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B-164313

Questionable Costs Included In Prices Negotiated For M-16 Rifles Purchased From Harrington & Richardson, Inc. Worcester, Massachusetts B-164313

Department of the Army

UNITED STATES
GENERAL ACCOUNTING OFFICE

NOV. 18, 1970

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

DEFENSE DIVISION

B-164313

Dear Mr. Secretary:

This is our report on the questionable costs included in prices negotiated for M-16 rifles purchased from Harrington & Richardson, Inc., Worcester, Massachusetts. The Chairman, Special Subcommittee on the M-16 Rifle Program, House Committee on Armed Services, in his report on the M-16 Rifle Procurement Program, dated September 26, 1968, recommended that we examine into the prices negotiated for the definitive contract. The significant contents of this report are summarized in the digest which is bound in the report.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53); the Accounting and Auditing Act of 1950 (31 U.S.C. 67); and the authority of the Comptroller General to examine contractors' records as set forth in contract clauses prescribed by the United States Code (10 U.S.C. 2313(b)).

Copies of this report are being sent to the Chairman of the Board, Walter Kidde & Company, Inc.; the Commanding Officer, United States Army Weapons Command; the Headquarters Office, Defense Contract Audit Agency; and the Regional Manager, Boston Region, Defense Contract Audit Agency.

We shall appreciate being advised of the results of actions discussed in this report.

DL004361

Sincerely yours,

C. M. Bailey

Director, Defense Division

The Honorable
The Secretary of the Army

GENERAL ACCOUNTING OFFICE REPORT TO THE SECRETARY OF THE ARMY

QUESTIONABLE COSTS INCLUDED IN PRICES NEGOTIATED FOR M-16 RIFLES PURCHASED FROM HARRINGTON & RICHARDSON, INC., WORCESTER, MASSACHUSETTS
Department of the Army B-164313

DIGEST

WHY THE REVIEW WAS MADE

In congressional hearings held in 1968, concern was expressed over the Army's award of a letter contract to Harrington & Richardson for the production of M-16 rifles after lower prices had been proposed by other companies. Concerned over the tentative price established with Harrington & Richardson--$35.6 million for 240,000 rifles--the Chairman, Special Subcommittee on the M-16 Rifle Program, House Committee on Armed Services, recommended that the General Accounting Office (GAO) closely audit the cost and pricing data submitted by Harrington & Richardson in support of the final contract price. GAO evaluated the reasonableness of the price in light of the data submitted and certified by Harrington & Richardson as being accurate, complete, and current.

FINDINGS AND CONCLUSIONS

GAO found that the negotiated price of $33.7 million included questionable costs of $836,000 consisting of:

--About $381,000, or about $1.59 a rifle, for costs allocated to Harrington & Richardson by a conglomerate company that had acquired control of the rifle manufacturer after the Army had awarded it the letter contract. The Army accepted these costs although it had selected Harrington & Richardson to produce the M-16 rifle several months before the acquisition on the basis of Harrington & Richardson's superiority over other competitors in its ability to meet or exceed the delivery schedule while maintaining good quality. These questionable costs included about $194,000 charged by the conglomerate company to Harrington & Richardson for its headquarters expenses and $187,000 for certain manufacturing consultant services. (See pp. 7 to 10.)

--About $455,000 for costs that were higher than indicated by cost information available to the contractor at the time of price negotiations. (See pp. 11 to 16.)

GAO also found that the Army had paid Harrington & Richardson $1 million for the construction of a contractor-owned rifle test range and a

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24,000-square-foot building addition, apparently without adequate control by the Army of the type and cost of construction. (See pp. 17 to 19.)

RECOMMENDATIONS OR SUGGESTIONS

GAO recommends that the Secretary of the Army consider whether the findings in this report and any other additional information available to the Department provide the Government with a legal entitlement to a price adjustment for the M-16 rifle contract.

GAO is recommending also to the Secretary of Defense that he consider whether

--it is reasonable to accept allocations of conglomerate company costs to defense contracts negotiated on the basis of cost data when acquisition occurs after a contract has been awarded and

--the agency should have exercised control over the cost of contractor-owned construction when a substantial portion of the costs was to be borne by the Government under the production contract.

AGENCY ACTIONS AND UNRESOLVED ISSUES

GAO discussed its findings informally with officials of the Army Weapons Command who in some instances disagreed with the findings. Their comments are contained in the body of the report. GAO has requested that it be advised by the Departments of Defense and the Army of the actions taken in regard to the matters presented for consideration.

Contents

ABBREVATIONS

ASPR	Armed Services Procurement Regulation
DCAA	Defense Contract Audit Agency
DOD	Department of Defense
GAO	General Accounting Office
H&R	Harrington & Richardson, Inc.

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CHAPTER 1

INTRODUCTION

The General Accounting Office (GAO) has reviewed the price negotiated with Harrington & Richardson, Inc. (H&R), Worcester, Massachusetts, by the Department of the Army for the production of M-16 rifles. The review was recommended by the Special Subcommittee on the M-16 Rifle Program, House Committee on Armed Services.

H&R, incorporated in 1888, manufactures a line of rifles, shotguns, and revolvers for the civilian and military markets. On August 8, 1968, about 4 months subsequent to the award of the M-16 rifle letter contract, H&R was acquired by Walter Kidde & Company, Inc., a conglomerate corporation.

AWARD OF LETTER CONTRACT

In April 1968, H&R and General Motors Corporation, Hydra-matic Division, in competition with other prospective offerors, were selected by a Source Selection Advisory Council, U.S. Army Materiel Command, as additional producers of the M-16 rifle. Despite the lower prices submitted by other firms, H&R and General Motors were selected to produce the rifle because of their ability (1) to meet or exceed the delivery schedule while maintaining good quality and (2) to provide the Government with a strong mobilization base. The Council gave H&R the highest technical rating of the competing firms. H&R also received an acceptable rating for its management, facilities, and financial capabilities.

On April 19, 1968, the Army Weapons Command, Rock Island, Illinois, awarded letter contract DAAF-03-68-C-0045 to H&R for 240,000 rifles at a ceiling price of $35.6 million, or $148.42 a rifle, including costs for preproduction, production, and test and inspection equipment. H&R also received cost-type facilities contract DAAF-03-68-C-0100 on April 19, 1968, with an initial ceiling price of $5.9 million for the purchase of Government-owned machinery and equipment for M-16 rifle production.

Letter contract -0045 required H&R to deliver 1,000 rifles a month beginning in February 1969, to gradually increase deliveries to 25,000 a month by November 1969, and to continue at that rate through April 1970. The delivery schedule has since been extended to November 1970, as a result of engineering changes made during production of the rifle.

CONGRESSIONAL INTEREST IN THE M-16 RIFLE PROGRAM

The Subcommittee was concerned with the unit prices established under the letter contracts awarded to H&R and General Motors. The Subcommittee recommended that the Defense Contract Audit Agency (DCAA) carefully review the price proposals and determine for a certainty that the provisions of Public Law 87-653 (The Truth-In-Negotiations Act) were complied with in every instance. It further recommended that GAO closely audit the cost and pricing data submitted by the contractor in support of the fixed price to be paid under the definitive contract.

CONTRACTOR'S PRICE PROPOSALS AND GOVERNMENT REVIEWS

H&R submitted price proposals to the contracting officer for definitizing the -0045 contract price on August 1 and October 21 and 28, 1968. During contract price negotiations which commenced on November 5, 1968, and ended with price agreement on December 4, 1968, H&R furnished revised price proposals.

DCAA, Waltham Branch Office, Waltham, Massachusetts, reviewed H&R's August 1, 1968, proposal and furnished the contracting officer with an advisory audit report dated October 25, 1968. Although some assistance was provided orally during negotiations, DCAA did not perform a formal review of the contractor's October 21 and 28, 1968, proposals but did examine into certain proposed corporate office expenses.

The contracting officer also received reports from Army Weapons Command price and technical analysts relating to the contractor's August 1 and October 21, 1968, proposals.

These personnel assisted the contracting officer during price negotiations in reducing the contractor's proposed price of $40.3 million, or $168.01 a rifle, by about 16 percent, which brought the price down to $33.7 million. These reviews revealed duplications and other deficiencies in the contractor's proposed price.

DEFINITIVE RIFLE PRICE

Contract -0045 was definitized on December 19, 1968, at a fixed price of $33,701,522 for 240,000 rifles, or a unit price of $140.42 consisting of preproduction at $17.61 a unit, production at $122.04 a unit, and test and inspection equipment at $0.77 a unit.

The contractor was subject to the provisions of Public Law 87-653 and the implementing Armed Services Procurement Regulation (ASPR). H&R, after the conclusion of negotiations on December 4, 1968, furnished a certificate that the data submitted to definitize the price were accurate, complete, and current.

The negotiated unit price of $140.42 was $8 less than the ceiling price of $148.42 established in the letter contract. The $140.42, however, did not include the $4.56 a rifle that had been transferred from the production contract to the facilities contract to cover the cost of transporting, converting, rehabilitating, and installing Government-owned equipment. Therefore the final negotiated price was only $3.44 a rifle lower than the letter-contract price. When the price was definitized, the Army had approved several modifications for the construction of buildings and for testing and design changes, which would increase the price for the rifle. In April 1970, the contract price was increased by $1.9 million, or $8.09 a rifle, because of two of these modifications. At the time our fieldwork was completed, the Army had not negotiated the cost for 36 other modifications which were estimated by H&R at $1.6 million, or $6.62 a rifle. If accepted by the Army, the final price could exceed the ceiling price of the letter contract by $11.27 a unit.

DCAA POSTAWARD AUDIT

DCAA, Waltham Branch Office, performed a postaward review of contract -0045 to determine whether the cost and pricing data submitted by H&R were accurate, complete, and current as of December 4, 1968, when the negotiations were completed. In a report dated May 19, 1969, DCAA stated that it appeared that adequate submission had been made by the contractor of all available cost and pricing data at the time of final price negotiations and that there was no indication of defective pricing.

CHAPTER 2

QUESTIONABLE CONGLOMERATE CORPORATE CHARGES

The negotiated price included about $381,000 for a portion of the charges allocated by Walter Kidde & Company, Inc., a conglomerate corporation, to its subsidiary, H&R. Kidde acquired H&R about 4 months after the award of the M-16 rifle letter contract and 3 months before final price negotiations. The negotiated price included about $194,000 for Kidde's home office expenses and about $187,000 for certain manufacturing consultant services to be provided to H&R by Kidde. These amount were accepted by the contracting officer during negotiations without the benefit of detailed analysis. It appears that these costs should have been questioned on the basis of the findings of DCAA and also from the standpoint that the Army had previously considered H&R qualified to produce M-16 rifles because of its own capability.

Initial contacts leading to the acquisition of H&R by Kidde took place in the summer of 1967; a public announcement regarding the proposed acquisition was made on October 26, 1967; and a formal agreement between Kidde and H&R was signed on December 22, 1967, and amended on April 22, 1968. H&R stockholders approved the agreement on July 31, 1968, and the transaction closed on August 8, 1968.

H&R was selected by the Army in April 1968 to produce the M-16 rifle primarily because the Army had decided that H&R possessed the ability to meet or exceed the delivery schedule while maintaining good quality and to provide the Government with the strongest mobilization base. This decision was arrived at after the Army completed a review of H&R's capabilities in April 1968, several months before the acquisition of H&R by Kidde. An Army Source Selection Evaluation Board, composed of experts in their respective fields, spent over 2,300 man-days in reviewing the managerial, technical, and financial ability of the four firms competing for the award of the M-16 rifle contract. The Board found that H&R possessed the highest technical ability and ranked a close second behind General Motors in managerial ability.

The findings of the Board were concurred in by an Army Source Selection Advisory Council which was established to review the findings of the Board and to present its findings to the Secretary of the Army. On the basis of the findings of the Board and the Council, the Secretary of the Army awarded letter contracts to the two most qualified firms, General Motors and H&R.

CORPORATE CHARGES

On August 1, 1968, H&R submitted its first price proposal for definitizing letter contract -0045. The price contained no amount for Kidde's headquarters expenses since the acquisition of H&R by Kidde did not take place until August 8, 1968. Later price proposals contained an allocation of about $230,000 for Kidde's corporate expense included in H&R's proposed general and administrative expenses. The negotiated price included an allocation of $194,000 for Kidde's corporate expense and related profit.

DCAA, Waltham Branch Office, obtained an assist audit of the proposed Kidde's headquarters expenses from another branch office. DCAA, in its audit of Kidde's cost allocation to H&R, questioned $47,000 of the costs allocated to H&R. The amount questioned included $21,000 relating to advertising, patent costs, and other costs connected with Kidde's efforts to acquire other firms. Advertising and patent costs are generally considered to be unallowable according to ASPR provisions relating to cost-type contracts. Additional costs of $26,000 were questioned because they were not considered to be properly allocable to H&R.

The record of negotiations contained no evidence that the audit findings had been considered by the contracting officer during negotiations. The contracting officer informed us that he was aware of the results of DCAA's audit but that he had accepted the full amount of conglomerate costs allocated to the H&R contract after a Kidde representative during negotiations had orally provided information on the Kidde charges.

A more fundamental question arises regarding the reasonableness of allowing Kidde's headquarters costs in this case. H&R had received contract -0045 prior to the takeover by Kidde. Moreover, H&R had initially submitted a proposal to definitize the contract price which purportedly contained the technical, managerial, and cost approaches necessary to accomplish the program's objectives without any assistance or technical advice from Kidde and without any amount for Kidde's headquarters expenses. When such costs were included in subsequent proposals, it would seem logical for DCAA and the contracting officer to have questioned the entire allocation of these expenses in terms of the benefits to be received by the Government. We recognize that headquarters expenses are necessary for the overall operation of a business; however, it is questionable that the Government should accept this additional layer of expense when a contractor is acquired by a conglomerate corporation after a contract has been awarded.

CONGLOMERATE CONSULTANT SERVICES

The negotiated price included $187,000 for consultant services that were to be performed by Kidde for H&R. At the negotiations Kidde representatives stated that these costs were appropriate for inclusion in the contract price because H&R needed assistance in solving difficult M-16 rifle production problems and in improving manufacturing processes, procedures, and techniques, which were to be applied in producing eight critical parts required by the contract. The costs were estimated by Kidde on the basis of its judgment of the assistance needed by H&R.

H&R's technical qualifications in each of the areas in which Kidde offered assistance had been evaluated by the Source Selection Evaluation Board and the Source Advisory Council. These evaluations showed that H&R had satisfactory technical capabilities with regard to production engineering, tools, gauges, purchasing, quality assurance and machine tool production.

DCAA and the Army Weapons Command technical analyst questioned the need for Kidde's assistance in their evaluation of the contractor's proposal. DCAA informed the contracting officer that there was no support for the conglomerate consultant cost. Originally, the technical analyst had advised that the cost was a duplication of engineering costs already included in the preproduction and production costs.

The contractor presented a schedule supporting the proposed consultant costs during negotiations. The contracting officer informed us that he had accepted the Kidde consultant costs on the basis of an Army Weapons Command technical analyst's determination during negotiations that the Kidde consultant services were needed to assist H&R. It appears that the results of the Source Selection Evaluation Board review concerning H&R's adequate technical capabilities and the original findings of DCAA and the Army Weapons Command technical analyst should have prompted the contracting officer to further evaluate the reasonableness of the costs proposed for the consultant's services.

CHAPTER 3

OTHER QUESTIONABLE NEGOTIATED COSTS

The definitized price negotiated for contract -0045 also included indirect costs of about $455,000 (including related expenses and profit) that were higher than indicated by cost and other information available to the contractor and Army Weapons Command at the time of negotiation. A more careful consideration by the contracting officer of the available cost information would have provided a sound basis for negotiating a lower price.

Following receipt of instructions from the Army Materiel Command, the Army Weapons Command told the contractor that negotiations would begin in November 1968 and that the contract would be definitized by the end of December. The contractor submitted revised sections of the proposal on October 28, 1968, and on that date the contracting officer requested the DCAA Waltham Branch Office to audit the contractor's final price proposal and to attend negotiations on November 5.

DCAA advised the contracting officer that it was not possible to perform a complete audit within the time allowed. At the negotiations DCAA compared the data in the revised proposals with the information it had obtained during its audit of the initial proposal.

During negotiations which lasted until December 4, 1968, H&R submitted additional revisions to its proposal. H&R's final proposal was about $2.3 million higher than the August 1, 1968, proposal. The revisions to the contractor's proposals received only a limited review by the contracting officer and his staff during the negotiations.

Notwithstanding the Army Weapons Command's position to the contrary, we could find no urgent need for the Army to definitize this contract as of December 4, 1968, and not to provide sufficient time for DCAA to audit the contractor's final proposal.

Our findings by cost element are listed below and discussed in detail in the sections that follow.

Cost element	Questionable costs	Related expenses and profit	Total questionable costs
Indirect labor	$161,000	$ 63,000	$224,000
Employees' medical insurance	76,000	17,000	93,000
Property taxes	32,000	7,000	39,000
Plumbing supplies	15,000	3,000	18,000
Gas and water	17,000	4,000	21,000
Holiday and vacation	27,000	10,000	37,000
First aid hospital and employee welfare	19,000	4,000	23,000
Total	$347,000	$108,000	$455,000

INDIRECT LABOR

The indirect labor costs proposed by H&R for salaries of security, maintenance, janitorial, and other types of indirect personnel assigned to various M-16 rifle production departments were about $161,000 higher than those indicated by available information. The contractor estimated these costs on the basis of manning charts and projected wage rates for the contract period April 1968 to April 1970.

About $103,000 of the increase occurred because the contractor's proposal included estimated costs of $492,000 for the period April through October 31, 1968, although lower actual costs of $389,000 that had been incurred for indirect labor were available for this period. Fewer people were employed at lower rates than had been proposed. The Army Weapons Command contracting officer informed us that he would examine into this matter to determine whether the Government is legally entitled to a price adjustment.

About $58,000 of the increase occurred because the contractor's proposal included indirect labor costs of $455,000 calculated to maintain an employment level for peak production until April 1970, even though the production of the rifle was scheduled for completion in February 1970. The Army Weapons Command technical analysts recognized that many of these indirect labor personnel would not be needed following the completion of production activities and made significant downward adjustments of 50 percent and 85 percent respectively in the number of indirect labor personnel proposed by the contractor for the months of March and April 1970.

The contracting officer informed us that the negotiated reduction to the contractor's proposal had not been calculated in the fashion specified in the Army Weapons Command technical analyst's report. The contracting officer indicated that the forecast reduction in personnel was spread over a longer period of time than the 2-month period and at lower pay rates than the average pay rate negotiated. He could not provide us, however, with specific data to support the basis for the negotiated reduction. Had the contracting officer reduced the proposed indirect labor costs for March and April 1970, as suggested by the Army Weapons Command technical analysts, the amount negotiated for indirect labor could have been reduced by an additional $58,000.

EMPLOYEES' MEDICAL INSURANCE

In computing the costs proposed for employees' medical insurance, the contractor estimated the total number of people that would be employed during production under the contract and multiplied this number by standard insurance company rates that averaged $16.69 a month, including judgmental increases. Our review indicated that the $447,000 included in the price negotiated for the contractor's contribution towards employee insurance was excessive by $76,000 because of the following three matters:

- Actual premium rates in effect at the date of price negotiations were $0.20 a man-month less than the rate used by the contractor to estimate the cost of family coverage in its proposal, a difference of $3,600.

- Only 90 percent of the eligible employees at the date of negotiations had selected coverage under the medical insurance plan. The projection of this experience over the term of the contract would have reduced the contractor's medical insurance contribution by an additional $33,900.

--Negotiated reductions in the level of employment were not entirely reflected in the amount negotiated for medical insurance. We estimated that, had the negotiated medical insurance rates been based on the negotiated man-months of employment, the cost would have been reduced by an additional $38,500.

The record of negotiations was not clear about the contracting officer's basis for accepting the negotiated amount for this cost, and responsible Army Weapons Command representatives were not able to furnish us with such a basis.

PROPERTY TAXES

Estimated property taxes of about $40,000 were proposed by the contractor and accepted in price negotiations on the basis of a full tax assessment for a building that would be constructed at a cost of about $500,000 and would be completed by January 1, 1969. In October 1968, however, more than a month prior to the completion of negotiations, H&R entered into a contract for the construction of a building at a cost of about $325,000 with a completion date of mid-1969. At the time of price negotiations, information available in the contractor's and builder's records showed that the foundation was not completed and that the building would be less than one-third completed by the end of 1968. These circumstances indicated that as of December 31, 1968, the property tax assessment would not be levied on a fully completed building valued at $500,000.

Nevertheless, in estimating the property tax for 1969, the contractor used an assessed value of $400,000 (80 percent of the $500,000) without considering that the building would cost $325,000 and would be only partially completed. We estimated that the proposed property tax of $40,000 accepted in negotiations should have been reduced by $32,000. The Army Weapons Command contracting officer informed us that he would examine into this matter to determine whether the Government is legally entitled to a price adjustment.

PLUMBING SUPPLIES

The contractor's proposal included $22,899 for plumbing supplies. The record of negotiations did not explain the contracting officer's basis for accepting the amount negotiated. The actual costs incurred for plumbing supplies during the months of January through October 1968 were available at the time of negotiations. If the percentage relationship of plumbing supply costs to direct labor costs for this period had been utilized, the negotiated costs could have been reduced by $15,000. An Army Weapons Command representative informed us that no specific review had been made of the proposed plumbing supplies because of the small amount proposed.

GAS AND WATER

Gas and water costs amounting to $61,579 were negotiated on the basis of the percentage relationship of these costs to direct labor. H&R had proposed these costs on the basis of experience during the period January through May 1968, using 1.81 percent. An Army Weapons Command representative informed us that the Army Weapons Command had accepted gas and water costs on the basis of information available through August 1968. At negotiations, however, costs for the months of January through October 1968 were available, which showed that the percentage relationship of these costs to direct labor had declined to 1.32 percent. If these expenses had been negotiated on the basis of the latest available cost information, negotiated costs could have been reduced by $17,000.

HOLIDAY AND VACATION PAY

H&R's final proposal included $363,527 for holiday and vacation pay applicable to all employees to be engaged in the production of the M-16 rifle. This amount was arrived at after considering the wages to be paid to employees in the various departments and the contractor's estimate of the holiday and vacation time that would accrue to them.

During negotiations the Army Weapons Command and the contractor agreed to certain reductions in wage rates and in the number of direct and indirect employees to be assigned to various departments producing the M-16 rifle. To give effect to this reduction, the contracting officer reduced the proposed holiday and vacation pay to $341,352. The record of negotiations was not clear about how the reduction had been computed. An Army Weapons Command representative informed us that a detailed evaluation had not been made of the information presented by the contractor. Instead, this cost was estimated at about 10 percent of direct labor.

Our examination of negotiated holiday and vacation pay showed that the amount accepted in price negotiations did not correctly reflect the reductions negotiated in the proposed number of employees and in wage rates. We estimated that, had these reductions been considered, these costs could have been reduced by an additional $27,000.

FIRST AID HOSPITAL AND EMPLOYEE WELFARE

The negotiated price included $31,209 for first aid hospital and employee welfare expenses. The contractor indicated that the amount had been based on the percentage relationship of prior cost experience to the total direct labor cost incurred in the past.

The contractor's proposed costs had been increased by applying judgmental factors which increased the relationship of these costs to direct labor costs from .37 to .92 percent. We found no indication that these judgmental factors had been reported to the contracting officer. Had these costs been negotiated on the basis of the historical costs, the negotiated costs could have been reduced by $19,000. The Army Weapons Command contracting officer informed us that he would examine into this matter.

CHAPTER 4

LACK OF CONTROL OVER CONSTRUCTION COSTS

The Army Weapons Command authorized the contractor to construct buildings on H&R's land for inspecting and testing the M-16 rifles without providing for approving the design or limiting the cost it would pay under the contract. The Government accepted in the price of the M-16 rifle over $1 million of the $1.3 million incurred by H&R to construct the facilites without assurance that these costs were necessary to contract performance. The buildings are owned by the contractor. We could find no Department of Defense (DOD) requirements for establishing controls over contractor-owned construction, the cost of which is borne by the Government under production contracts. Such controls may have resulted in the Government's paying lower prices for M-16 rifles.

H&R's initial proposal for definitizing letter contract -0045, submitted in August 1968, included $300,000 to extend existing firing ranges and to construct a 16,000-square-foot addition to a contractor-owned building. At the time, H&R considered this construction necessary to meet test requirements of the letter contract.

By modification 6 issued July 1968 to the letter contract, however, the Army directed H&R to acquire such facilities and to make any other preparations to meet new test requirements for the M-16 rifle. In October 1968, H&R contracted for a 24,000-square-foot building addition for assembling, inspecting, and testing rifles. In December 1968, after completing negotiations of the basic price under contract -0045, H&R contracted for the construction of a specially designed firing-range building. Both the firing range and the building addition were constructed on H&R's land at a cost of over $1.3 million.

In March 1970, the Administrative Contracting Officer, Defense Contract Administration Services Region, Boston, Massachusetts, negotiated a price of $700,000 for the construction costs. An additional $300,000 for construction costs had been included in the price negotiated in December

1968 under the basic contract. Of the total $1.3 million construction cost, the contractor absorbed $300,000 for plumbing, heating, electrical work, air conditioning, and other items.

The Administrative Contracting Officer informed us that he had accepted the major portion of the construction costs because modification 6 had placed no limitation on the type of construction or on the costs for the facilities needed to meet the Army's new test requirements for the M-16 rifle.

H&R representatives informed us that the new firing-range building and the 24,000-square-foot addition had been constructed so that they would be able to meet the increased test requirements stipulated in modification 6. They further indicated that the broad language used by the Army in modification 6 was an authorization to construct the buildings without submitting their plans to the Army Weapons Command for approval.

We questioned the reasonableness of the Army's decision not to require the contractor to obtain approval of its construction plans. The Army Weapons Command contracting officer informed us that he had not imposed controls on the buildings to be constructed by H&R because of the urgency to proceed with the construction to comply with the new test requirements of modification 6. We found, however, that modification 6 was issued in July 1968 and that the contract to construct the range building was not awarded until December 1968. It appears that the Army had sufficient time to establish reasonable controls for the approval of the construction plans and for the maximum costs it would pay. Although we have no assurance that substantial reductions in the costs to the Government would have occurred, the Government's interests would have been better protected through such actions.

ASPR contains no guidance for the approval or control of contractor-owned construction when a substantial portion of the costs will be borne by the Government. ASPR does contain, however, extensive guidance for the approval and control of construction of Government-owned buildings. These controls include the approval of specific construction projects by progressively higher administrative levels in

DOD, the level depending on the amount of money to be spent; consideration of alternate means of satisfying requirements; and the ultimate disposition of the property. There appears, however, to be a need for DOD to consider establishing guidance for the design approval and for control over costs of contractor-owned construction when it is known that a substantial portion of the costs will be borne by the Government.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

In our opinion the limited time allowed to review and negotiate the definitization of the M-16 rifle contract with H&R contributed to the acceptance of questionable costs of $836,000 that were included in the contract price.

DOD guidance appears to be needed on the acceptance and control of costs for negotiated contracts, as shown by the following examples of the acceptance of questionable costs by contracting officials.

--Allocations of conglomerate corporation costs to defense contracts negotiated on the basis of cost and pricing data. (See p. 7.)

--Costs of contractor-owned construction, a substantial portion of which will be borne by the Government under production contracts. (See p. 17.)

RECOMMENDATIONS

We recommend that the Secretary of the Army consider whether the findings in this report and any other additional information available to the Department provide the Government with a legal entitlement to a price adjustment for the M-16 rifle contract.

We are recommending also to the Secretary of Defense that he consider whether:

--It is reasonable to accept allocations of conglomerate company costs to defense contracts negotiated on the basis of cost data when acquisition occurs after a contract has been awarded.

--The agency should have exercised control over the cost of contractor-owned construction when a substantial portion of the costs was to be borne by the Government under the production contract.

CHAPTER 6

SCOPE OF EXAMINATION

Our review was primarily concerned with evaluating the adequacy of the cost and pricing data submitted by the contractor in establishing M-16 rifle prices and with the manner in which these prices were negotiated. Our review included an examination, by cost element, of the cost and pricing data supporting the contractor's price proposals for definitization of contract -0045 and of other data available at the time of price negotiations. In addition to examining the contractor's cost records and techniques used to estimate costs, we examined the procurement files, the records of negotiations prepared by the contracting officer, and other memoranda in connection with the establishment of contract prices, including those prepared by DCAA, Army Weapons Command price analysts, and technical personnel.

We also held discussions with Government and contractor representatives. These discussions served to clarify the manner in which the cost and pricing data were utilized by both parties and other considerations that entered into the formulation of M-16 rifle prices.

U.S. GAO Wash., D.C.