review of Fees Paid Nonsponsored Not-for-Profit Organizations by Various Agencies of the Government."

As the draft report recognizes, the development of guidelines appropriate to govern agency negotiation of fees payable to non-sponsored not-for-profit Government contractors would require detailed consideration of the affected agencies' policies, procedures and practices, including the fee criteria applicable to other types of contracts and contractors. As you know, a broad legislative charter for the comprehensive review of Federal procurement has been granted to the Commission on Government Procurement, along with the obligation to report findings and recommendations to the Congress. In this connection, we understand that cost contract and nonprofit contractor fees are among the subjects scheduled for review by a Commission study group.

While it would be appropriate for the Office of Management and Budget to work with the Commission and affected agencies to explore the feasibility of developing the suggested guidelines, we believe it would be premature for us to take the leadership in developing uniform guidelines prior to the completion of any pertinent Commission review. We will, of course, be fully cooperating with the Commission on this and related projects, and should affirmative OMB action appear desirable during or as a result of Commission study we will consider such action in the light of circumstances then presented.

Sincerely,



Director

PRINCIPAL OFFICIALS OF
GOVERNMENT AGENCIES
RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES
DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
<u>DEPARTMENT OF DEFENSE</u>		
SECRETARY OF DEFENSE:		
Melvin R. Laird	Jan. 1969	Present
Clark M. Clifford	Mar. 1968	Jan. 1969
Robert S. McNamara	Jan. 1961	Feb. 1968
SECRETARY OF THE ARMY:		
Robert F. Froehlke	July 1971	Present
Stanley R. Resor	July 1965	June 1971
Stephen Ailes	Jan. 1964	July 1965
SECRETARY OF NAVY:		
John H. Chafee	Jan. 1969	Present
Paul R. Ignatius	Sept. 1967	Jan. 1969
Charles F. Baird (acting)	Aug. 1967	Sept. 1967
Robert H. B. Baldwin (acting)	July 1967	Aug. 1967
Paul H. Nitze	Nov. 1963	June 1967
SECRETARY OF THE AIR FORCE:		
Dr. Robert C. Seamans, Jr.	Jan. 1969	Present
Dr. Harold Brown	Oct. 1965	Jan. 1969
Eugene M. Zuckert	Jan. 1961	Sept. 1965

OFFICE OF MANAGEMENT AND BUDGET

DIRECTOR:		
George P. Shultz	July 1970	Present
Robert P. Mayo	Jan. 1969	July 1970
Charles J. Zwick	Jan. 1968	Jan. 1969
Charles L. Schultze	June 1965	Jan. 1968
Kermit Gordon	Feb. 1963	June 1965

Tenure of officeFrom ToGENERAL SERVICES ADMINISTRATION

ADMINISTRATOR:

Robert L. Kunzig	Feb. 1969	Present
Lawson B. Knott	Nov. 1964	Feb. 1969

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARESECRETARY OF HEALTH, EDUCATION,
AND WELFARE:

Elliot L. Richardson	June 1970	Present
Robert H. Finch	Jan. 1969	June 1970
Wilbur J. Cohen	Mar. 1968	Jan. 1969
John W. Gardner	Aug. 1965	Mar. 1968

DEPARTMENT OF AGRICULTURE

SECRETARY OF AGRICULTURE:

Clifford M. Hardin	Jan. 1969	Present
Orville L. Freeman	Jan. 1961	Jan. 1969

DEPARTMENT OF TRANSPORTATION (note a)

SECRETARY OF TRANSPORTATION:

John A. Volpe	Jan. 1969	Present
Alan S. Boyd	Jan. 1967	Jan. 1969

ATOMIC ENERGY COMMISSION

CHAIRMAN:

Dr. Glenn T. Seaborg	Mar. 1961	Present
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Tenure of office
From To

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

ADMINISTRATOR:

Dr. James C. Fletcher	Apr. 1971	Present
Dr. George M. Low (acting)	July 1970	Apr. 1971
Dr. Thomas O. Paine	Oct. 1968	July 1970
James E. Webb	Feb. 1961	Oct. 1968

^aCreated by Department of Transportation Act
(Pub. L. 89-670), October 15, 1966.

Copies of this report are available from the U. S. General Accounting Office, Room 6417, 441 G Street, N W., Washington, D.C., 20548.

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