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Financial Audit of
GRACE V. VAUGHN & ASSOCIATES, INC.
Contract No. AID/OTR-0000-C-00-3023-00
Audit Report No. 84-35
August 17, 1984

This report questions \$23,490 and suspends \$55,831 in costs claimed by Grace V. Vaughn & Associates, Inc., through December 31, 1983, under its contract with AID. It also discloses (1) serious problems with the contractor's financial capacity to perform as well as technical ability to monitor and record costs, (2) that AID did not follow prescribed procedures in entering into this contract or its subsequent management, and (3) that AID improperly amended the contract several times to increase the fee, which was fixed by the contract terms, and another time to waive the maximum overhead rate without consideration.

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GRACE V. VAUGHN & ASSOCIATES, INC.**

Contract No. AID/OTR-0000-C-00-3023-00

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Financial Audit of
GRACE V. VAUGHN & ASSOCIATES, INC.

Contract No. AID/OTR-0000-C-00-3023-00

EXECUTIVE SUMMARY

INTRODUCTION

Grace V. Vaughn & Associates, Inc. (GVA), a minority-owned firm, was awarded a contract under Section 8(a) of the Small Business Act to provide AID post-audit coverage of selected commodity import program transactions. This report addresses the allowability and reasonableness of costs incurred under this contract during the period November 15, 1982 through December 31, 1983. It also discusses (1) GVA's financial capacity to perform under the contract including their ability to maintain adequate records supporting the contract costs charged, (2) AID's failure to follow prescribed procedures in entering into as well as in subsequently managing its contract with GVA, and (3) AID's improperly amending the contract to increase GVA's fee which, under the terms of the contract, was fixed. Following the period covered by our audit, AID also waived the maximum overhead rate without regard for the regulations applicable to amendments without consideration. A companion report is being issued which focuses on GVA's performance under the contract and the adequacy of AID's procedures in awarding and managing the contract.

FINDINGS AND RECOMMENDATIONS

Costs claimed and reimbursed during the period covered by the audit totaled \$465,401. Of this amount, we recommended acceptance of \$386,080, questioned \$23,490, and suspended \$55,831. Recommendation No. 1 is directed at this problem. In the agency response to our draft report, we were told that action has already been taken to settle the majority of these costs. The report text and related recommendation have been revised accordingly. (See pages 2 and 3.)

Through our audit of these costs, many problems surfaced which cast serious doubt as to GVA's financial capacity to perform under the contract as well as its technical ability to monitor and record expenditures under U.S. Government contracts.

We found that GVA is insolvent in the bankruptcy sense in that its liabilities exceed its assets. If the firm were to liquidate, it could only pay its creditors 50% on the dollar without an additional capital investment of at least \$46,452. GVA lost \$71,829 during the year ending December 31, 1982 and another \$32,054 the year following. Further, GVA routinely used its billings to AID as collateral for cash advances from commercial banks to meet its short-term obligations. The major factor accounting for GVA's precarious financial situation was the maximum overhead rate of 45.0 percent which was less than half that needed to fully recover its indirect contract costs.

We further found that AID did not follow prescribed procedures in entering into as well as in subsequently managing its contract with GVA. For example, AID did not request a preaward survey as required by its regulations. Such a

survey would have revealed GVA's shaky financial position. It would have also revealed the lack of an adequate basis for the maximum overhead rate allowed by the contract. Finally, AID improperly amended the contract several times to increase GVA's fee by \$32,532 which, under the contract terms, was fixed. Recommendations No. 3 and 4 are directed at these problems. (See pages 5 and 6.)

GVA officials acknowledge that they do not have personnel with sufficient experience to adequately monitor and record expenditures under U.S. Government contracts nor the money to hire them. GVA has experienced chronic difficulty in meeting its short-term cash requirements and is completely incapable of meeting its long-term obligations. Therefore, we do not believe that GVA now has or is likely to have in the near future the financial capacity or people qualified to satisfactorily perform under U.S. Government contracts. Recommendation No. 5 is directed at this problem. (See pages 6 and 7.)

Subsequent to the period covered by our audit, AID issued four additional amendments to the GVA contract. One of these--amendment 13--increased the maximum overhead rate from 45.0 percent to 93.6 percent. This action enabled GVA to recover all of its indirect costs incurred through December 31, 1983, without consideration, at a cost to the Government of \$68,385. This action was taken without regard for AID's regulations setting forth standards and procedures for granting extraordinary contractual relief.

The primary rationale advanced in support of amendment 13 was our draft IG report which, AID alleges, proposed the higher 93.6 percent rate. There is nothing in our draft report that provides any basis for such an assertion. Even had our draft report been understood to say this, AID should know that the IG is not in a position to recommend waiver of a legally binding contract provision. Further, the amendment was signed by a contracting officer who is not authorized to approve such actions. Taken in conjunction with the other improprieties discussed in this report, we are left with the impression that M/SER/CM has little respect for regulations and procedures relating to their stewardship of public funds.

Accordingly, Recommendation No. 6 has been added calling for the ratification of this action after the applicable standards and procedures have been satisfied, or the nullification of amendment 13 and recovery of the amounts improperly paid GVA. (See pages 7-10.)

Exhibit D lists all the recommendations made.

Financial Audit of
GRACE V. VAUGHN & ASSOCIATES, INC.

Contract No. AID/OTR-0000-C-00-3023-00
Awarded Under Section 8(a) of the
Small Business Act

BACKGROUND

In 1982, AID entered into a contract with the Small Business Administration (SBA) which, on AID's behalf, then entered into a cost-plus-fixed-fee contract with the firm of Grace V. Vaughn & Associates, Inc. (GVA), under Section 8(a) of the Small Business Act. This Contract (AID/OTR-0000-C-00-3023-00) was originally for \$371,822, including fee, and covered the period November 15, 1982 to November 15, 1983. It was subsequently amended 14 times, the cost-plus-fixed-fee was increased to \$832,545, and the termination date was extended to June 15, 1984.

GVA is a minority-owned and equal opportunity firm incorporated in 1977 under the laws of the Commonwealth of Virginia. This was GVA's first contract with AID and the only U.S. Government contract with GVA during the period of our audit. Under this contract, GVA was to provide post-audit coverage of selected commodity import program transactions. As of December 31, 1983, GVA had 12 full-time people working on this contract (including two officers) plus three consultants on an as-needed basis.

OBJECTIVES, SCOPE AND METHODOLOGY

The audit was conducted by the Office of the Regional Inspector General for Audit/Washington (RIG/A/W) and covered the period November 15, 1982 through December 31, 1983. The objective of our review was to determine (a) the allowability of costs incurred, (b) reasonableness of overhead and fringe benefit rates proposed for calendar years 1982 and 1983, and (c) the adequacy of GVA's accounting records. We also reviewed GVA's performance under the contract and the adequacy of AID's procedures in awarding and managing this contract. This latter evaluation is being reported on separately.

We reviewed pertinent documents and accounting records maintained by AID/Washington and the contractor, and held discussions with responsible officials of these organizations. A draft of this report was reviewed by responsible AID officials and our overall evaluation of their written comments is contained in the final section of this report. Certain matters were brought to our attention through these comments which resulted in our revising the report to (1) reflect actions taken on amounts questioned and suspended, and (2) add a new section and recommendation dealing with contract amendment 13 which was executed subsequent to the period covered by our audit.

This audit was made in accordance with the Comptroller General's standards for audit of governmental organizations and activities and, accordingly, included such tests of records and internal controls as was considered necessary in the circumstances.

AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Costs claimed and reimbursed during the period covered by the audit totaled \$465,401. Of this amount, we recommended acceptance of \$386,080, questioned \$23,490, and suspended \$55,831. These costs are summarized on Exhibit A. The report draft--but not the exhibits--has been revised to reflect actions AID told us they have already taken to settle these amounts.

Additionally, we confirmed the duplicate claims for subcontractor billings already identified by AID's Surveillance and Evaluation Division (M/SER/COM/SE) which previously resulted in a \$38,157 refund from GVA.

Through our audit of the costs charged to the AID contract, many problems surfaced which cast serious doubt as to GVA's financial capacity to perform under the contract, as well as its technical ability to monitor and record expenditures under U.S. Government contracts. Given the nature of the problems we found, it appeared that GVA did not adequately understand the terms and conditions of its contract with AID.

We also found that AID did not follow prescribed procedures before entering into as well as in subsequently managing its contract with GVA. For example, AID did not request a preaward survey as required by its regulations. Such a survey would have revealed GVA's questionable financial position. It would have also shown that there was no adequate basis for the maximum overhead rate allowed by the contract. Also, AID improperly amended the contract several times to increase GVA's fee which, under the contract terms, was fixed. Subsequent to the period covered by our audit, AID improperly amended the contract again to grant GVA extraordinary contractual relief of \$68,385.

CONTRACT COSTS QUESTIONED AND SUSPENDED

Direct salaries. GVA based its December 1983 claim for direct salary costs on estimated hours worked. GVA is on a cash basis, however, and the Federal Procurement Regulations (FPR's) therefore requires such claims to be based on actual hours worked. In adjusting the claimed costs to actual costs recorded in 1983, we questioned \$7,257 in direct salary costs. Amendment 13 adjusted allowable direct salaries downward by the questioned costs.

We also found that GVA had billed consultant costs as direct salaries which were not authorized by the AID contract. GVA representatives informed us that these costs were a result of their direct hire employees refusing to work unless they were paid more money. After receiving the verbal approval of the Office of Contract Management (M/SER/CM), these employees were given consultant agreements which incorporated an increase in the hourly rate equivalent to the 21.9 percent fringe benefit rate. Neither the contract, as amended, or negotiation files provided a basis for these actions. Therefore, we have suspended \$17,548. Amendment 13 adjusted allowable direct salaries downward by the suspended costs.

Fringe benefits. We questioned \$10,202 in fringe benefit costs as a result of adjusting the calendar year 1983 contract ceiling rate of 21.9 percent to the actual audited rate of 15.04 (see Exhibit C). Amendment 13 adjusted allowable fringe benefits downward by the questioned costs.

Overhead Costs. We adjusted the overhead costs for the direct salaries and fringe benefit costs questioned above. As a result, we questioned and suspended overhead costs totaling \$15,754. Amendment 13 adjusted the allowable overhead costs downward by the costs both questioned and suspended.

Other Direct Costs. We adjusted total billed costs to actual costs recorded by GVA resulting in a credit of \$1,826 to the questioned costs discussed above.

Subcontractor Costs. Our review of subcontractor, CEXEC, Inc., billings disclosed that GVA paid \$6,031 in January 1984 for services rendered in 1983. We suspended these costs because GVA is on a cash basis, and thus they are not allowable as 1983 costs.

Consultant Fees. Both FPR 1-1.713-3 and the contract agreement between GVA and SBA requires prior written approval of SBA and the designated contracting office to hire consultants. We found that SBA did not give written approval to GVA for the use of consultants. Therefore, we suspended \$24,355 billed consultant costs.

Recommendation No. 1

AID's Office of Contract Management (M/SER/CM) should finalize settlement of the \$23,490 in questioned costs and \$55,831 in suspended costs.

OVERHEAD AND FRINGE BENEFIT RATES

Overhead Rates. The direct salary and subcontract portion of GVA's overhead rate proposals for calendar years 1982 and 1983 were accrued. Since GVA is on a cash basis, however, accrued costs are not allowable. Further, the overhead base was understated because it did not include fringe benefit costs. We further found numerous mathematical errors in the overhead computations. A comparison of the proposed and audited rates in relation to the contract ceiling rate is shown below. As discussed in the following section, no preaward survey was done. Had one been done, there would not have been such a large discrepancy between proposed and audited rates.

<u>Calendar Year</u>	<u>GVA's Proposed Rate</u>	<u>Audited Rate</u>	<u>Contract Ceiling Rate</u>
1982	288.75%	45.0% ^{1/}	45.0%
1983 (corrected after submission)	86.70%	93.6%	45.0%

^{1/} Our review was limited to the comparison of GVA's computerized ledger accounts and 1982 U.S. corporate tax return with their calendar year 1982 proposals.

We recommend overhead rates that correspond to the maximum contract ceiling of 45.0 percent allowed under Article VIII of the basic GVA contract. Therefore, no adjustment is necessary in the overhead billing rate (see Exhibit B).

Fringe Benefit rates. FPR 1-15.205-16 only allows the cost of officers' life insurance if the insurance represents additional compensation to the employee. Since the beneficiary of the insurance is GVA, we recommend that the proposed cost for this insurance of \$2,323 be disallowed.

The rates which we recommend be accepted are summarized below. Note that in 1983, the recommended rate is below the ceiling rate of 21.90 percent.

<u>Calendar Year</u>	<u>GVA's Proposed Rate</u>	<u>Audited Rate</u>	<u>Recommended Rate</u>
1982	55.81%	21.90% <u>1/</u>	21.90% <u>1/</u>
1983	22.72%	15.04%	15.04%

Recommendation No. 2

The Office of Contract Management (M/SER/CM) should (a) finalize overhead and fringe benefit rates as follows:

<u>Calendar Year</u>	<u>Overhead Rates</u>	<u>Fringe Benefit Rates</u>
1982	45.0%	21.90%
1983	45.0%	15.04%

and (b) continue applying the maximum overhead rate of 45.0 percent and the audited rate of 15.04 percent for fringe benefits for the subsequent period until renegotiated.

THE CONTRACT PROPOSALS WERE NOT AUDITED AS REQUIRED

FPR 1-3.809 requires Government contracting offices to request an audit of proposals for cost-reimbursement contracts exceeding \$250,000 when (a) there is inadequate knowledge concerning the contractor's accounting policies or cost systems, or (b) the contractor's cost experience is not available for the procurement of a new product.

Notwithstanding this requirement, M/SER/CM issued the \$371,822 contract to GVA without either a technical evaluation or preaward survey by the Office of

1/ Our review was limited to the comparison of GVA's computerized ledger accounts and 1982 U.S. corporate tax return with their calendar year 1982 proposals.

Inspector General. Thus, GVA's cost proposals, financial capability to perform, and ability to monitor and record U.S. Government contract costs were not adequately evaluated. As discussed later in this report, a preaward survey would have revealed GVA's weak financial capacity to perform under the AID contract. It would also have revealed the lack of an adequate basis for the maximum overhead rate allowed by the contract.

Recommendation No. 3

The Associate Assistant to the Administrator for Management (M/AAA/SER) should require the Office of Contract Management (M/SER/CM) to comply with FPR 1-3.809 relating to preaward survey requests prior to issuing cost-reimbursement contracts.

GVA'S FIXED FEE WAS IMPROPERLY RENEGOTIATED

The GVA contract was originally for \$371,822, including a \$17,805 fixed fee. Through December 31, 1983, the contract cost was increased to \$465,401, including increases of \$10,554 in the fixed fee. Details regarding the original contract amount and the contract amount as of December 31, 1983, are shown below:

	<u>Contract Amount as of 11/15/82</u>	<u>Contract Amount as of 12/31/83</u>	<u>Dollar Increase</u>	<u>Percentage Increase</u>
Cost	\$354,017	\$437,042	\$ 83,025	23.5%
Fixed Fee	<u>17,805</u>	<u>28,359</u>	<u>10,554</u>	59.3%
Total Cost	<u>\$371,822</u>	<u>\$465,401</u>	<u>\$ 93,579</u>	

Note: Through the 13th contract amendment extending the termination date to June 15, 1984, this fixed fee has increased by \$32,532 for a total of \$50,337. This amounts to an increase of 183 percent of the original fee.

Our review of GVA contract amendments disclosed that the fixed fee was increased without any change in the scope of services to be performed. These actions conflict with FPR 1-3.405-5 which requires that the fixed fee, once negotiated, not vary with actual cost unless there are subsequent changes in the work or services to be performed. When the fixed fee does vary with actual costs, the contract is considered by 10 U.S. Code 2306 as a cost-plus-percentage-of-cost contract which is barred by the statute. This prohibition is restated in M/SER/CM's Contract Administrative Memorandum (CAM) No. 62-6, dated August 23, 1982, which provides guidelines for negotiating and justifying the dollar amount of the fixed fee or profit. Accordingly, we believe that the amendments to the GVA contract increasing the fixed fee are invalid.

Recommendation No. 4

The Associate Assistant to the Administrator for Management (M/AAA/SER) should require the Office of Contract Management (M/SER/CM) to comply with FPR 1-3.405-5 and 10 U.S. Code 2306 and, therefore, nullify the contract amendments allowing for increases in the fixed fee and seek recovery of amounts improperly paid GVA.

GVA DOES NOT HAVE THE FINANCIAL CAPACITY
OR PEOPLE QUALIFIED TO PERFORM UNDER
U.S. GOVERNMENT CONTRACTS

Summarized below is an unaudited balance sheet dated December 31, 1983 furnished us by GVA:

Assets:		
Current assets		\$37,290
Fixed assets		10,351
Other assets		<u>2,614</u>
Total assets		<u>\$50,255</u>
Liabilities and capital accounts:		
Current liabilities	\$ 29,262	
Long-term liabilities	<u>67,445</u>	
Total liabilities		\$96,707
Capital accounts		<u>(46,452)</u>
Total liabilities and capital accounts		<u>\$50,255</u>

Note: All of the long-term liabilities are loans payable to stockholders. Also, a portion of the short-term liabilities are classified as deferred compensation to officers. Thus it appears that in a liquidation, GVA would be able to meet its obligations to outside creditors.

As shown above, GVA's total liabilities exceed total assets by almost a two to one ratio. This means that if the firm were to liquidate, it could only pay its creditors 50¢ on the dollar without an additional capital investment of at least \$46,452. Thus, GVA is insolvent in the bankruptcy sense in that its liabilities exceed its assets.

Our review of GVA's financial statements and records showed that the firm lost \$71,829 during the year ending December 31, 1982, and another \$32,054 the year following. As evidence of its serious cash flow problems, GVA routinely uses its billings to AID as collateral for cash advances from commercial banks. While allowing GVA to meet its short-term obligations, this practice has proved expensive in the long-term, costing GVA an estimated \$4,355 over the contract period.

The major factor accounting for GVA's precarious financial situation is that the maximum overhead rate of 45.0 percent was less than half the 93.6 percent needed to recover indirect contract costs. For this reason, it cost GVA more to perform under the contract than they were reimbursed by AID prior to the waiver of the maximum overhead rate granted by contract amendment 13 as discussed in the following section.

GVA officials told us that they were in the process of requesting financial assistance from SBA and also competing on three contracts from other U.S. Government agencies. If successful, these officials believe that GVA will be capable of performing under a new AID contract.

We do not agree with GVA's assessment. GVA has experienced chronic difficulty in meeting its short-term cash requirements and is incapable of meeting its long-term financial obligations without a large additional capital investment. Further, GVA officials acknowledge that they do not have personnel with sufficient experience to adequately monitor and record expenditures under U.S. Government contracts nor the money to hire them. For these reasons, we do not believe that GVA now has, or is likely to have in the near future, the financial capacity or people qualified to satisfactorily perform under contracts with AID or any other U.S. Government agency.

Recommendation No. 5

The Office of Contract Management (M/SER/CM) should not award any new contract to GVA until a stringent review is made of any actions GVA may take to become a responsible contractor and suitable for continued AID contracts in accordance with FPR requirements.

EFFECT OF CONTRACT AMENDMENTS SUBSEQUENT TO PERIOD COVERED BY OUR AUDIT

As stated earlier, our audit covered the period November 15, 1982 through December 31, 1983. Through June 15, 1984, however, the contract was amended an additional four times for a total of 14 amendments. The 13th amendment, dated June 1, 1984, increased the contract amount by \$121,603, of which \$97,076 reflected an increase in the fringe benefit and overhead rates. The 14th amendment, dated June 15, was executed to adjust certain budget cost categories, but it did not increase the total contract amount.

While we were aware of the 13th amendment, and referred to it in our draft report, its real effect became apparent through AID's response to our draft report. The amendment is important because it settles, in whole or in part, the majority of the costs questioned and suspended; the report has been changed to reflect these actions. However, this amendment also results in an action with which we strongly disagree. This action neither serves as a model for dealing with Section 8(a) contractors or for following procedures prescribed by AID Acquisition Regulations (AR's) which superseded AID Procurement Regulations (PR's) effective April 1, 1984.

Our audit showed that while GVA incurred indirect expenses under the AID contract totaling \$136,896, only \$68,511 of these costs were reimbursable. This is because Article VIII of the basic contract established a maximum ceiling rate of 45.0 percent whereas a rate of 93.6 percent was needed for GVA to recover all of their indirect costs. Notwithstanding the existence of the 45.0 percent ceiling, the 13th contract amendment increased this rate to 93.6 percent without consideration from GVA. Accordingly, GVA has now recovered every dollar of indirect expenses incurred through December 31, 1983, at an additional cost to the Government of \$68,385.

The memorandum of negotiation to the contract file supporting the 13th contract amendment, while acknowledging the existence of the 45.0 percent ceiling, alleges that our draft report proposed a rate of 93.6 percent. While not stated in this document, comments to our draft report received both in writing and orally also indicated that the language setting forth the 45.0 percent ceiling rate in the original contract was ambiguous and thus, according to M/SER/CM, allowed for its renegotiation. Both rationale are invalid.

Nothing in our draft report suggests that we thought the 45.0 percent maximum overhead rate was unclear or should be renegotiated. Rather, we state on page 7 of the draft report:

"We recommend overhead rates that correspond to the maximum contract ceiling of 45.0 percent allowed under Article VIII of the basic GVA contract. Therefore, no adjustment is necessary in the overhead billing rate (See Exhibit B)."

Further, Recommendation No. 2 on page 8 of the draft report states that M/SER/CM should finalize the overhead rate at 45.0 percent for both calendar years 1982 and 1983. Even had M/SER/CM misunderstood this language, they should know that the IG is not in a position to recommend waiver of a legally binding contract provision. Accordingly, we believe that M/SER/CM must accept full responsibility for the decision it made and for knowing the procedures to follow in support of it.

In regards to the alleged ambiguity in contract language, Article VIII of the original contract setting forth the 45.0 percent overhead rate is followed by the statement:

"In no event shall reimbursement of allowable indirect overhead and fringe benefit costs exceed the rates set forth above."

The "unambiguous" language contained in amendment 13 increasing this rate to 93.6 percent reads:

"Reimbursement for indirect costs shall be at final negotiated rates, but not in excess of the . . . ceiling rates."

We can see no difference in what is being said, but only how it is being said. If anything, the original contract language is stronger and more inclusive in that it starts with the words "in no event." It is interesting that it is M/SER/CM that finds ambiguity in the language in its own contract with GVA. This leads us to believe that M/SER/CM wanted to increase the costs

reimbursable by GVA under the contract and was not very selective in the rationale it advanced for doing this.

Subpart 750.71 of the AR's sets forth the standards and the procedures for disposition of requests for extraordinary contractual actions including amendments without consideration. The Director, Office of Contract Management, may approve actions up to \$50,000 and the Associate Assistant to the Administrator for Management may approve actions up to \$250,000. Such approvals are subject to very exacting and detailed requirements that emphasize the use of sound judgment based on all of the facts of the individual case. The mere fact that losses occur under a contract is not, by itself, a sufficient basis for the exercise of this authority. The standards and procedures applicable to the use of this authority include the following.

- A contractor seeking relief shall submit a request in duplicate to the contracting officer which states, as a minimum: (a) the precise adjustment requested; (b) the essential facts, summarized chronologically in narrative form; and (c) the contractor's conclusions based on these facts showing why the contractor considers itself entitled to the adjustment.
- The Director, Office of Contract Management, shall be responsible for assuring that the cognizant contracting officer in all cases shall make a thorough investigation of all facts and issues relevant to each case including signed statements of material facts. The investigation shall establish both the facts essential to meeting the standards for deciding the particular case and the essential facts as to who has authority to approve the request.
- Prior to the submission of a case to the approving authority recommending extraordinary contractual relief, the claim will be fully developed by the Office of Contract Management and concurrences or comments obtained from the Office of General Counsel and the Inspector General for the proposed relief to be granted.
- The approving authority, whether approving or denying the request, shall sign a decision which shall be dated and contain certain specific information. This decision document shall be retained in Agency files along with other specifically designated documents as a record of each action processed.

None of the above cited standards or procedures required for the disposition of requests for extraordinary contractual actions were met. In fact, we could find no evidence that GVA even requested the relief granted by the 13th contract amendment. In pursuing this matter with the contracting officer, we were told that there was no written documentation supporting this amendment other than the memorandum to the file previously discussed.

In addition to misrepresenting our position on the maximum overhead rate, this memorandum contained several other errors and inaccuracies:

- It stated that we proposed a 93.6 percent provisional overhead rate for 1984, a subject never even alluded to in our draft report. Worse yet,

in carrying this figure forward to the actual contract amendment, it was increased to 98.6 percent. This gives the contractor authority to be reimbursed another 5 percent over the previous unjustified rate, again for no apparent reason.

- The action taken through this amendment exceeded the authority of the contracting officer to execute. Because \$68,385 of the total increase in the contract amount represents an amendment without consideration, approval would be required of the Associate Assistant to the Administrator for Management after all other applicable standards and procedures have been met.
- While minor in amount, the figure for the total fringe benefit and overhead rate was incorrectly computed. This is mentioned only to demonstrate that in addition to being poorly thought through, the amendment was carelessly executed.

Because AID did not develop the essential facts supporting its decision to grant GVA extraordinary contractual relief, we have no basis for evaluating whether this decision would have been sustained were the proper procedures followed. However, maximum overhead rates are put in contracts to limit the Government's liability for such costs as well as to provide contractors an incentive to keep their overhead expenses within some reasonable limit. The fact that GVA was able to recover every last dollar of indirect costs incurred despite the maximum overhead rate stated in the contract sets a very poor precedent. Taken in conjunction with the other improprieties discussed in this report, we are left with the impression that M/SER/CM has little respect for regulations and procedures relating to their stewardship of public funds.

Not only do we believe that the 13th contract amendment should not have been executed in its present form but, in fact, it may be invalid as it was not signed by an official having the authority to approve such actions.

Recommendation No. 6

The Associate Assistant to the Administrator for Management (M/AAA/SER) should either ratify contract amendment 13 once the applicable standards and procedures have been met, or require the Office of Contract Management (M/SER/CM) to nullify the amendment and seek recovery of amounts improperly paid GVA.

AGENCY COMMENTS AND OUR EVALUATION

Overall, we did not find the comments on the recommendations made in our draft report responsive. Therefore, we are dealing with them separately so as not to confuse those sections of the report text leading to these recommendations.

For example, the basis for Recommendation No. 3 was that the required preaward survey of GVA had not been done. This fact was not challenged, but AID's response was that "CM does have pre-award surveys performed on contractors with whom AID has not previously dealt." While this may be generally true, it was not in the contract with GVA which was the only case discussed in our draft report. Had such a survey been done, many of the problems we found

could have been avoided. Accordingly, the actions called for in our recommendation need to be taken so that this problem is not repeated.

In regards to Recommendation No. 4, AID's response was that "Although the contract does not state that it is a level of effort contract, it is in effect, a level of effort contract." In seeking clarification as to what was meant by this statement, we were told that because the intent was that it be a level of effort contract, it was being treated as if it were one. We were further told that while this problem was recognized and some thought was given to remedying it a year ago, it was decided by M/SER/CM that it would be too much trouble as this would require that the contract be terminated and a new one executed.

Other than the statement that the contract was being treated as a level of effort contract, there is nothing in the record to indicate that any steps were taken to make it one. No daily rates were established nor was there any analysis reconciling the reimbursements of actual costs to fixed prices under a level of effort scheme. Accordingly, to "treat" it as a level of effort contract is so inconsistent with the actual provisions of the contract as to render the contract meaningless. Thus, our recommendation remains valid as stated.

GRACE V. VAUGHN & ASSOCIATES, INC. (GVA)

Contract No. OTR-0000-C-00-3023-00

Summary of Costs Claimed and Accepted for the
Period November 15, 1982 through December 31, 1983

	<u>Costs Claimed</u>	<u>Costs Questioned</u>	<u>Costs Suspended</u>	<u>Total Costs Accepted</u>
Direct Salaries	\$156,855	\$ 7,257 1/	\$ 17,548 2/	\$132,050
Fringe Benefits	<u>30,400</u>	<u>10,202 3/</u>		<u>20,198</u>
Subtotal	\$187,255	\$ 17,459	\$ 17,548	\$152,248
Overhead	84,265	7,857 4/	7,897 4/	88,511
Subcontractor	113,460		6,031 5/	107,429
Consultants	24,355		24,355 6/	
Other Direct Costs	<u>28,601</u>	<u>(1,826) 7/</u>		<u>30,427</u>
Total Costs	\$437,936 8/	\$ 23,490	\$ 55,831	\$358,615
Fixed Fee	<u>27,465</u>	<u>-</u>	<u>-</u>	<u>27,465</u>
Total Costs and Fixed Fees	<u>\$465,401</u>	<u>\$ 23,490</u>	<u>\$ 55,831</u>	<u>\$386,080</u>

Explanatory Notes:

1/ Contractor's billings for calendar year 1983 direct salaries were estimated and not adjusted to actual costs recorded by GVA.

2/ Contractor's billings for direct salaries included consultant fees that were not authorized by the GVA contract.

Explanatory Notes: (Continued)

3/ Fringe Benefits adjusted as follows:

Fringe Benefits Claimed			\$ 30,400
Fringe Benefits Accepted:			
Direct Labor Claimed (CY 1982)	\$ 4,921		
Maximum Fringe Benefit Rate	<u>x21.9%</u>	\$ 1,078	
Direct Labor Claimed (CY 1983)	\$ 151,934		
Less: Audit Adjustment	<u>24,805</u>		
	\$ 127,129		
Audit Fringe Benefit Rate (Exhibit C)	<u>x15.04%</u>	<u>19,120</u>	<u>20,198</u>
Net Adjustment			<u>\$ 10,202</u>

4/ Overhead expenses are adjusted as follows:

Overhead Claimed			\$ 84,265
Overhead Accepted			
Direct Salaries Accepted (CY 1982)	\$ 4,921		
Fringe Benefits Accepted	<u>1,078</u>		
	\$ 5,999		
Maximum Contract Ceiling			
Overhead Rate	<u>x45.0%</u>	\$ 2,699	
Direct Salaries Accepted (CY 1983)	\$127,129		
Fringe Benefits Accepted	<u>19,120</u>		
	\$146,249		
Maximum Contract Ceiling			
Overhead Rate (Exhibit B)	<u>x45.0</u>	<u>65,812</u>	<u>68,511</u>
Net Adjustment			<u>\$ 15,754</u>

5/ CEXEC, Inc., billings for services rendered in 1983 but not paid until January 1984.

6/ Line item "Consultant Fees" approved by Contract Amendment No. 5. However, AID/Small Business Administration (SBA) Agreement dated November 22, 1982, requires prior written consent of SBA contracting officer and FPR 1-1.713-3 requires prior written approval of the SBA and designated contracting officer.

7/ Other direct costs recorded but not yet claimed by GVA.

8/ Total cost allowed by contract was \$437,042.

GRACE V. VAUGHN & ASSOCIATES, INC. (GVA)

Computation of Overhead Rate
For Calendar Year Ended December 31, 1983

	<u>Contractor's Proposal</u>	<u>Costs Questioned</u>	<u>Costs Suspended</u>	<u>Costs Accepted</u>
<u>Indirect Expenses</u>				
Officers Salaries	\$ 76,000	\$ -	\$ -	\$ 76,000
Rent	28,700	-	-	28,700
Janitorial	750	-	-	750
Telephone	984	-	-	984
Office Supplies	2,542	-	-	2,542
Consultants	4,998	-	-	4,998
Auto Expense	6,855	-	-	6,855
Subscriptions/ Publications/Seminars	304	-	-	304
Legal and Accounting	2,097	-	-	2,097
Postage and Delivery	333	-	-	333
Licenses and Permits	563	-	-	563
Repair and Maintenance	317	-	-	317
Bank Charges	24	-	-	24
Depreciation	999	-	-	999
Fringe Benefit Costs (Officer's Salaries)	-	(11,430) 1/	-	11,430
Total	<u>\$125,466</u>	<u>\$(11,430)</u>	<u>\$ -</u>	<u>\$136,896</u>
<u>Direct Labor and Fringe Benefit Base</u>				
Direct Salaries	\$144,731	\$ -0-	\$ 17,602 2/	\$127,129
Fringe Benefits	-0-	(19,120) 3/	-0-	19,120
	<u>\$144,731</u>	<u>\$(19,120)</u>	<u>\$ 17,602</u>	<u>\$146,249</u>
Overhead Rate	<u>86.7%</u>			<u>93.6% 4/</u>
Maximum Overhead Rate Allowable under Contract Terms				<u>45.0% 4/</u>

Explanatory Notes:

1/ Adjustment for fringe benefit costs for officer's salaries not claimed by GVA.

Explanatory Notes (Continued)

2/ Direct salaries are adjusted as follows:

(a) Consultant fees claimed as direct salaries and not authorized by GVA contract.	\$ 17,548
(b) Other direct costs claimed as salaries	54
	<u>\$ 17,602</u>

<u>3/</u> Fringe Benefit Claimed		-0-
Fringe Benefit Allowed:		
Direct Salaries Accepted	\$127,129	
Audited Fringe Benefit Rate (Exhibit C)	<u>x15.04%</u>	<u>19,120</u>
Net Adjustment		<u>\$ 19,120</u>

4/ Contract provision (Article VIII) for maximum ceiling rate is 45.0%, therefore, overhead expense adjustment not necessary.

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EXHIBIT C

GRACE V. VAUGHN & ASSOCIATES, INC. (GVA)

**Computation of Fringe Benefit Rate
for Calendar Year Ended December 31, 1983**

	<u>Contractor's Proposal</u>	<u>Costs Questioned</u>	<u>Cost Suspended</u>	<u>Costs Accepted</u>
<u>Fringe Benefit Expenses</u>				
Leave Earned	\$ 3,923	\$ -	\$ -	\$ 3,923
Holidays	7,817	-	-	7,817
FICA Taxes	10,324	-	-	10,324
Unemployment Compensation	2,886	-	-	2,886
Workmen's Compensation	1,367	-	-	1,367
Health Insurance	4,241	-	-	4,241
Life Insurance	<u>2,323</u>	<u>2,323 1/</u>	<u>-</u>	<u>-0-</u>
Total Expenses	<u>\$ 32,881</u>	<u>\$ 2,323</u>	<u>\$ -</u>	<u>\$ 30,558</u>
<u>Total Labor Base</u>				
Direct Salaries	\$144,731	\$	\$ 17,602 2/	\$127,129
Officers Salaries	<u>-0-</u>	<u>(76,000) 3/</u>	<u>-</u>	<u>76,000</u>
Fringe Benefit Base	<u>\$144,731</u>	<u>\$(76,000)</u>	<u>\$ 17,602</u>	<u>\$203,129</u>
Fringe Benefit Rate	<u>22.72%</u>			<u>15.04%</u>

Explanatory Notes:

1/ Adjustment represents life insurance cost for officers where the beneficiary is GVA.

2/ Direct salaries are adjusted as follows:

(a) Consultant fees claimed as direct salaries and not authorized by GVA contract

\$ 17,548

(b) Other direct costs claimed as salaries

54
\$ 17,602

3/ Officers salaries are included in "Indirect Overhead Pool" but used in computing the fringe benefit rate (Exhibit C).

Financial Audit of
GRACE V. VAUGHN & ASSOCIATES, INC.

LIST OF RECOMMENDATIONS

Recommendation No. 1

AID's Office of Contract Management (M/SER/CM) should finalize settlement of the \$23,490 in questioned costs and \$55,831 in suspended costs.

Recommendation No. 2

The Office of Contract Management (M/SER/CM) should (a) finalize overhead and fringe benefit rates as follows:

<u>Calendar Year</u>	<u>Overhead Rates</u>	<u>Fringe Benefit Rates</u>
1982	45.0%	21.90%
1983	45.0%	15.04%

and (b) continue applying the maximum overhead rate of 45.0 percent and the audited rate of 15.04 percent for fringe benefits for the subsequent period until renegotiated.

Recommendation No. 3

The Associate Assistant to the Administrator for Management (M/AAA/SER) should require the Office of Contract Management (M/SER/CM) to comply with FPR 1-3.809 relating to preaward survey requests prior to issuing cost-reimbursement contracts.

Recommendation No. 4

The Associate Assistant to the Administrator for Management (M/AAA/SER) should require the Office of Contract Management (M/SER/CM) to comply with FPR 1-3.405-5 and 10 U.S. Code 2306 and, therefore, nullify the contract amendments allowing for increases in the fixed fee and seek recovery of the amounts improperly paid GVA.

LIST OF RECOMMENDATIONS (Continued)

Recommendation No. 5

The Office of Contract Management (M/SER/CM) should not award any new contract to GVA until a stringent review is made of any actions GVA may take to become a responsible contractor and suitable for continued AID contracts in accordance with FPR requirements.

Recommendation No. 6

The Associate Assistant to the Administrator for Management (M/AAA/SER) should either ratify contract amendment 13 once the applicable standards and procedures have been met, or require the Office of Contract Management (M/SER/CM) to nullify the amendment and seek recovery of amounts improperly paid GVA.

**Financial Audit of
GRACE V. VAUGHN & ASSOCIATES, INC.**

LIST OF REPORT RECIPIENTS

Assistant to the Administrator for Management, AA/M	1
Associate Assistant to the Administrator for Management, M/AAA/SER	5
Audit Liaison Officer, M/AAA/SER	1
Director, Office of Contract Management, M/SER/CM	5
Director, Office of Commodity Management, M/SER/COM	1
Controller, Office of Financial Management, M/FM	1
Office of Financial Management, M/FM/ASD	1
Office of Media, Bureau for External Affairs, XA/PA/M	2
Office of Legislative Affairs, LEG	1
Office of General Counsel, GC	1
Bureau for Program and Policy Coordination, PPC/EA	1
Center for Development Information and Evaluation, PPC/CDIE	2
Office of Inspector General, IG	1
RIG/A/Nairobi	1
RIG/A/Manila	1
RIG/A/Cairo	1
RIG/A/Karachi	1
RIG/A/Dakar	1
RIG/A/LA	1
AIG/A	1
IG/PPP	1
IG/II	1
IG/EMS/C&R	16