

**GOVERNMENT OF THE DISTRICT OF COLUMBIA  
OFFICE OF THE INSPECTOR GENERAL**

**REPORT ON NONCOMPLIANCE  
WITH THE REQUIREMENT  
TO PERFORM COST ANALYSES**



**CHARLES J. WILLOUGHBY  
INSPECTOR GENERAL**

**GOVERNMENT OF THE DISTRICT OF COLUMBIA**  
**Office of the Inspector General**

Inspector General



March 22, 2012

James Staton  
Chief Procurement Officer  
Office of Contracting and Procurement  
One Judiciary Square  
441 4<sup>th</sup> Street, N.W., Suite 700-S  
Washington, D.C. 20001

Dear Mr. Staton:

Enclosed is our final report summarizing the results of the Office of the Inspector General's (OIG) *Report on Noncompliance With the Requirement to Perform Cost Analyses (OIG No. 10-1-19TO (b))*. We issued a Management Alert Report (MAR), Noncompliance with Requirement to Perform Cost Analyses, OIG MAR No. 11-A-01, to you on October 7, 2011. The OIG discovered this weakness during our Audit of Contracting Actions at the Office of the Chief Technology Officer (OIG No. 08-2-06TO (a)) and during our Audit of Information Technology Staff Augmentation (ITSA) Contract (OIG No. 10-1-19TO).

As a result of the MAR, we directed one recommendation to the Office of Contracting and Procurement (OCP) for action we considered necessary to correct the identified deficiencies. We received OCP's written response to the MAR on October 28, 2011. We also received a memorandum from OCP to supplement its response on November 8, 2011. OCP agreed with the report's finding and conclusion but did not concur with the recommendations. We consider the recommendations unresolved.

Therefore, we request that OCP reconsider its position on the recommendations and provide an additional response to us by April 12, 2012. Accordingly, we will continue to work with OCP to reach final agreement on the unresolved recommendations. The full text of OCP's response is included at Exhibit B.

Mr. Staton  
OIG No. 10-1-19TO(b) – Final Report  
March 22, 2012  
Page 2 of 4

We appreciate the cooperation and courtesies extended to our staff during this audit. If you have any questions, please contact me or Ronald W. King, Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,

  
Charles J. Willoughby  
Inspector General

Enclosure

CJW/fg

cc: See Distribution List

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# REPORT ON NONCOMPLIANCE WITH THE REQUIREMENT TO PERFORM COST ANALYSES

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## ACRONYMS

CO	Contracting Officer
CPO	Chief Procurement Officer
DCMR	District of Columbia Municipal Regulations
FY	Fiscal Year
IT	Information Technology
ITSA	Information Technology Staff Augmentation
MAR	Management Alert Report
OCP	Office of Contracting and Procurement
OCTO	Office of the Chief Technology Officer
OIG	Office of the Inspector General

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**REPORT ON NONCOMPLIANCE WITH THE REQUIREMENT  
TO PERFORM COST ANALYSES**

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## **EXECUTIVE SUMMARY**

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### **OVERVIEW**

This report summarizes the results of the Office of Inspector General's (OIG) Management Alert Report (MAR), Noncompliance With the Requirement to Perform Cost Analyses at the Office of Contracting and Procurement (OCP). The OIG issued the MAR to address this weakness, which was identified during our Audit of Contracting Actions at the Office of the Chief Technology Officer (OIG No. 08-2-06TO (a)) and during our Audit of Information Technology Staff Augmentation (ITSA) Contract (OIG No. 10-1-19TO).

The Procurement Practices Reform Act of 2010, D.C. Law 18-0371, effective April 8, 2011 (codified at D.C. Code §§ 2-351.01 – 362.03 (2011)), repealed the cost/pricing data submission requirement in D.C. Code § 2-303.08(a) (2006). However, cost/pricing data are necessary to perform cost analyses.

### **CONCLUSION**

OCP did not perform cost analyses to determine contract price fairness and reasonableness for almost all negotiated contracts valued in excess of \$500,000 during fiscal year 2011.<sup>1</sup> Specifically, OCP did not: obtain cost or pricing data or other related information; effectively conduct cost analyses; follow its policies and procedures for performing cost analyses; and effectively conduct and document price negotiations.

We discussed these conditions with OCP contracting officials who indicated that cost analyses were unnecessary and redundant. Specifically, the officials indicated that awarded contract prices were based on adequate price competition. We disagree with OCP's position that price analyses were adequate, based upon the finding from our recent audit report.

As a result of not performing the required cost analyses, OCP exposed the District to the risk of higher and/or unreasonable contract prices for all negotiated contracts valued at in excess of \$500,000. Our review of contract awards and modifications for the majority of fiscal year 2011, with a total value of \$353 million, indicated that OCP performed a cost analysis in only 1 of the 139 procurements.

### **SUMMARY OF RECOMMENDATIONS**

We recommend that OCP coordinate with the Council of the District of Columbia to reinstate the statutory requirement, previously found in D.C. Code § 2-303.08(a) (2006), to mandate contractors or offerors submit cost or pricing data for all negotiated contracts in excess of \$100,000. We also recommend that OCP mandate that contracting officers perform cost analyses for all negotiated contracts valued in excess of \$500,000 as required in 27 DCMR § 1626.1.

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<sup>1</sup> As of June 29, 2011.

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## **EXECUTIVE SUMMARY**

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### **MANAGEMENT RESPONSES**

We received OCP's written response to the MAR on October 28, 2011. We also received a memorandum from OCP to supplement its response on November 8, 2011. OCP agreed with the report's finding and conclusion but did not concur with the recommendations. We consider the recommendations unresolved, and request that OCP reconsider its position taken on the recommendations and provide an additional response by March 31, 2012. The full text of OCP's response is included at Exhibit B.

A summary of the potential benefits resulting from the audit is shown at Exhibit A.

## INTRODUCTION

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### BACKGROUND

The Office of Contracting and Procurement (OCP), under the direction of the Chief Procurement Officer, procures goods and services for selected agencies and offices within the District government. OCP is organized into four commodity buying groups: Services; Goods; Transportation and Specialty Equipment; and Information Technology. Experienced procurement officials, led by senior managers, purchase goods and services to meet agency requirements.

The D.C. Code and District of Columbia Municipal Regulations (DCMR) Title 27, Contracts and Procurement, prescribes the cost and price negotiation policies and procedures for negotiated prime contracts (including subcontracts) and contract modifications, including modifications to contracts awarded by sealed bidding.

The objective of cost analysis is to ensure that the final agreed-to price is fair and reasonable. Price analyses should always be performed to determine that the overall price offered is fair and reasonable. However, cost analyses must be used to evaluate the reasonableness of the individual cost elements when cost or pricing data are required.

### DEFINITIONS

Title 27 DCMR § 1699 defines the terms cost analysis, cost/pricing data, price, and price analysis as follows:

**Cost analysis** -- the review and evaluation of the separate cost elements and proposed profit or fee of an offeror's or contractor's cost or pricing data and the judgmental factors applied in projecting from the data to the estimated costs, in order to form an opinion on the degree to which the proposed costs represent what the contract should cost, assuming reasonable economy and efficiency.

**Cost or pricing data** -- all facts as of the time or price agreement that prudent buyers and sellers would reasonably expect to affect price negotiations significantly. Cost or pricing data are factual, not judgmental, and are therefore verifiable. While they do not indicate the accuracy of the prospective contractor's judgment about estimated future costs or projections, they do include the data forming the basis for that judgment. Cost or pricing data are more than historical accounting data; they are all the facts that can be reasonably expected to contribute to the soundness of estimates of future costs and to the validity of determinations of costs already incurred. They also include factors such as vendor quotations; nonrecurring costs; information on changes in production methods or purchasing volume; data supporting projections of business prospects

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## INTRODUCTION

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and objectives and related operational costs; and unit cost trends, such as those associated with labor efficiency, make-or-buy decisions, estimated resources to attain business goals, and information on management decisions that could have a significant bearing on cost.

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**Price** -- cost plus any fee or profit applicable to the contract type.

**Price analysis** -- the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit.

### CRITERIA

The D.C. Code and DCMR set forth criteria that define the procedures for acquiring goods and services for the District using competitive sealed proposals.

To that end, 27 DCMR § 1626.1 states, “The contracting officer *shall* be required to perform a cost analysis in either of the following circumstances: (a) The award of any contract in excess of . . . [\$500,000]; or (b) The modification of any contract when the modification exceeds . . . [\$500,000].” (Emphasis supplied). In addition, D.C. Code § 2-303.08(a) (2006) required that:

A contractor or offeror *shall* submit cost or pricing data for procurements in excess of \$100,000, and shall certify that, to the best of the contractor’s or offeror’s knowledge and belief, the cost or pricing data submitted was accurate, complete, and current as of a mutually determined specified date, before entering into:

- (1) Any contract awarded through competitive sealed proposals or through sole source procurement; or
- (2) Any change order or contract modification.

(Emphasis supplied).

The Procurement Practices Reform Act of 2010, D.C. Law 18-371, effective April 8, 2011 (codified at D.C. Code §§ 2-351.01 – 362.03 (2011)), repealed the cost/pricing data submission requirement in D.C. Code § 2-303.08(a) (2006). However, these data are necessary to perform cost analyses.

## INTRODUCTION

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### OBJECTIVES, SCOPE, AND METHODOLOGY

The overall objectives of the MAR were to determine whether the agency performs cost analyses to arrive at fair and reasonable prices for negotiated contracts. Our specific objectives for this MAR were to determine whether OCP: (1) complied with the requirements for obtaining cost or pricing data or information other than cost or pricing data; (2) had adequate policies and procedures for performing cost analysis; (3) effectively conducted cost analysis; and (4) effectively conducted and documented price negotiations.

To accomplish the objectives of the MAR, we reviewed applicable laws, policies and procedures. We also conducted interviews with OCP contracting officials. Further, we analyzed management contract data and financial records.

Audit work supporting this MAR was performed in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

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## AUDIT RESULTS

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<p><b>FINDING: NONCOMPLIANCE WITH THE REQUIREMENT TO PERFORM COST ANALYSES</b></p>
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### SYNOPSIS

OCP did not perform cost analyses to determine the fairness and reasonableness of contract prices for almost all negotiated contracts valued in excess of \$500,000 during the period October 1, 2010 – June 29, 2011. Specifically, OCP did not: obtain cost or pricing data or information other than cost or pricing data; effectively conduct cost analyses; follow its policies and procedures for performing cost analyses; and effectively conduct and document price negotiations.

We discussed these conditions with OCP contracting officials who indicated that cost analyses were unnecessary and redundant. Specifically, the officials indicated that awarded contract prices were based on adequate price competition. We disagree with OCP's position that price analyses were adequate, based upon the finding of our recent audit report.

As a result of not performing the required cost analyses, OCP exposed the District to the risk of higher and/or unreasonable contract prices for all negotiated contracts in excess of \$500,000. Our review of contract awards and modifications for the majority of fiscal year 2011, with a total value of \$353 million, indicated that a cost analysis was performed in only 1 of 139 procurements.

### DISCUSSION

The OIG believes that conducting a cost analysis is a critical element of determining the fairness and reasonableness of a contractor's proposed price because it allows the District to evaluate the support for the cost elements contained in the contractor's price proposal, including the judgmental factors used by the contractor to project future costs. Specifically, the cost analysis allows the District to assess the reasonableness of the proposed profit and whether it is commensurate with the risks assumed by the contractor in performing the contract.

**Cost or Pricing Data.** Cost or pricing data are generally required for sole source procurements and procurement by competitive sealed proposal. It typically includes all the facts that, as of the date of price agreement, prudent buyers and sellers would reasonably expect to affect price negotiations significantly. Title 27 DCMR § 1624.2 requires certification from the contractor that the cost/pricing data are accurate, complete, and current. The data must also form the basis for the contractor's judgment about future estimated costs. They include historical accounting data and information on actual labor and overhead rates and quotes for materials costs. The DCMR's threshold for cost or pricing data submissions is currently \$500,000.

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## AUDIT RESULTS

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Two recent OIG audits, discussed below, disclosed specific instances in which District contracting personnel failed to obtain sufficient supporting data and conduct the required cost analysis.

### **Audit of Contracting Actions at the Office of the Chief Technology Officer (OIG No. 08-2-06TO(a), issued September 15, 2010.**

In this audit, the OIG reported:

OCP did not obtain certified cost or pricing data as required by D.C. Code § 2-303.08(a) [(2006)] prior to the award of . . . Contract Number PODS-2004-C-920-60 valued at \$999,999. OCP also did not determine reasonableness of cost and profit in accordance with 27 DCMR § 1626.1, which requires a cost analysis where a contract award or modification exceeds \$500,000 . . . [As a result,] the District paid unreasonable contract prices for IT services, which allowed [the contractor] to make \$602,411 . . . in excessive profit over a 2-year period.

### **Audit of Information Technology Staff Augmentation (ITSA) Contract (OIG No. 10-1-19TO), issued August 3, 2011.**

The OIG determined that the OCP contracting officer (CO) did not perform a detailed cost analysis, and therefore did not adequately determine price reasonableness prior to awarding the ITSA contract (with an annual value of \$75,000,000) or when exercising option years via subsequent contract modification.<sup>2</sup> Further, the CO did not document specific reasons to demonstrate that the winning proposal was determined responsive to the request for proposal, as the proposal did not contain certified cost or pricing data. Accordingly, we believe that: (1) the CO should have determined that the winning proposal was nonresponsive; and (2) the CO did not have sufficient justification to eliminate the other vendor from award consideration. Without performing a cost analysis, the CO could not determine whether the winning price proposal was fair, reasonable, and in the best interest of the District.

**OCP Procurement Procedures.** In February 2009, OCP issued an updated procedures manual for the administration of contracts. Chapter 4, Section 7, Paragraph 4.7.6, states that when executing bilateral modifications, “[t]he contract specialist ensures that a price/cost analysis is performed when cost or pricing data is required. An OCP cost/price analyst or estimator may assist with these tasks.”

During the course of the two audits, the OIG determined that OCP has established procedures implementing all significant areas of its pricing policy. However, OCP contracting personnel did

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<sup>2</sup> The \$75,000,000 contract value represents the maximum required amount of purchase. This contract has subsequently been modified to exercise 2 option years.

## AUDIT RESULTS

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not comply with its procedures for awarding negotiated contracts. Specifically, OCP internal controls did not provide oversight to ensure that the cost analyses were performed for negotiated pricing actions.

**Contract Price Negotiations.** As previously discussed, OCP's contracting personnel did not comply with the requirements for obtaining cost or pricing data. OCP contracting personnel also did not comply with the requirement to conduct cost analyses. Therefore, OCP did not determine whether the costs in each offeror's proposal: (1) were realistic for the work to be performed; (2) reflected a clear understanding of the requirements; and (3) were consistent with the various elements of the offeror's technical proposal. Accordingly, we believe that OCP did not effectively conduct contract price negotiations.

**FY 2011 Contract Actions Subject to Cost Analyses Requirements:** In addition, during the course of conducting the ITSA audit, the OIG reviewed OCP's contract actions and determined that OCP contracting officials did not consistently perform cost analyses in accordance with 27 DCMR § 1626.1. The OIG requested- and OCP provided on June 29, 2011-a report of all fiscal year (FY) 2011 contract awards or modifications exceeding \$500,000, to date, that were subject to 27 DCMR § 1626.1.

The report listed 139 contract awards or modifications, with a total contract value of \$353 million. Our review of these awards and modifications indicated that a cost analysis was performed in only 1 of the 139 actions. Without performing a cost analysis, the CO exposes the District to increased risks of paying unreasonable contract prices.

## CONCLUSION

OCP should coordinate with the Council of the District of Columbia to reinstate the statutory requirement, previously found in D.C. Code § 2-303.08(a) (2006), to mandate contractors or offerors submit cost or pricing data, and that contracting officers perform cost analyses for procurements in excess of \$500,000 as required in 27 DCMR § 1626.1.

We conclude that noncompliance with the requirements for obtaining cost or pricing data as of the date of price agreement, would significantly affect OCP's prudence in price negotiations. Also, without performing the required cost analyses, OCP cannot determine whether the costs in the offeror's proposal: (1) are realistic for the work to be performed; (2) reflect a clear understanding of the requirements; and (3) are consistent with the various elements of the offeror's technical proposal.

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## AUDIT RESULTS

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### RECOMMENDATIONS, MANAGEMENT RESPONSES, AND OIG COMMENTS

#### RECOMMENDATION 1

We recommend that OCP mandate that contracting officers perform cost analyses for all negotiated contracts valued in excess of \$500,000 as required in 27 DCMR § 1626.1.

#### OCP RESPONSE

OCP stated that it disagrees with the recommendation because performing cost analyses for all contracts in excess of \$500,000 is not cost effective. The full text of the OCP response is included at Exhibit B.

#### OIG COMMENT

We consider OCP's response to the recommendation nonresponsive because OCP did not provide justification to support its assertion that the costs of performing the cost analyses are greater than the benefits derived from it. Also, the OIG made this recommendation consistent with District regulations governing procurement by competitive sealed proposal.

On November 8, 2011, the OIG met with OCP officials to review documentation to support OCP's response. At the meeting, the officials explained that their response was not supported by a formal cost benefit analysis. On November 8, 2011, OCP provided a memorandum, "Costs for Implementing Cost Analysis of All Contracts for \$500,000 and Above." The memorandum indicated all FY 2011 contract awards or modifications exceeding \$500,000 (150 in total with a contract value of \$721 million), that were subject to 27 DCMR § 1626.1.

The memorandum also indicated that a cost analysis was performed in only 48 of the 150 actions. Accordingly, OCP indicated that the costs of performing cost analyses would have been \$586,000 for all contracts awarded or modified during FY 2011. However, the memorandum did not indicate the potential benefits that would have been derived from performing the required cost analyses.

In the absence of this comparison, the OIG's recent audit report, Audit of Contracting Actions at the Office of the Chief Technology Officer (OIG No. 08-2-06TO(a)), issued September 15, 2010, reported that as a result of the failure to conduct a cost analysis for one contract, the District paid unreasonable contract prices for IT services, which allowed the contractor to make \$602,411 (10% of contract price paid to a contractor) in excessive profit over a 2-year period.

Therefore, the OIG strongly believes that the benefits of performing cost analyses for negotiated procurements in excess of \$500,000 are substantially greater than the costs OCP

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## AUDIT RESULTS

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indicates it would have incurred if cost analyses had been performed in accordance with D.C. law in FY 2011.

### RECOMMENDATION 2

We also recommend that OCP coordinate with the Council of the District of Columbia to reinstate the statutory requirement, previously found in D.C. Code § 2-303.08(a) (2006), to mandate contractors or offerors submit cost or pricing data for all negotiated contracts valued in excess of \$100,000.

### OCP RESPONSE

OCP stated that it disagrees with the recommendation because the revised District of Columbia Procurement Practices Act no longer requires contractors or offerors to submit cost or pricing data. The full text of the OCP response is included at Exhibit B.

### OIG COMMENT

We consider OCP's response to the recommendation nonresponsive. OCP should coordinate with the Council of the District of Columbia to reinstate the statutory requirement because failure to obtain cost or pricing data as of the date of price agreement, would significantly affect OCP's prudence in price negotiations. Also, without performing the required cost analyses, OCP cannot determine whether the costs in the offeror's proposal: (1) are realistic for the work to be performed; (2) reflect a clear understanding of the requirements; and (3) are consistent with the various elements of the offeror's technical proposal.

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**EXHIBIT A. SUMMARY OF POTENTIAL BENEFITS  
RESULTING FROM AUDIT**

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<b>Recommendations</b>	<b>Description of Benefit</b>	<b>Amount and Type of Benefit</b>	<b>Agency Reported Estimated Completion Date</b>	<b>Status<sup>3</sup></b>
1	<b>Internal Control and Economy and Efficiency.</b> Enhances operational efficiency and reduces the risk of fraud, waste, and abuse.	Non-Monetary	TBD	Open
2	<b>Internal Control and Economy and Efficiency.</b> Enhances operational efficiency and reduces the risk of fraud, waste, and abuse	Non-Monetary	TBD	Open

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<sup>3</sup> This column provides the status of a recommendation as of the report date. For final reports, “Open” means management and the OIG are in agreement on the action to be taken, but action is not complete. “Closed” means management has advised that the action necessary to correct the condition is complete. If a completion date was not provided, the date of management’s response is used. “Unresolved” means that management has neither agreed to take the recommended action nor proposed satisfactory alternative actions to correct the condition.

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## EXHIBIT B. OFFICE OF CONTRACTING AND PROCUREMENT RESPONSE TO MANAGEMENT ALERT REPORT

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GOVERNMENT OF THE DISTRICT OF COLUMBIA  
OFFICE OF CONTRACTING AND PROCUREMENT



OFFICE OF THE DIRECTOR

October 28, 2011

Charles Willoughby  
Office of the Inspector General  
717 14<sup>th</sup> St, N.W.  
Washington, DC 20005

Re: **MAR No.11-A-01**

Dear Mr. Willoughby:

Thank you for the opportunity to respond to the Office of the Inspector General's (OIG) Management Alert Report No. 11-A-01. My office has reviewed your analysis regarding the Office of Contracting and Procurement's (OCP) internal control weakness as it pertains to complying with the requirement to perform a cost analysis when either a contract award or modification exceeds \$500,000 (27 DCMR 1626.1). Please see OCP's management response below:

**Recommendation:** We recommend that OCP coordinate with the District of Columbia Council to reinstate the statutory requirement, previously found in D.C. Code § 2-303.08(a)(2006), to mandate contractors or offerors to submit cost or pricing data, and that contracting officers perform cost analysis for procurements in excess of \$500,000, the same monetary threshold as set forth in 27 DCMR § 1626.1.

**OCP's Response:** OCP disagrees with this recommendation. As we previously explained in our response to the audit of the Information Technology Staff Augmentation (ITSA) Contract (OIG No. 10-1-19IO), OCP acknowledges that the 27 DCMR 1624.1 and 1626.1 require that the Contracting Officer perform a cost analysis for any contract in excess of \$500,000. However, due to recent changes in the Procurement Practices Reform Act (PPRA), effective April 8, 2011, Chapter 16 of 27 DCMR is in the process of being revised. Again, as we previously explained,

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## EXHIBIT B. OFFICE OF CONTRACTING AND PROCUREMENT RESPONSE TO MANAGEMENT ALERT REPORT

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given the current economic climate and spending pressures, staffing an entire unit dedicated to performing cost-price analyses of all contracts valued at five hundred thousand dollars (\$500,000) or more is not cost effective. Often, the presence of competition alone provides the District with the best possible price.

OCP does not agree that it should coordinate with the District of Columbia Council to reinstate the statutory requirement, previously found in D.C. Code § 2-303.08(a)(2006), to mandate contractors or offerors to submit cost or pricing data. The revised PPRA no longer requires contractors or offerors to provide such data. When cost or pricing data is necessary to support a decision on price reasonableness, the Contracting Officer may request factual information reasonably available to the contractor or prospective contractor to substantiate that the price or cost offered, or some portion of it, is reasonable. *See* PPRA § 419. Mandating an offeror or contractor to provide cost or pricing data is unnecessary if price is based on adequate price competition. In which case, usually no additional information is required from the offeror.

To ensure that awards are fair and reasonable, in Fiscal Year (FY) 2012, OCP will develop and provide a comprehensive onsite training program for all contracting staff. The training program will address the core requirements of cost and price analysis and when such analysis is necessary. Additionally, OCP's Office of Procurement Integrity and Compliance (OPIC) will commence periodic audits of procurement personnel's files to ensure effective cost and price analysis is conducted when appropriate and to provide guidance in the development and delivery of cost/price analysis training.

If you have any further questions regarding this response, please contact \_\_\_\_\_, OCP Procurement Integrity & Compliance Officer, at [ocp.integritycompliance@dc.gov](mailto:ocp.integritycompliance@dc.gov) or \_\_\_\_\_, Procurement-Strategic Analyst, Office of Procurement Integrity & Compliance at 724-5279.

Sincerely,



James D. Staton, Jr.  
Chief Procurement Officer  
Office of Contracting and Procurement

cc: Mr. Allen Lew, City Administrator