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UNITED STATES GENERAL ACCOUNTING OFFICE  
REGIONAL OFFICE  
ROOM 7068 FEDERAL BUILDING  
300 NORTH LOS ANGELES STREET  
LOS ANGELES, CALIFORNIA 90012

MAR 12 1971

Mr. Edward Curtis  
Vice President, Contracts and Pricing  
Douglas Aircraft Company  
McDonnell Douglas Corporation  
3855 Lakewood Boulevard  
Long Beach, California 90801

Dear Mr. Curtis:

We recently completed a survey of the pricing of negotiated defense contracts at Douglas Aircraft Company, Long Beach, California. The objective of our survey was to 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.

Included in our survey were 25 firm fixed-price procurements over \$100,000 awarded to Douglas during the period July 1, 1968, to November 30, 1970. Based on the results of our work, we do not plan to perform any detailed examinations of the pricing of these procurements at this time. Although the results of our survey were discussed with the Director, Military Contracts Division, and his staff, we thought it would be useful to summarize those issues which we believe warrant your attention.

Need to disclose current cost estimates  
prior to contract negotiations

We noted that several orders under basic ordering agreements (BOA's) had not been negotiated until a substantial portion of the effort had been completed. This occurred primarily on those A-4 aircraft modification kit orders which required considerable developmental effort. Due to the substantial engineering effort required, the contractor deferred the submission of cost proposals to the Government until this effort was substantially complete and a more

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sound basis existed for estimating production costs. The cost proposals were essentially based on forward pricing data; however, contract negotiations were conducted on the basis of recorded costs plus an estimate to complete (ETC). Therefore, the cost data in the original proposals were not relied on by the Government contracting officer. These data, however, were certified to by the contractor at negotiations.

We found that prior to negotiations the contractor developed estimates of costs to complete these orders but did not disclose the estimates to the Government contracting officer. Contractor officials advised us that the estimates are not submitted unless the cost of performance plus ETC vary significantly from the original cost proposals. In addition, we were advised that the contractor places greater reliance on the estimates contained in the original proposals.

While we do not endorse the late negotiation of orders on the basis of actual performance costs, we do believe that when these conditions arise, performance costs should be considered during the negotiation process. In addition, we believe that the ETC's constitute pertinent cost and pricing data that should be disclosed in writing to the Government prior to negotiations.

Use of firm fixed-price orders for highly developmental aircraft modification kits

As previously discussed, orders for A-4 aircraft modification kits frequently have not been negotiated in a timely manner primarily because of the uncertainty in establishing firm prices at the outset. The use of firm fixed-price orders to procure hardware which requires a high level of engineering and developmental effort has apparently contributed to these delays.

Douglas recognized the need for timely negotiation of these orders and recommended to the Naval Air Systems Command (NAVAIR) that a more flexible contractual arrangement be considered. In May 1967 and March 1968, Douglas requested that future BOA orders be awarded on a fixed-price incentive basis. Although these requests were favorably endorsed

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by the Naval Plant Representative, subsequent orders were awarded on a firm fixed-price basis. Your staff has advised us that, in the future, you plan to seek a more flexible contractual arrangement for orders involving a high degree of engineering and developmental effort. We plan to bring this matter to the attention of NAVAIR for their consideration in the award of future orders.

We would appreciate your comments on the matters discussed in this letter, in particular, your views on the need for disclosure of ETC data to the Government for consideration in the negotiation process.

We wish to take this opportunity to acknowledge the courtesy and cooperation extended to our representatives during this survey.

Very truly yours,

H. L. KRIEGER

H. L. KRIEGER  
Regional Manager

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