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

OCT 26 1970

LM089287

Colonel Eugene G. Barbaro
Commanding Officer
U. S. Army, Frankford Arsenal
Tacony and Bridge Streets
Philadelphia, Pennsylvania 19137

Dear Colonel Barbaro:

As you are aware, our Philadelphia Regional Office has recently completed a review of procurement practices at Frankford Arsenal. The results of the work were reported to you and the Commanding General, U. S. Army Munitions Command, on September 21, 1970. In conjunction with that review, we have examined into the reasonableness of prices proposed and negotiated for firm fixed-price contract DAAA25-69-C-0343, awarded on June 30, 1969, to Teledyne Mechanical Products, South El Monte, California, by Frankford Arsenal. The contract was negotiated in the amount of $1,305,300 and provided for the contractor to furnish 11,450,000 M14A1 20 MM cartridge links for use with M61 automatic weapons systems.

Our examination was performed pursuant to the provisions of Public Law 87-653 and the implementing Armed Services Procurement Regulation (ASPR). The review was primarily concerned with (1) the reasonableness of proposed and negotiated contract costs in relation to cost or pricing data available at the time of contract negotiations, (2) the adequacy of technical and audit evaluations of the contractor's cost proposal, and (3) the adequacy of the contractor's cost or pricing data submission for compliance with pertinent provisions of ASPR.

We found that (1) the proposed costs for contract -0343 were higher than indicated by available cost information at the time of negotiations by about $81,000, including applicable overhead, general and administrative (G&A) expense and profit, (2) the proposal reviews by Government representatives were generally adequate with minor exceptions, and (3) the cost information submitted in support of the proposed contract price did not fully comply with applicable provisions of ASPR since the bases for proposed labor and G&A costs were not identified. In addition, we found that contract price reductions for

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LOS ANGELES REGIONAL OFFICE

AIRMAIL

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Regional Manager, Philadelphia

Regional Manager, Los Angeles - H. L. Krieger H. L. KRIEGER

Review of procurement practices at Frankford Arsenal (61801)

As previously coordinated with Mr. Joseph Sternberg of your staff, we have today released our letter report to the Commanding Officer, Frankford Arsenal, relating to our review of the prices negotiated for contract DAAA25-69-C-0343 awarded to Teledyne Mechanical Products, South El Monte, California. Our review was initiated in accordance with your memorandum of March 4, 1970. On August 12, 1970, we summarized the results of the review for possible inclusion in your draft report on the procurement practices at Frankford Arsenal.

Enclosed for your information are copies of the letter report to the Arsenal and letters to the contractor and contract audit and administrative agencies. The working papers containing the details of our review are being retained in the regional office. You will note that in our letter to Frankford Arsenal we have extended the opportunity to meet and further discuss the matters contained in our report. In the event the need arises, we would want to coordinate this effort with your staff. Please let us know if you receive any subsequent inquiries from Frankford Arsenal.

Enclosures:
- Letter report to Frankford Arsenal
- Letter to Teledyne Mechanical Products
- Letter to Regional Manager, Defense Contract Audit Agency
- Letter to Commander, Defense Contract Administration Services Region

cc: Director, DD, w/o enclosures
Director, FOD, w/o enclosures
Associate Director, DD - J. H. Hammond
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Government furnished material (GFM) under contract -4040 and a prior M14A1 link contract were understated by about $6,700 and $13,500, respectively, because the price reductions were based on lower material costs than those estimated for the contract and excluded applicable G&A and profit.

The details of our review are included in the attached report. These matters were discussed with Arsenal procurement officials during the review by members of our Philadelphia staff. We would, however, be more than willing to meet with you and provide further details on the issues discussed in our report.

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We would appreciate a written reply within 60 days expressing your views and comments on the matters discussed in this report, together with advice as to the action taken or planned. Copies of this report are being sent to the Regional Manager, Los Angeles Region, DCAA, and the Commander, Defense Contract Administration Services Region, Los Angeles, California.

Sincerely yours,

H. L. KRIEGER

H. L. KRIEGER
Regional Manager

Enclosure

cc: Regional Manager, DCAA,
Los Angeles

Commander, DCASR, Los Angeles

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

REPORT

OF

REVIEW OF THE PRICING OF

CONTRACT DAAA25-69-C-0343

AWARDED TO

[illegible] MECHANICAL PRODUCTS

SOUTH EL MONTE, CALIFORNIA

BACKGROUND

Contract -0343 was issued as a letter contract on January 30, 1969. The contractor's proposal to definitize the contract was dated February 5, 1969, and amounted to $1,409,900. Additional cost information was submitted to the contracting officer on March 25, 1969 in support of the proposed price. The contractor's cost proposal was audited by the Defense Contract Audit Agency (DCAA) and the results were forwarded to the contracting officer on May 9, 1969. A technical evaluation and cost analysis of the proposal were performed by the Arsenal's Munitions Production Division and Price Analysis Office.

Contract negotiations were conducted on May 22, 1969, and resulted in a total contract price of $1,305,300 or $.114 a unit. Mechanical Products executed a Certificate of Current Cost or Pricing Data on May 26, 1969. A defective pricing clause was incorporated into the contract. The contract price was negotiated on a total price basis and, therefore, the amounts negotiated for each element of cost could not be determined. The negotiated price reduction amounted to $104,600.

RESULTS OF GAO EVALUATION

The results of our review of proposed contract costs including an evaluation of the adequacy of the proposal reviews performed by DCAA and the Arsenal, are detailed as follows.

Direct labor hours

We estimate that proposed direct labor production hours were higher than indicated by available pricing data by about 9,500 hours amounting to approximately $56,500, including applicable overhead, G&A and profit. This resulted because anticipated labor savings from the procurement of new production equipment prior to negotiation were not disclosed to the contracting officer.

The contractor proposed direct labor at a unit cost of $.03119, including tool maintenance, for a total proposed cost of $357,100, excluding overhead. Proposed hours amounted to 945.2 for each lot of 75,000 units or 144,332 for the total contract requirements. Included in the proposal were estimates of 9,200 and 9,800 hours for the degrease and heat treat operations, respectively. The contractor's proposal did not identify the basis of the proposed labor cost. In addition, we were unable to determine the basis inasmuch as present contractor management was not involved in pricing contract -0343 and support for the proposal was not available. However, we found that the proposed production labor hours approximated those experienced by the contractor under a prior M14A1 link contract.

The proposed direct labor hours were reviewed as part of the technical evaluation performed by the Munitions Production Division. On the basis of past experience and personal observations of M14A1 production processes, the technical evaluator questioned a total of 27,900 production labor hours, including 5,700 hours relating to the degrease operation. We found that the technical evaluation did not include a visit to the contractor's facilities to determine the reasonableness of the proposed hours. The price analyst accepted the recommendations of the technical evaluator; however, the contracting officer advised us that no agreement was reached in negotiations with respect to the labor hours proposed under the contract.

Our review disclosed that prior to negotiation of contract -0343 the contractor purchased a spiral drum washer system for use in the production (degrease operation) of the M14A1 link assemblies, as well as other product lines. The contractor estimated that the new equipment would reduce its labor force by six persons at an annual savings of $93,000. The washer equipment included a complete material handling system which allows clean parts to be fed automatically into the heat treat furnaces. We found that the labor requirements for the degrease and heat treat operations were reduced by about 50 percent due to the acquisition of the washer system.

On March 22, 1969, the contractor received a price quotation for the washer system and in April approval was obtained from the corporate office to purchase the equipment. A purchase order was issued on April 21, 1969, prior to the negotiation of contract -0343.

We were advised by contractor officials that any labor savings which may have resulted from this equipment could not be reasonably estimated prior to the negotiation of the contract. In addition, they stated that any potential labor savings may have been considered in the lump sum reduction in contract price effected during negotiation. Procurement officials at Frankford Arsenal advised us that the acquisition of the washer system was not disclosed during contract negotiations.

In our opinion, the contractor's proposed direct labor hours for the degrease and heat treat operations were higher than indicated by available pricing data prior to negotiation by about 9,500 hours amounting to $56,500, including add-on pricing factors. We believe that the acquisition of new production equipment constituted pertinent pricing data which should have been disclosed to the contracting officer. In addition, had the technical evaluation of the cost proposal included a visit to the contractor's plant this situation may have come to the attention of Government representatives.

General and administrative expense

We estimate that the proposed G&A costs under the contract were higher than indicated by available cost information at the time of negotiations by about $24,500, including profit. This resulted because the proposed G&A rate for the contract included a corporate fee assessment which did not represent an allocation of corporate office costs and, therefore, was inappropriate for contract bidding purposes.

The cost proposal did not identify the basis of the proposed G&A rate. However, the proposed rate of 8.0 percent was apparently based on historical cost data for the 3-month period November 1968 through January 1969, which reflected an 8.13 percent rate.

The DCAA preaward audit report recommended a G&A rate of 5.1 percent on the basis of a comparison of the proposed rate with actual rates experienced during the 5-month period November 1968 through March 1969. The DCAA audit did not include a review of the reasonableness of the various expenses comprising the G&A rate. Upon receipt of DCAA's report the Arsenal price analyst requested DCAA to provide additional data for a 17-month period on the basis that this time frame was more representative for bidding purposes. The analyst accepted the proposed rate since the contractor's experienced rate for the 17-month period was 8.1 percent. Although the contract was negotiated on total price basis, the record of negotiation indicates that the contracting officer accepted the proposed rate as reasonable.

Our review disclosed that the proposed G&A rate included an item of expense designated as corporate fee. This item represents a monthly assessment to the contractor for various management services provided by the Teledyne corporate office and is charged to all Teledyne operating entities on a return on investment principle. In recent years, this has resulted in total fee assessments which are significantly greater than the expenses incurred by the corporate office. For example, during the contractor's fiscal year 1969 the actual corporate office expenses amounted to only 29 percent of the corporate fee assessments to all Teledyne entities.

In its annual audits of the corporate office G&A expense claim, DCAA has developed an allocation rate acceptable for the distribution of the actual expenses to Government flexible type contracts. The rate is computed by deleting unallowable and unallocable costs from the contractor's claim pursuant to ASPR Section 15 cost principles, and distributing the adjusted cost pool over the total corporate sales base. The resulting rate was considered reasonable by DCAA and various Teledyne entities for bidding indirect expenses on fixed-price contracts. Adjusting the booked G&A costs to reflect the most current corporate expense allocation rate available prior to negotiation, we found the following downward trend in the G&A rate at Mechanical Products:

Time period	G&A rate
May 1968 - April 1969 (12 months)	7.0
November 1968 - April 1969 (6 months)	6.0
February 1969 - April 1969 (3 months)	5.6