

093304



UNITED STATES GENERAL ACCOUNTING OFFICE  
REGIONAL OFFICE

3086 FEDERAL OFFICE BUILDING, 909 FIRST AVENUE  
SEATTLE, WASHINGTON 98104

AUG 8 1972

Commanding General  
U.S. Army Missile Command  
Redstone Arsenal, Alabama 35899



Dear Sir:

We have entered into the pricing of contract DAA01-71-G-1067 awarded to the John Fluke Manufacturing Company, Inc., Mountain View, Washington, for voltage calibrators. This was a fixed-price, noncompetitive contract based on the catalog price of an item which the contractor represented (1) had been sold in substantial quantities to the general public and (2) was therefore exempt from the cost or pricing data provisions of Public Law 87-653. The purpose of this letter is to bring to your attention certain inaccurate representations made by the contractor during contract negotiations which we believe resulted in the use of an improper method of negotiation and additional costs to the Government.

CONTRACT PRICE BASED ON  
EXHIBIT B AND C

In response to a solicitation by the Missile Command, Fluke submitted, on March 1, 1971, a proposal for furnishing 133 units of a model 3322/AF voltage calibrator at \$2,375.21 each, or a total price of about \$316,001. This was the first and only order by the Government of the "AF" modification to Fluke's basic 3322 model. The proposed unit price was based upon the existing catalog price of \$2,445 for the basic 3322 model plus \$164 for the desired AF modification, less a 10 percent quantity discount. Other amounts were also included in the price for freight and military packaging.

Negotiations were conducted between the Command and Fluke on a sole-source basis without cost or pricing data having been furnished to the negotiator. Such data was not requested because the AF modification represented only a minor change in configuration from the basic 3322 model, which the contractor asserted in his proposal had been sold in substantial quantities to the general public. In support of this contention, the contractor represented to the Government that his sales history for the basic 3322 model for the past year consisted of commercial sales of \$311,225 and Government

713821 / 093304

AUG 8 1972

sales of \$67,095. Therefore, Fluke represented that about 76 percent of its 332B sales were to commercial customers. The Command's Price Negotiation Memorandum indicates the negotiator relied upon the contractor's reported sales experience and did not verify the validity of this data.

Contract negotiations, which were conducted by telephone on April 19, 1971, resulted in a reduction of \$67.64 a unit. This reduction was attributed to a corrected discount rate of 12 percent and the elimination of freight charges from the proposal. During negotiations, the contracted quantity was also reduced by two units. On April 27, 1971, Fluke was awarded fixed-price contract DAAM01-71-C-1067 for 131 units of Model 332B/AF at \$2,307.57 each, or a total price of \$302,291.67.

Our review showed that Fluke should have known that the commercial sales figure represented to the Army was substantially overstated. On January 22, 1971--about 6 weeks before Fluke's representation to the Army--the contractor submitted its annual report to the Renegotiation Board for the year ending September 30, 1970. Backup data for this report showed that Fluke's renegotiable (Government) sales of the 332B amounted to 60 percent of its total sales of that model. Fluke officials should therefore have been aware that the company's commercial sales could not have exceeded 40 percent, as compared to the 76 percent subsequently represented to the Army.

In commenting upon the manner in which the contractor derived the renegotiable sales figures for the 332B as well as all other models, Fluke's report to the Renegotiation Board stated that:

"Renegotiable sales have been segregated by reference to individual purchase orders, item by item, which indicated direct sales to Government agencies or for use in subcontract."

In other words, the company asserted that it had made a detailed analysis of its sales documents in order to compile the data included in the report.

We therefore believe that the renegotiation report backup data should, as a minimum, have been used by Fluke in its representation to the Army. However, we found that this data also overstated the company's commercial sales. For example, during the year ending September 30, 1970, the backup data showed sales of 100 units of the

332B at a gross price (before volume discounts were applied) of \$234,150. The commercial portion of these sales included five units shipped to Fluke sales representatives. Fluke officials agree that these shipments are not product sales, but instead are used by the sales representatives for demonstration purposes. In addition, the backup data incorrectly showed sales of 14 units of 332D as commercial sales, although they were actually for end use by the Government.

The following table compares Fluke's actual sales of the 332B with that (1) represented to the Command and (2) compiled for the report to the Renegotiation Board.

| Per CAO Review                 | Sales of Model 332B<br>During the Year Ending 9/30/70 |            |
|--------------------------------|-------------------------------------------------------|------------|
|                                | No. of Units                                          | % of Total |
| Government--Prime Contracts    | 27                                                    | 29         |
| Government--Subcontracts       | 45 <sup>(a)</sup>                                     | 48         |
| Total Government               | 72                                                    | 77         |
| Commercial Orders              | 21 <sup>(b)</sup>                                     | 23         |
| Total                          | 93                                                    | 100        |
| Per Renegotiation Report       |                                                       |            |
| Backup Data                    |                                                       |            |
| Government                     | 60                                                    | 60         |
| Commercial                     | 40 <sup>(c)</sup>                                     | 40         |
| Total                          | 100                                                   | 100        |
| Represented to Missile Command |                                                       |            |
| Government                     | 29                                                    | 24         |
| Commercial                     | 90                                                    | 75         |
| Total                          | 119                                                   | 103        |

<sup>a</sup>Consists of nine subcontracts, of which five were for a total of 41 units. Two additional units were coded on Fluke's machine tab run as being procurements under a GSA contract.

<sup>b</sup>Includes one unit sold to a State government.

<sup>c</sup>Includes five units shipped to Fluke sales representatives for demonstration purposes.

AUG 8 1972

Contractor officials were unable to demonstrate to us how they arrived at the sales breakdown they submitted to the Command, but expressed the belief that they must have erroneously considered some of the larger Government subcontracts as commercial sales. They informed us that, in order to expedite the process of segregating 332B sales between Government and commercial, they must have obtained the data by scanning their machine tab run of shipments, using their customer coding system to distinguish between the two types of sales rather than physically examining the orders involved. They informed us that generally their customer codings of "85,000" or over relate to U.S. Government customers and codings under "85,000" pertain to commercial customers. Under this system, however, Government subcontractors would always be classified as commercial customers, as would shipments to Fluke sales representatives, since both groups are assigned customer numbers under "85,000."

It appears evident to us that the contractor had ample time to examine at least the larger sales orders (to customers with codes under "85,000") to determine the end use of these sales. Fluke submitted its sales representation to the Army on March 3, 1971, but negotiations were not concluded until April 19, 1971, or about 6 weeks later. If only the five largest orders had been examined prior to or during that period, Government prime contract numbers shown on those orders would have identified 41 additional units as being sold to Government contractors rather than to commercial customers as indicated by the customer coding system. Contractor officials agreed that their representation to the Command should have been based upon the sales data compiled for the renegotiation report. In addition, we believe the contractor erred in reporting the five demonstration units, which are readily identifiable on Fluke's tab runs, as commercial sales.

In summary, we found that Fluke's actual commercial sales of the 332B were only \$49,025, or about 23 percent of the total sales of the model. We also found that all of Fluke's commercial sales were for one unit each compared with the 131 units being purchased by the Government on one contract. Therefore, we believe that Fluke's commercial sales as represented to the Command were substantially overstated and it seems unlikely that Fluke's actual sales experience would have supported a determination by the Command to negotiate on the basis of the catalog price.

Based on a Fluke cost analysis, it appears that the contractor achieved a profit rate on the model 332B/AF contract about four times

