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UNITED STATES GENERAL ACCOUNTING OFFICE
REGIONAL OFFICE
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300 NORTH LOS ANGELES STREET
LOS ANGELES, CALIFORNIA 90012

MAR 12 1971

Rear Admiral T. J. Walker
Commanding Officer
Naval Air Systems Command
Navy Department
Washington, D. C. 20360

Dear Admiral Walker:

We recently completed a survey of the pricing of negotiated defense contracts at Douglas Aircraft Company, a division of McDonnell Douglas Corporation, Long Beach, California. The objective of our survey was to review the procurement process and determine the extent of compliance by contractor and Government personnel with the requirements of Public Law 87-653 and the implementing provisions of the Armed Services Procurement Regulation (ASPR). During our work, we noted certain matters concerning the use of basic ordering agreements (BOA's) and the timeliness of price negotiations which we are presenting for your consideration and any action you may deem appropriate.

Included in our survey were several orders over \$100,000 awarded to Douglas during the period July 1, 1968, to November 30, 1970, under BOA's N00019-69-A-0011 and N00019-70-A-0004. Considerable delays were experienced in the procurement process for these orders. For example, an average of 9 months elapsed between the order issue and proposal submission dates; also, an average of 13 months elapsed between the order issue and negotiation dates.

The major factor contributing to the time lags appears to be the utilization of firm fixed-price orders to procure A-4 aircraft modification kits which require considerable developmental effort. Due to the substantial engineering and developmental effort required, the contractor deferred the submission of cost proposals to the Government until this effort was essentially complete and a more sound basis existed for estimating production costs. This delay along with the time required to evaluate and negotiate the cost proposals resulted in many of these orders being negotiated after a substantial portion of the total effort had been completed.

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As you are aware, ASPR provides that firm fixed-price contracts are suitable when available cost or pricing data permit the development of realistic estimates of probable performance costs. When uncertainties surrounding the contract price cannot be sufficiently identified to evaluate their impact on contract prices, the use of other than a firm fixed-price contract should be considered.

We also noted that order LB-24 under BOA -0011 and LB-01 under BOA -0004 were utilized to procure two prototype A-4M aircraft at a total price of about \$13.7 million. The use of BOA orders to acquire prototype aircraft does not appear to be a proper application of this form of contracting.

The contractor recognized the need for timely negotiation of orders and recommended to the Naval Air Systems Command (NAVAIR) that a more flexible-priced contractual arrangement be considered. In May 1967 and March 1968, the contractor requested that future BOA orders be awarded on a fixed-price incentive basis. Although these requests were favorably endorsed by the Naval Plant Representative, subsequent orders were awarded on a firm fixed-price basis. Contractor and Naval Plant Representative officials are still of the opinion that highly developmental A-4 aircraft kit procurements should be awarded on a more flexible-priced basis. We have been advised that NAVAIR plans to procure fiscal year 1972 A-4 aircraft modification kit requirements from Douglas on a firm fixed-price order basis.

It should be recognized that our observations are based solely on information and documentation obtained from the Naval Plant Representative and contractor personnel. We have not reviewed any documentation at NAVAIR concerning the use of BOA's or discussed our observations with your staff.

We would appreciate receiving your comments on the matters discussed above together with advice as to any actions taken or planned with respect to these issues. We would be glad to discuss these matters in greater detail if you so desire.

Sincerely yours,

H. L. KRIEGER

H. L. KRIEGER
Regional Manager

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