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UNITED STATES GENERAL ACCOUNTING OFFICE  
REGIONAL OFFICE  
ROOM 7054, FEDERAL BUILDING  
300 NORTH LOS ANGELES STREET  
LOS ANGELES, CALIFORNIA 90012

JUN 30 1971

**AIRMAIL**

**Rear Admiral J. A. Scott**  
**Commanding Officer**  
**U. S. Navy Ships Parts Control Center**  
**Mechanicsburg, Pennsylvania 17055**



**Dear Admiral Scott:**

As part of our review of the negotiation of contract prices under the provisions of Public Law 87-653, we have examined into the price proposed and negotiated for order number 97 to Basic Ordering Agreement N00104-68-A-0004 awarded to North American Rockwell Corporation, Anaheim, California, by the Ships Parts Control Center. The order provided for 20 converters at a total price of \$139,520. The order price was negotiated by the Air Force Plant Representative Office (AFPO).

Our examination was primarily concerned with (1) the reasonableness of the price negotiated in relation to cost or pricing data available at the date of contract negotiations, (2) the adequacy of the evaluations of the contractor's cost proposal by Government representatives, and (3) the adequacy of the contractor's cost or pricing data submissions for compliance with pertinent provisions of the Armed Services Procurement Regulation (ASPR).

**We found that:**

1. The proposed order price was about \$7,000 higher than indicated by available cost information at the date of contract negotiations.
2. The contracting officer's waiver of the requirement for preaward audit by the Defense Contract Audit Agency (DCAA) was not justified based on available information.
3. Weighted guidelines as set forth in ASPR were not used to establish the negotiated profit objective for this order.

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We also noted that the contractor's cost proposal submission properly identified the basis for proposed costs as required by ASFR.

#### BACKGROUND

Basic Ordering Agreement -0004 was awarded on March 1, 1968, for spare parts for Ships Inertial Navigation Systems equipment. Unpriced order 97 was issued on May 22, 1968, for 20 converters (part number 67932-304). The contractor submitted a firm fixed-price proposal on July 19, 1968, in the amount of \$148,480. The proposed price was revised to \$139,520 in October 1968 to reflect savings resulting from combining requirements for order 97 with 10 identical units being procured under order 5003A to contract H104-190008; also, the revised price incorporated the latest negotiated pricing formula for material and labor conversion factors. The AFPRO contracting officer waived the requirement for pre-award audit of the cost proposal. Negotiations were conducted on October 25, 1968, and resulted in acceptance of the revised proposed price.

The contractor executed a Certificate of Current Cost or Pricing Data on October 25, 1968; also, the basic ordering agreement contained a defective pricing clause.

#### RESULTS OF OUR EVALUATION

The results of our review of proposed costs, including an evaluation of the adequacy of the proposal reviews performed by Government representatives, are detailed below.

#### Material costs

We estimate that proposed material costs were higher than indicated by available cost information by about \$4,100 or about \$7,000, including add-on pricing factors. This resulted because the contractor did not update proposed material costs to reflect purchases made under order 97 prior to contract negotiations. For example, the contractor proposed a unit cost of \$32.34 for part number 261-6137-001 based on a purchase of 19 units on May 4, 1968. However, 25 units were purchased at \$22.77 each

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on July 25, 1968, 3 months prior to negotiations to fulfill the requirements of order 97. As another example, the contractor proposed a unit cost of \$30.25 for part number 141-0119-001 based on the average inventory value at April 17, 1968. However, 20 units were purchased at \$12.80 each on September 25, 1968, 1 month prior to negotiations to fulfill the requirements of order 97.

In our opinion, such information should have been disclosed by the contractor at negotiations. Contractor officials agreed with our observations on the need to update the proposal and stated that there had been an oversight in the estimating process.

The AFPSO price analyst's review of estimated material costs performed on October 18, 1968, consisted of tracing proposed unit costs to the sources referenced in the proposal. In our opinion, the review was not performed in sufficient depth to determine the reasonableness of proposed material costs since no determination was made that the proposed costs were based on the most current purchasing data available at the date of the review.

#### Need for preaward audit

The AFPSO contracting officer waived the requirement for preaward audit of the contractor's cost proposal on July 25, 1968. The justification cited was the availability of sufficient information to perform a price analysis. However, we found that the acceptance of the proposed price was based on a cost analysis since prior procurement history of the items was insufficient for conducting a price analysis. In our opinion, an audit should have been requested since a significant portion of the proposed price included material costs, verification of which is normally the responsibility of DCAA.

AFPSO officials stated that the decision to waive the audit was a matter of judgment; however, they agreed that the services of DCAA would be obtained in similar situations.

#### Weighted guidelines

The weighted guidelines method was not used to determine the profit objective for order 97 as required by ASPR 2-403. Instead, the order was negotiated using the pricing formula, including profit which had been

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negotiated by the AFFRO for the basic ordering agreement. Since profit was included in the pricing formula at 12.8 percent of estimated cost, no consideration was given to the degree of risk involved in production of order #7, contractor's input to performance, and other selected factors, including past performance. We also found no evidence that the weighted guidelines concept was used to establish the profit rate included in the pricing formula.

AFFRO officials stated that the additional administrative effort required to negotiate profit on an individual order basis was not warranted since it would not vary significantly from the overall profit factor negotiated for the basic ordering agreement. We believe that profit objectives should be established on an individual order basis using the weighted guidelines concept prescribed by ASPR. In our opinion, the administrative effort required would be relatively insignificant.

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In our opinion, the contracting officer should consider the above findings, along with any additional information available, to determine the extent to which the Government may be legally entitled to a price adjustment concerning proposed material costs.

We would appreciate being advised of actions taken or contemplated with regard to the matters discussed in this letter. A copy of this letter is being sent to the Regional Manager, DCAA, for consideration in their continuing surveillance of the contractor's cost estimating system. We are also furnishing a copy of this letter to the Commander, Headquarters, Air Force Contract Management Division, and the Air Force Plant Representative at North American Rockwell Corporation, for their consideration in the negotiation of future orders.

Sincerely yours,

H. L. KRIEGER

H. L. KRIEGER  
Regional Manager

cc: Regional Manager, DCAA, Los Angeles  
Commander, Headquarters, AFCMD, Los Angeles  
AFFRO, North American Rockwell Corporation, Anaheim

bcc: Associate Director, DD - J. H. Hammond  
Regional Manager, Philadelphia