IG-98-007

# AUDIT REPORT

## CONTRACTOR FACILITY LEASES

March 5, 1998

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National Aeronautics and Space Administration

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National Aeronautics and
Space Administration

**Headquarters**
Washington, DC 20546-0001

Reply to Attn of: W

March 5, 1998

TO: H/Associate Administrator For Procurement

FROM: W/Acting Assistant Inspector General for Auditing

SUBJECT: Final Report on the Audit of Contractor Facility Leases
(Assignment No. A-HA-97-042)

The subject final report is provided for your use. Your comments to a draft of this report were responsive to our recommendations and additional comments are not required. Please refer to the executive summary for the overall audit results.

If you have questions concerning the report, please contact Mr. Lorne A. Dear, Program Director, Procurement and International Agreements at (818) 354-3360, or Ms. Bobbie J. Wells, Auditor-in-Charge at (216) 433-8980. We appreciate the courtesies extended to the audit staff.

Russell A. Rau

Enclosure

cc:
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JM/D. Green
GSFC/200-1/H. McDonald
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109/J. Struhar
136/E. Taylor
LeRC/3-2/D. Campbell
15-2/H. Wharton

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# CONTRACTOR FACILITY LEASES

## EXECUTIVE SUMMARY

***BACKGROUND***

Contract awards with commercial organizations sometimes require contractors to acquire facilities to perform government work. NASA's Office of Procurement (Code H) and installation procurement divisions are responsible for carrying out the acquisition process which includes complying with applicable contract regulations and evaluating contractor facility costs.

According to the Federal Acquisition Regulations (FAR), lease costs for facilities are an allowable cost, but must be reasonable (FAR 31, Contract Cost Principles and Procedures, August 1992). FAR implements requirements of the Financial Accounting Standards Board for recording the costs of leased facilities. Specifically, Financial Accounting Standard (FAS) 13, *Accounting For Leases*, states that a leased facility can be classified as either a capital lease (i.e., treated as a purchased asset and depreciated) or an operating lease (i.e., treated as an expense), depending on the lease terms and other factors.

NASA contracting officers should follow the FAR to ensure contractors comply with the FAS 13 and may rely on the Defense Contract Audit Agency (DCAA) to ensure the required FAS 13 analysis is performed to determine the proper treatment of lease costs.

***OBJECTIVES***

The audit objective was to determine whether NASA is adequately managing facility leasing. Specifically, we answered the following questions:

- Were contractor facilities effectively utilized?
- Were contractor facility leases correctly classified?
- Did contractors accurately bill lease costs to the government?

Additional information on objectives, scope, and methodology is shown in Appendix 1.

***RESULTS OF AUDIT***

NASA's management of facility leasing can be improved. The lease costs billed to the government were accurate, however, 13 of 82 (16 percent) facilities visited had significant idle space. In addition, four contractor leases were incorrectly classified as operating leases rather than capital leases. As a result, NASA will incur more costs. During our field work, NASA took corrective action on one of the idle facilities we identified at a Langley Research Center prime contractor site and may realize a cost savings of over $183,000. In addition, since our exit conference, NASA has also taken action on six other facilities identified with idle space and may realize additional savings. However, if NASA management does not take corrective actions on the remaining leases, we estimate that NASA could spend over $9 million over the next five years for unnecessary lease costs. We intend to perform a follow-up review at a later time to quantify any actual savings from management's actions on the recommendations.

***MANAGEMENT ACTION DURING THE AUDIT***

During the audit, we issued a rapid action report on two leases at the Lewis Research Center. For one leased facility, the contractor submitted a $164,000 proposal to NASA for reconstruction work; however, we found that the City of Cleveland was planning to purchase the same building as part of an airport expansion project and destroy it to make room for a runway expansion. NASA canceled the reconstruction work and saved the $164,000. On a second leased facility, a contractor requested NASA to pay refurbishment costs of $1 million. The original documentation called for refurbishment costs of $250,000, and we found no documentary evidence to support the increased costs. Management subsequently received an estimate for $470,000, which would save $530,000. Negotiations for a final cost are on-going.

***RECOMMENDATIONS***

We recommended that the Associate Administrator for Procurement direct contracting officers to:

1. reevaluate the facility requirements for those contractor sites with idle space,

2. review the allowability of costs for those leases that have substantial idle space for over one year,

3. request DCAA to include FAS 13 analysis in their full cost proposal reviews, and

4. review the classification of the specific questioned leases to ensure that leases are appropriately classified, and if not, take corrective action as required; including determining the allowability of costs.

NASA management's actions were responsive to the recommendations.

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# OBSERVATIONS AND RECOMMENDATIONS

***OVERALL EVALUATION***

NASA's management of facility leasing can be improved. Although the lease costs billed to the government were accurate, a significant number of contractor facilities were not effectively used and some contractor leases were not correctly classified. As a result, NASA could needlessly spend over $13.7 million over the remaining life of the leases reviewed.

***IDLE SPACE IN FACILITIES COULD COST NASA OVER $9.7 MILLION***

Thirteen of 82 (16 percent) facilities visited had idle space ranging from 9 to 78 percent of the total available lease space. The chart on the following page shows the idle space we observed at the 13 facilities. During the audit, Langley Research Center initiated action on the idle space at one contractor facility, Computer Science Corporation (CSC). NASA and CSC officials agreed to list idle space with a commercial real estate firm to have the space sublet as soon as possible and could realize a cost savings of more than $183,000. Since the exit conference on July 16, 1997, NASA officials and contractors have taken action on an additional 6 of the 13 leased facilities for a potential savings of approximately $4.3 million. However, if no action is taken on the remaining six facilities, NASA could spend over $5.2 million by fiscal year 2002, when the last lease expires (see Appendices 3 and 3-1).

FAR 31.205-17, Idle facilities and idle capacity costs, gives provisions for the treatment of idle facilities and idle capacity. This regulation states that idle capacity costs are allowable for a reasonable period, ordinarily not to exceed one year, depending upon the initiative taken to use, lease, or dispose of the idle facilities. (Additional details are shown in Appendix 2).

The contracting officers and the contractors gave various reasons for the idle space. We were told that most of the idle space was the result of relocating staff, downsizing of the government and reduced tasks for the contractor. A Goddard Space Flight Center contractor official stated that "*idle space should be expected in this era of downsizing*." This contractor currently has 3 locations with idle facilities that could cost the government more than $1.2 million and account for at least 12 percent of the potential savings.

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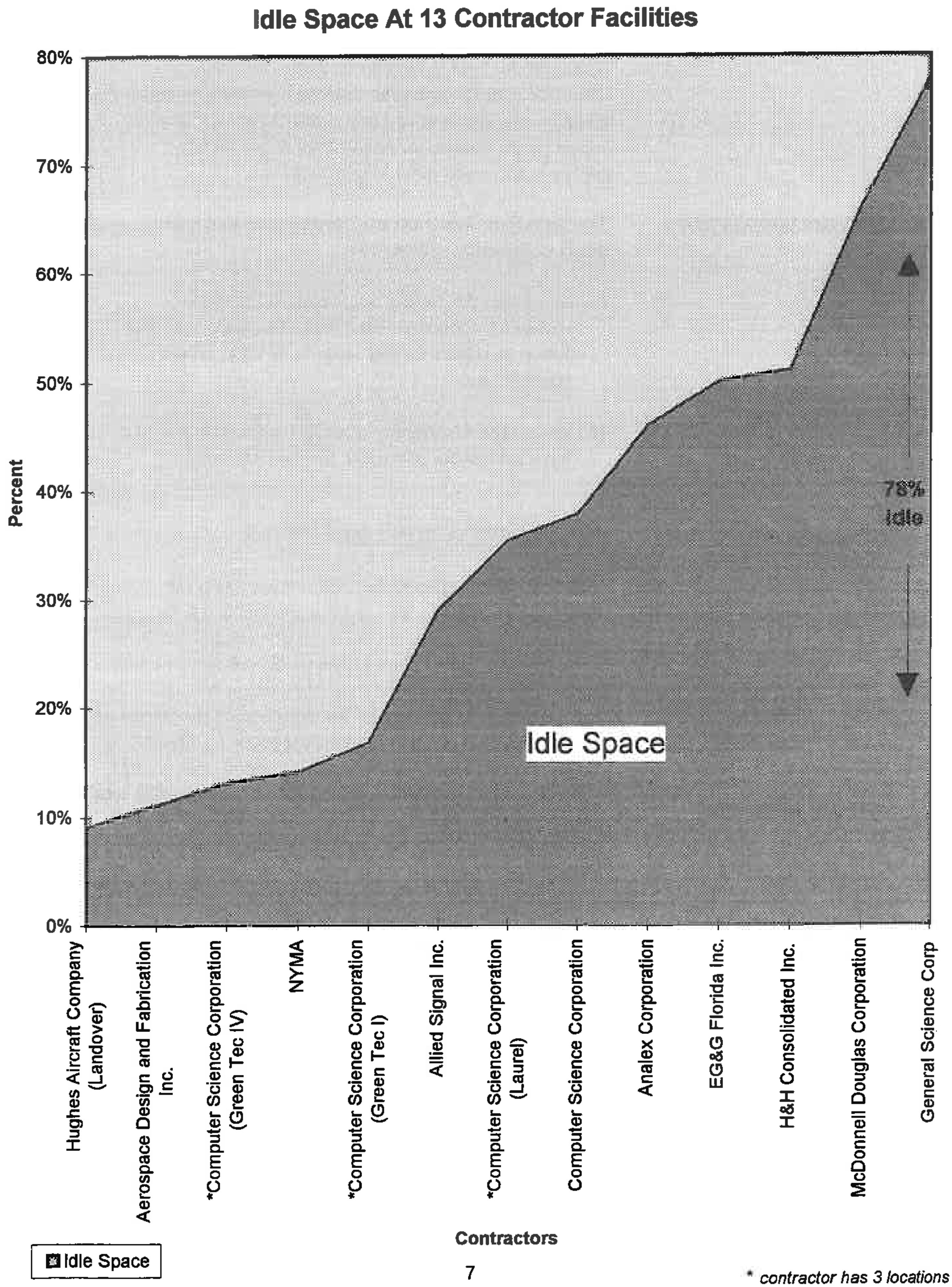


* contractor has 3 locations

NASA pays a substantial amount for unused space. Although the FAR provision includes idle space as an allowable cost for one year, reasonable steps should be taken by management to ensure only necessary space is leased by the contractor and measures are taken to sublease space that is no longer required.

***RECOMMENDATION 1***

The Associate Administrator for Procurement should direct contracting officers to:

(a) reevaluate the facility requirements for those remaining contractor sites with idle space, and take action to reduce facility costs to NASA, where possible, and

(b) review the allowability of costs for those leases that have substantial idle space for over one year.

***Management's Response***

RECOMMENDATION 1 (a): CONCUR

The contracting officers for the contracts with the remaining contractor sites from Appendix 3 will be directed to reevaluate the facility requirements for those sites and take appropriate action to reduce facility costs. Information was provided to us that action was taken by the Centers after the date of the draft report for certain of the contractor sites identified in Appendix 3. Those actions support that the projected potential cost savings amounts contained in the report for those sites and in total are overstated. We request that the projected potential cost savings amounts be adjusted to reflect the impact of the actions taken.

***Evaluation of Management's Response***

Management's action is responsive to our recommendation. We confirmed that management took action on Analex Corporation and Aerospace Design and Fabrication Incorporated after the draft report was released. As a result, the projected potential cost savings went down by approximately $733,397. We adjusted the final report accordingly. We will also perform a follow-up review at a later date to quantify any actual savings resulting from management's actions.

***Management's Response***

RECOMMENDATION 1(b): CONCUR

The Associate Administrator for Procurement will issue direction to the contracting officers for those leases in Appendix 3 having idle space for over one year. The guidance will request that those leases be reviewed to determine the allowability of the costs in accordance with FAR 31.205-17. Paragraph (b)(2) of that cost principle uses one year as a general guideline for determining reasonableness; however, it is not the sole criterion.

That paragraph goes on to state that reasonableness also depends on the initiative taken by the contractor to use, lease, or dispose of the idle facilities.

***Evaluation of Management's Response***

Management's action is responsive to our recommendation.

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***INCORRECT CLASSIFICATION OF LEASES COULD COST NASA APPROXIMATELY $4.0 MILLION***

Four of 82 contractor facility leases were incorrectly classified as operating leases. The four leases should have been capital leases based on Financial Accounting Standard (FAS) 13, *Accounting for Leases*, issued by the Financial Accounting Standards Board. The Statement says, in part, leases should be classified as capital leases if the present value of the minimum lease payments equals or exceeds 90 percent of the facility fair market value (see Appendix 2 for more details). The four leases are separately listed in Appendix 4.

NASA incurs more costs by allowing contractors to classify leases as operating leases rather than capital leases due to the method of accounting. A contractor would depreciate the value of a facility over the life of the lease on a capital lease. For an operating lease, the contractor may charge the government in the period the expense occurred. For the four leases, the total lease payments will exceed the total fair market value (i.e., not just the 90 percent criteria) of the facility by approximately $4.0 million by the time the leases expire (see chart on the next page). The total lease payments the government will pay for the Rockwell International Corporation facility, for example, exceed the facility fair market value by more than $2 million.

***FULL COST PROPOSAL AUDITS DID NOT INCLUDE FAS 13 ANALYSIS***

The leases were not classified correctly for two reasons. First, the Defense Contract Audit Agency (DCAA) did not perform the Financial Accounting Standard (FAS ) 13 analysis as part of the full cost proposal audits requested by NASA. Although NASA contracting officers should follow the FAR to ensure contractors comply with the FAS 13, the contracting officer may rely on a pricing analyst or the DCAA to ensure the required FAS 13 analysis is performed. If the contracting officers rely on DCAA, normally a full cost proposal audit is requested. According to NASA officials, they contacted DCAA regarding the performance of the full cost proposal audit. NASA was told that DCAA reviewed their "canned" cost proposal audit program and found that it did not contain a step for performing the FAS 13 analysis. Therefore, if NASA did not specifically request DCAA to perform the FAS 13 analysis, such an analysis was not done. None of the contracting files for the four leases contained any documentation to show such an analysis was performed, as required.

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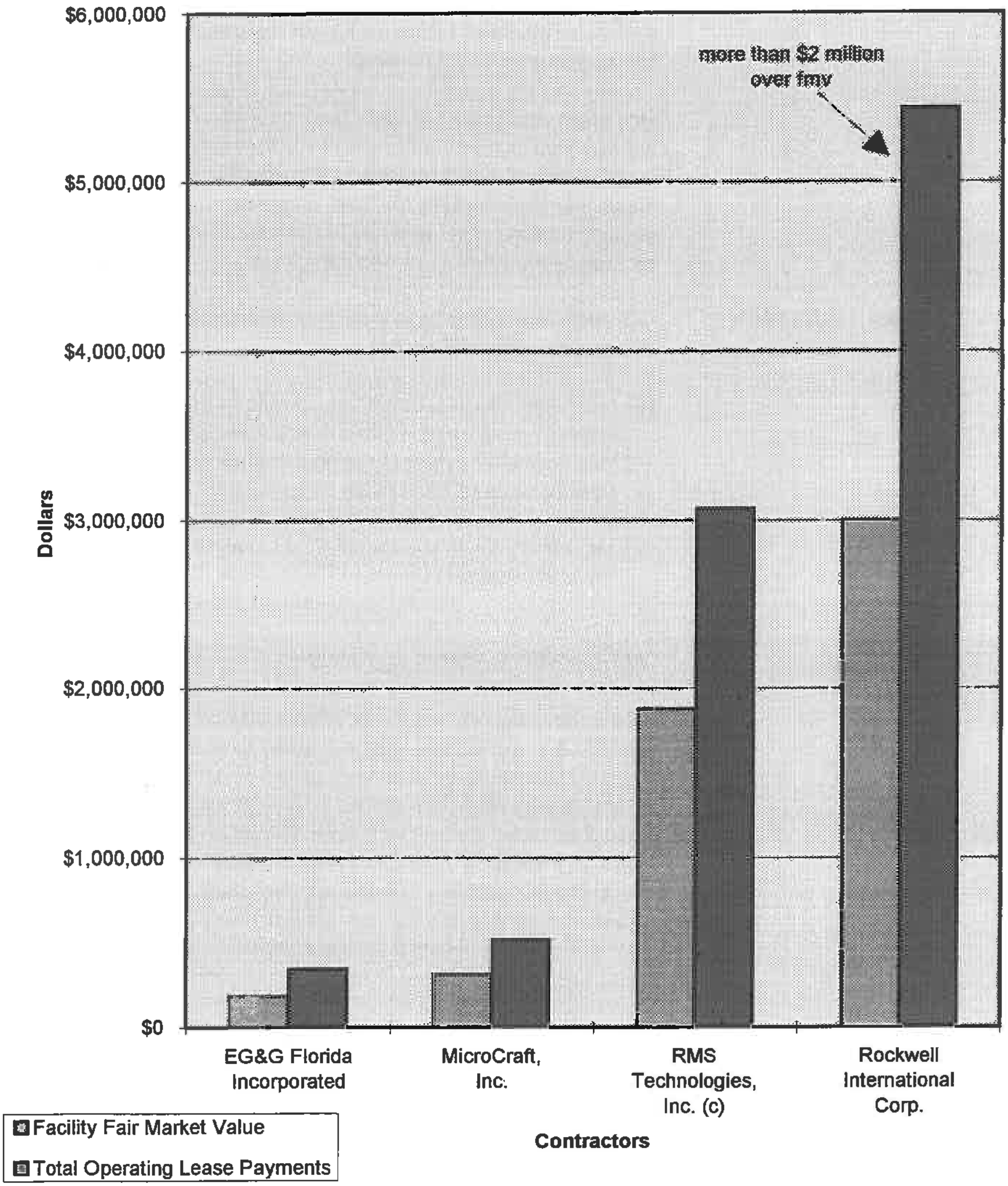
## Total Operating Lease Costs In Excess Of Fair Market Value



Second, based on interviews with the four contractors, we found that they either had not performed the required analysis, or had used incorrect data. Two of the four contractors had not performed the FAS 13 analysis. One contractor provided a lease versus purchase analysis, but not the required FAS 13 analysis.

One other contractor had performed the FAS 13 analysis, but had used incorrect information which resulted in the lease being incorrectly classified. For example, the FAS 13 analysis performed by the KSC contractor did not use the correct lease term, resulting in the lease being incorrectly classified as an operating lease.

***RECOMMENDATION 2***

The Associate Administrator for Procurement should direct contracting officers to:

(a) review the classification of the specific questioned leases to ensure that leases are appropriate, and if not, take corrective action as required, including the determination of allowability of costs, and

(b) request DCAA to include a FAS 13 analysis in their full cost proposal reviews.

***Management's Response***

RECOMMENDATION 2(a): CONCUR

The contracting officers for those contracts with facilities identified in Appendix 4 will be directed to review whether the leases involved were properly classified and, if not, to take corrective action. Although we agree to take this action, we believe that the $4 million potential savings amount on Appendix 4, representing lease costs in excess of fair market value, may be over stated. The reason for our belief is that any savings should be based on the difference between the lease payments and a contractor's depreciation (FAR 32.205-11 (m)) and facilities capital cost of money (FAR 31.205-10), and not the difference between the lease costs and the fair market value as it done in the report. We request that the audit report be revised to make it clear that the lease costs over fair market value amounts may not accurately reflect the true potential savings.

A question as to the accuracy of the amounts identified in Appendix 4 for the RMS Technologies, Inc. lease has been raised. DCAA issued draft supplemental audit report number 6261-97A17900005S1, dated October 24, 1997. That report concluded that the lease was misclassified as an operating lease. However, the report also stated that the previously questioned $631,854, due to this misclassification, had been revised to $0 because the ownership costs exceeded the lease costs. It is our understanding that a error may have occurred in DCAA's development of the $0 amount. DCAA will be requested to review their assumptions and to recalculate their figures. If DCAA determines that there is a cost impact to the Government, contractor views on the DCAA audit results will be requested and, based on their response, a determination made as to whether any costs should be recovered.

***Evaluation of Management's Response***

Management's action is responsive to our recommendation. The purpose of Appendix 4 is to show that contractors paid lease costs both (a) in excess of the 90 percent criteria (column 5) and (b) in excess of the fair market value of the properties (column 7). We agree that depreciation and cost of money should be taken into account in arriving at actual savings. The savings could be less than $4 million, depending on the circumstances involved with each specific lease. We will perform a follow-up review at a later date to quantify any actual savings resulting from management's actions.

***Management's Response***

RECOMMENDATION 2(b): CONCUR

Contrary to a strict reading of the recommendation, it is our understanding, based on a discussion with the OIG, that the intent of the report recommendation is to have a FAS 13 analysis performed only when it makes sense rather than to require one be performed as part of every full cost proposal review. We believe the intent of the OIG would best be served if contracting officers request a FAS 13 analysis as part of a proposal audit whenever the procurement would involve a significant dollar amount for the lease of a facility. Other times, we believe it would be sensible for the contracting officer to inquire with DCAA regarding the following information: (1) whether the contractor has leased facilities, and (2) whether a FAS 13 analysis has been performed for those facilities and, if yes, when it was performed and the results. Based on

DCAA's response to these questions, a FAS 13 review could be requested if deemed appropriate. We have consulted with DCAA Headquarters on this approach, and they concur with it. Direction will be provided to all the procurement offices to adopt this approach.

***Evaluation of Management's Response***

Management's action is responsive to our recommendation. We agree that a FAS 13 should be performed only when it makes good business sense. However, we would like to reemphasize the requirement that the FAS 13 analysis should be performed at the inception of the lease; either by contracting officer, pricing analyst or DCAA.

# OBJECTIVES, SCOPE, AND METHODOLOGY

## Objectives

The overall audit objective was to determine whether NASA is adequately managing facility leasing. Specifically, we answered the following questions:

⇒ Were contractor facilities effectively utilized?

⇒ Were contractor facility leases correctly classified?

⇒ Did contractors accurately bill lease costs to the government?

## Scope

We performed the audit field work at four NASA installations: The Goddard Space Flight Center (GSFC), Kennedy Space Center (KSC), Langley Research Center (LARC), and Lewis Research Center (LERC).

## Audit Universe

To establish the audit universe, we contacted procurement personnel at each location and requested a listing of all contractors having facility lease cost charges to NASA contracts. We also used the NASA telephone directory and/or a locator system to identify support service contractors both on and off-center. In addition, we conducted follow up interviews with procurement officials to ensure the accuracy of our listing.

We determined that our audit universe consisted of 191 NASA contracts valued at more than $16.9 billion. These contracts included facility charges of 38 direct and 153 indirect leases. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly to the contract (i.e., direct lease). However, costs not directly identified with a single, final cost objective, but identified with two or more final cost objectives, or an intermediate cost objective, are indirect costs and are computed in the overhead rates for the applicable contract (i.e., indirect lease).

We selected a judgmental sample of 73 NASA contracts valued at $16.7 billion. We reviewed all direct leases with facility charges to NASA contracts, regardless of the dollar value, and we reviewed indirect leases where the applicable NASA contract award was valued at $10 million and over. The sample included 38 direct leases and 44 indirect leases.

## Methodology

To determine whether the contractor facility leases were correctly classified, we reviewed applicable laws, regulations and guidelines for classifying facility leases. We then interviewed contractor and NASA personnel to develop a list of potential contractor facility leases and to obtain copies of active contractor facility lease agreements. We reviewed NASA contract files to (1) verify justifications for approving lease agreements, and (2) analyze comparative cost analyses performed by NASA and/or contractors. We also reviewed DCAA incurred cost audits and recommendations. To perform the capital lease calculations and analyses, we used the FASB 13 software package provided to us by the DCAA and subsequently relied on their validation of the software package. We did not perform our own validation of the software.

To determine whether contractor facilities were effectively utilized, we (1) determined the total amount of space being leased, identified the number of staff, and the amount of space actually being used and (2) performed a walk through at each leased facility. In the case where the facility was primarily used for storage, we determined the initial requirements and observed the amount of space actually used. We estimated the value of idle space by comparing the identified staffing level to the staffing level during the period of our review (February through October 1996), calculated the percentage of reduction and multiplied it times the monthly lease cost. In cases where the percent of NASA work did not equal 100 percent, we only calculated the percent of NASA work to determine NASA's cost. A chart on page 4 shows the idle space we observed at these facilities. Additional details on the costs NASA will pay if corrective action is not taken are included in Appendices 3 and 4.

To determine whether contractors accurately bill lease costs, we verified that the contractor was approved for facilities reimbursement. We also compared invoices billed by the landlord to the contractor with those lease costs billed by the contractor to NASA. In addition, we reviewed the 533 cost reports submitted by the contractors to NASA.

## Audit Field Work

The audit was conducted from February 1996 through October 1997 at field offices and the contractors' sites in accordance with generally accepted government auditing standards.

Appendix 2

# DEFINITIONS, GUIDELINES AND REGULATIONS GOVERNING CONTRACTOR FACILITY LEASING

## I. IDLE FACILITIES

**FAR 31.205-17 (Idle facilities and idle capacity costs)**
The cost of idle facilities are unallowable unless the facilities (1) are necessary to meet fluctuations in workload; or (2) were necessary when acquired and are now idle because of changes in requirements, production economies, reorganization, termination, or other causes which could not have been reasonably foreseen. Costs of idle facilities are allowable for a reasonable period, ordinarily not to exceed 1 year, depending upon the initiative taken to use, lease, or dispose of the idle facilities.

**IDLE CAPACITIES** are defined as the unused capacity of partially used facilities.

**IDLE FACILITIES** are completely unused facilities that are excess to the contractor's current needs.

## II. LEASE CLASSIFICATION

**FAR 31.201-3 (Reasonableness)**
A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Reasonableness of specific costs must be examined more closely when competition is not a factor.

**FAR 31.205-11(m) (Depreciation)**
48 CFR 9904.404, Capitalization of Tangible Assets, applies to assets acquired by a "capital lease" as defined in Statement of Financial Accounting Standard No. 13 (FAS 13), Accounting for Leases, issued by the Financial Accounting Standards Board. Compliance with 48 CFR 9904.404 and FAS 13 requires that such leased assets (capital leases) be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their leased life as amortization charges as appropriate.

**FAR 31.205-36 (b)(1) (Rental costs)**
Rental costs are allowable costs under operating leases, to the extent that the rates are reasonable at the time of the lease decision, after consideration of (i) rental costs of comparable property, if any; (ii) market conditions in the area; (iii) the type, life expectancy, condition, and value of the property leased; (iv) alternatives available; and (v) other provisions of the agreement.

**FAS 13 (Capital versus Operating Leases)**
The Financial Accounting Standards Board (FASB) issued FAS 13 establishing the generally accepted accounting principles and practices (GAAP) of financial accounting and reporting for leases by lessees and lessors. FAR 31.205-11(m) incorporates the standards prescribed by FAS 13. According to the FAS 13, a lease is defined as an agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets) usually for a stated period of time. FAS 13 also classifies a lease as either (1) a capital lease where the lease obligation is treated similar to that of a purchased asset acquired with borrowed funds, or (2) an operating lease where all payments are treated as an expense of the accounting period during which they are incurred. FAS 13 lists four criteria for a capital lease:

(1) lease transfers ownership (title) to lessee during lease term,
(2) lease contains a bargain purchase option,
(3) lease term is 75 percent or more of the estimated economic life of the leased property, and
(4) present value of minimum lease payments equals or exceeds 90 percent or more of fair market value (FMV) of the leased property less any lessor investment tax credit.

If a lease, at its inception, meets any one of the above criteria, FAS 13 states it shall be classified as a capital lease. A lease not meeting any of the above criteria shall be classified as an operating lease.

# Schedule of Facilities with Idle Space

| NASA CENTER | Contractor | Idle Space | Estimated Annual Cost Impact | Remaining years/mo. | Total Cost Impact | % NASA Work | Estimated NASA Cost |
|---|---|---|---|---|---|---|---|
| GSFC | Hughes Aircraft Company (Landover) | 9% | $388,444 | 6/7 | $2,557,259 | 95% | $2,429,396 |
| LeRC | Aerospace Design and Fabrication Inc. | 11% | $33,511 | 4/0 | $134,044 | 95% | $127,342 |
| GSFC | *Computer Science Corporation (Green Tec IV) | 13% | $218,868 | 2/6 | $547,170 | 100% | $547,170 |
| LeRC | NYMA | 14% | $212,630 | 2/9 | $584,733 | 98% | $573,038 |
| GSFC | *Computer Science Corporation (Green Tec I) | 17% | $63,313 | 2/6 | $158,284 | 100% | $158,284 |
| GSFC | Allied Signal Inc. | 29% | $664,495 | 2/6 | $1,661,238 | 87% | $1,445,277 |
| GSFC | *Computer Science Corporation (Laurel) | 35% | $222,742 | 2/6 | $556,855 | 100% | $556,855 |
| LaRC | Computer Science Corporation | 38% | $46,748 | 3/11 | $183,096 | 100% | $183,096 |
| LeRC | Analex Corporation | 46% | $385,378 | 4/0 | $1,541,512 | 90% | $1,387,361 |
| KSC | EG&G Florida Inc. | 50% | $12,000 | 1/9 | $21,000 | 100% | $21,000 |
| GSFC | H&H Consolidated Inc. | 51% | $2,295 | 0/9 | $2,295 | 100% | $2,295 |
| GSFC | McDonnell Douglas Corporation | 66% | $489,628 | 2/9 | $1,346,476 | 96% | $1,292,617 |
| GSFC | General Science Corp | 78% | $513,616 | 2/0 | $1,027,232 | 100% | $1,027,232 |
| TOTAL | 13 | | | | | | $9,750,963 |

* This contractor has 3 locations

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## NASA Actively Seeks To Resolve Idle Space

| | NASA CENTER | Contractor | Potential Savings |
|---|---|---|---|
| ***Action taken during audit*** | LaRC | Computer Science Corporation | $183,096 |
| ***Actions taken since exit conference*** | GSFC | General Science Corp | $1,027,232 |
| | GSFC | H&H Consolidated Inc. | $2,295 |
| | GSFC | McDonnell Douglas Corporation | $1,292,617 |
| | KSC | EG&G Florida Inc. | $21,000 |
| | LeRC | Analex Corporation | $1,387,361 |
| | LeRC | NYMA | $573,038 |
| | SUBTOTAL | 6 | $4,303,543 |
| | TOTAL | 7 | $4,486,639 |

*Note: An exit conference was held on July 16, 1997. Since that time, NASA has shown positive efforts to resolve idle space issues at the* contractor sites listed in this schedule.

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# SCHEDULE OF LEASES EXCEEDING 90 PERCENT CRITERIA AND IN EXCESS OF FACILITY FAIR MARKET VALUE

| (1) NASA CENTER | (2) Contractor | (3) Facility Fair Market Value | (4) 90 Percent Fair Market Value (a) | (5) Amt. over 90 Percent Criteria (a) (col 3-4) | (6) Total Operating Lease Payments (b) | (7) Lease Costs over Fair Market Value (b) (col 6-3) |
|---|---|---|---|---|---|---|
| KSC | EG&G Florida Incorporated | $183,000 | $164,700 | $18,300 | $348,391 | $165,391 |
| LARC | MicroCraft, Inc. | $315,036 | $283,532 | $31,504 | $519,372 | $204,336 |
| LERC | RMS Technologies, Inc. (c) | $1,876,000 | $1,688,400 | $187,600 | $3,066,305 | $1,190,305 |
| KSC | Rockwell International Corp. | $3,000,000 | $2,700,000 | $300,000 | $5,434,665 | $2,434,665 |
| TOTAL | 4 | | | | | $3,994,697 |

a) These columns were used to show calculations to determine whether the leases met the 90 percent criteria for a capital lease.

b) These columns were used to show calculations to determine lease costs in excess of fair market value.

c) As a result of our exit conference, NASA management requested the DCAA to perform a FAS 13 analysis. DCAA determined that the lease should be classified as a capital lease and identified questioned costs for the period of January 1992 through December 1996. DCAA also identified questioned costs which represent interest expense associated with leasehold improvements.

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## Management's Response to the Audit Recommendations

National Aeronautics and
Space Administration
**Headquarters**
Washington, DC 20546-0001

Reply to Attn of: HK

DEC 17 1997

TO: W/Assistant Inspector General for Auditing

FROM: H/Associate Administrator for Procurement

SUBJECT: Code H Response to OIG Draft Audit Report of Contractor Facility Leases, No. A-HA-97-042 (previous A-LE-96-002)

Enclosed is our response to the subject report dated November 13, 1997.

Please contact Joe Le Cren at 358-0444 or Jack Horvath at 358-0456 if you have any questions or need further coordination or assistance on this matter.

Laura Layton

Laura Layton

Enclosure

HEADQUARTERS OFFICE OF PROCUREMENT

RESPONSE TO

OFFICE OF THE INSPECTOR GENERAL (OIG)

DRAFT REPORT NO. A-HA-97-042 (PREVIOUS A-LE-96-002)

DATED NOVEMBER 13,1997

CONTRACTOR FACILITY LEASES

DATE: DEC 17, 1997

ENCLOSURE

Code H Response to OIG
11/13/97 Draft Report,
A-HA-97-042 (previous A-LE-96-002)
Page 2

Code H's narrative response is provided as follows:

OIG RECOMMENDATION 1(a): ($0)

The Associate Administrator for Procurement should direct contracting officers to reevaluate the facility requirements for those remaining contractor sites with idle space, and take action to reduce facility costs to NASA, where possible.

CODE H RESPONSE TO RECOMMENDATION 1(a): ($0) CONCUR

The contracting officers for the contracts with the remaining contractor sites from Appendix 3 will be directed to reevaluate the facility requirements for those sites and take appropriate action to reduce facility costs. Information was provided to us that action was taken by the Centers after the date of the draft report for certain of the contractor sites identified in Appendix 3. Those actions support that the projected potential cost savings amounts contained in the report for those sites and in total are overstated. We request that the projected potential cost savings amounts be adjusted to reflect the impact of the actions taken.

| | |
|---|---|
| CORRECTIVE ACTION OFFICIAL: | Code HKJJ. Le Cren |
| CORRECTIVE ACTION CLOSURE OFFICIAL: | Code HK/S. Thompson |
| PROJECTED CORRECTIVE ACTION CLOSURE DATE: | February 6, 1998 |

OIG RECOMMENDATION 1(b): ($0)

The Associate Administrator for Procurement should direct contracting officers to review the allowability of costs for those leases that have substantial idle space for over one year.

CODE H RESPONSE TO RECOMMENDATION 1(b): ($0) CONCUR

The Associate Administrator for Procurement will issue direction to the contracting officers for those leases in Appendix 3 having idle space for over one year. The guidance will request that those leases be reviewed to determine the allowability of the costs in accordance with FAR 31.205-17. Paragraph (b)(2) of that cost principle uses one year as a general guideline for determining reasonableness; however, it is not the sole criterion.

That paragraph goes on to state that reasonableness also depends on the initiative taken by the contractor to use, lease, or dispose of the idle facilities.

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| CORRECTIVE ACTION OFFICIAL: | Code HK/J. Le Cren |
| CORRECTIVE ACTION CLOSURE OFFICIAL: | Code HK/S. Thompson |
| PROJECTED CORRECTIVE ACTION CLOSURE DATE: | February 6, 1998 |

OIG RECOMMENDATION 2(a): ($0)

The Associate Administrator for Procurement should direct contracting officers to review the classification of the specific questioned leases to ensure that leases are appropriate, and if not, take corrective action as required, including the determination of allowability of costs.

CODE H RESPONSE TO RECOMMENDATION 2(a): ($0) CONCUR

The contracting officers for those contracts with facilities identified in Appendix 4 will be directed to review whether the leases involved were properly classified and, if not, to take corrective action. Although we agree to take this action, we believe that the $4 million potential savings amount on Appendix 4, representing lease costs in excess of fair market value, may be over stated. The reason for our belief is that any savings should be based on the difference between the lease payments and a contractor's depreciation (FAR 32.205-11(m)) and facilities capital cost of money (FAR 31.205-10), and not the difference between the lease costs and the fair market value as is done in the report. We request that the audit report be revised to make it clear that the lease costs over fair market value amounts may not accurately reflect the true potential savings.

A question as to the accuracy of the amounts identified in Appendix 4 for the RMS Technologies, Inc. lease has been raised. DCAA issued draft supplemental audit report number 6261-97A17900005S1, dated October 24, 1997. That report concluded that the lease was misclassified as an operating lease. However, the report also stated that the previously questioned $631,854, due to this misclassification, had been revised to $0 because the ownership costs exceeded the lease costs. It is our understanding that a error may have occurred in DCAA's development of the $0 amount. DCAA will be requested to review their assumptions and to recalculate their figures. If DCAA determines that there is a cost impact to the Government, contractor views on the DCAA audit results will be requested and, based on their response, a determination made as to whether any costs should be recovered.

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| CORRECTIVE ACTION OFFICIAL: | Code HK/J. Le Cren |
| CORRECTIVE ACTION CLOSURE OFFICIAL: | Code HK/S. Thompson |
| PROJECTED CORRECTIVE ACTION CLOSURE DATE: | February 6, 1998 |

OIG RECOMMENDATION 2(b): ($0)

The Associate Administrator for Procurement should direct contracting officers to request DCAA to include a FAS 13 analysis in their full cost proposal reviews.

CODE H RESPONSE TO RECOMMENDATION 2(b): ($0) CONCUR

Contrary to a strict reading of the recommendation, it is our understanding, based on a discussion with the OIG, that the intent of the report recommendation is to have a FAS 13 analysis performed only when it makes sense rather than to require one be performed as part of every full cost proposal review. We believe the intent of the OIG would best be served if contracting officers request a FAS 13 analysis as part of a proposal audit whenever the procurement would involve a significant dollar amount for the lease of a facility. Other times, we believe it would be sensible for the contracting officer to inquire with DCAA regarding the following information: (1) whether the contractor has leased facilities, and (2) whether a FAS 13 analysis has been performed for those facilities and, if yes, when it was performed and the results. Based on DCAA's response to these questions, a FAS 13 review could be requested if deemed appropriate. We have consulted with DCAA Headquarters on this approach, and they concur with it. Direction will be provided to all the procurement offices to adopt this approach.

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| CORRECTIVE ACTION OFFICIAL: | Code HK/J. Le Cren |
| CORRECTIVE ACTION CLOSURE OFFICIAL: | Code HK/S. Thompson |
| PROJECTED CORRECTIVE ACTION CLOSURE DATE: | February 13, 1998 |

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Appendix 6

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