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REGIONAL OFFICE
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LOS ANGELES, CALIFORNIA 90012

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AIRMAIL

MAR 19 1971

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Rear Admiral J. A. Scott
Commanding Officer
U. S. Navy Ships Parts Control Center
Mechanicsburg, Pennsylvania 17055

Dear Admiral Scott:

As part of our review of the negotiation of contract prices under the provisions of Public Law 87-653, we have examined into the price proposed and negotiated for firm fixed-price contract N00104-69-C-0092 awarded to Alcan Aluminum Corporation, Riverside, California, by the U. S. Navy Ships Parts Control Center (SPCC). The contract price was definitized on February 7, 1969, in the amount of $1,642,500 and provided for the contractor to furnish 45,000 Zuni Rocket Motors, 5.0" MK 16 Mod 1. The contract price was subsequently increased to $2,447,000 to provide for 22,065 additional units.

Our examination was primarily concerned with the reasonableness of the price negotiated in relation to cost or pricing data available at the date of contract negotiations and the adequacy of technical and audit evaluations of the contractor's cost proposal.

We found that proposed labor costs were higher than indicated by cost information available at the date of contract negotiations by about $91,400, including applicable overhead and profit. Also, proposed tool maintenance costs were apparently understated, to a lesser extent, because the most current cost information was not considered in the pricing of this contract. The evaluations of the contractor's proposal by Government representatives were not performed in sufficient depth to determine whether the proposed contract price was based on the most current, complete, and accurate cost or pricing data.

The details of our review are discussed below.

BACKGROUND

SPCC awarded letter contract -0092 to Alcan on October 2, 1968, for the production of 45,000 Zuni Rocket Motors. Alcan submitted a cost proposal on November 1, 1968, in the amount of $1,760,850. A revised proposal was submitted on December 12, 1968, to reflect more current labor and overhead bid rates.

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The Defense Contract Administration Services (DCAS) performed a technical evaluation of the original proposal and the Defense Contract Audit Agency (DCAA) performed a preaward audit of the revised cost proposal. Negotiations were conducted by telephone on January 30 and 31, 1969, resulting in a contract price of $1,642,500. The negotiated reduction of $118,350 was in the general and administrative expense and profit. The contract contained an option clause for additional quantities at the same unit price for the 45,000 units. SPCC exercised the option on February 19 and March 19, 1969, for 22,065 additional units.

The contractor executed a Certificate of Current Cost or Pricing Data on January 31, 1969, and a defective pricing clause was incorporated into the contract.

RESULTS OF OUR EVALUATION

The results of our review of proposed costs, including an evaluation of the adequacy of the technical and audit reviews performed by Government representatives, are detailed as follows:

Machine hours

We estimate that proposed machine hours used to compute labor costs were higher than indicated by available cost information by about 6,658 hours amounting to approximately $91,400, including applicable overhead and profit. This resulted because the contractor did not update the cost proposal to reflect the most current machine hour standards for two production operations.

Alcan proposed 11,982 machine hours for the aging operation based on a standard production rate of 6 units an hour. The standard was revised to 12 units an hour on November 12, 1968, several months prior to contract price negotiations. According to contractor officials, the revision was the result of modifications to the aging furnace which doubled its capacity. However, the cost proposal was not updated to reflect this increased capacity. As a result, we estimate that proposed labor costs for the aging operation were higher than indicated by available cost information at the date of contract negotiations by about $13,000, or about $82,200, including applicable overhead and profit.

We estimate that proposed labor costs for the anneal operation were similarly increased by about $1,500, or about $9,200, including applicable overhead and profit because the cost proposal was not updated to reflect the most current machine hour standard for that operation.

Contractor officials stated that the cost proposal had not been updated to reflect the revised standards nor were the standards disclosed to the contracting officer because the changes were not considered significant. However, we believe the changes were significant and should have been disclosed to the contracting officer during negotiations.

The proposed machine hours were reviewed as part of the technical evaluation performed by DCAS. We found that the technical evaluator traced the standards in the proposal to an operation worksheet issued in August 1968, which was the basis for the proposed machine hours. However, we found no evidence that more current data was examined. DCAS officials stated that the revised standards, issued on November 12, 1968, may not have been available at the date of their review which was performed during November 15-27, 1968. Based on our discussions with contractor officials, it appears that the revised standards could have been available at the time the technical evaluation was performed. In any event, we believe that the technical evaluation should have included an assessment of the most current standards in effect at the date the review was performed.

Tool maintenance costs

The contractor proposed $41,500 for tool maintenance on the basis of historical costs of $0.618 a unit experienced in the production of units under prior contracts during the period January to June 1968. We found that the contractor was experiencing a higher tool maintenance rate at the time of contract negotiation than had been proposed as shown below. However, the cost proposal was not updated to reflect the higher rate.

Period	Unit cost	Amount based on contract quantities
January - December 1968	$.713	$47,800
July - December 1968	.807	54,200
October - December 1968	.888	59,500

We were unable to determine the reasons for the increased tool maintenance rate because the financial records did not provide adequate visibility as to the composition of such costs. As a result, we could not determine whether the costs experienced in the latter months would have been representative of what the contractor could expect to incur during performance of contract -0092. It does, however, appear that the proposed tool maintenance costs may have been understated based on the most current data available at negotiations.

Contractor officials advised us that their policy has been not to update cost proposals at negotiations unless the more current cost data varies significantly from proposed costs. In our opinion, the more current information should have been disclosed to the contracting officer during negotiations.

We found that the DCAA preaward audit of the contractor's cost proposal did not include a review of proposed tool maintenance costs. Had a review been performed, we believe that the higher rate would have been disclosed to the contracting officer for consideration during negotiations.

Unsupported cost estimate

The contractor included proposed costs of $139,900 for an item of expense designated as bar premium. This item represents the cost differential between extruding bar stock at Alcan and the higher costs if performed by outside vendors. Contractor officials advised us that at the time the proposal was submitted for contract -0092, the 3,500-ton press used to extrude bar stock for prior Zuni Rocket Motor production was scheduled to capacity with other plant work. Since the contractor intended to extrude bar stock for contract -0092 on the 3,500-ton press, this necessitated the purchase of extruded bar stock from outside vendors for other plant work.

We were unable to verify that the 3,500-ton press had been scheduled to full capacity since the contractor does not retain production scheduling records. Contractor officials advised us that the records had been available for review by Government representatives prior to negotiations.

The contractor's rationale for including the bar premium costs in the pricing of contract -0092 was disclosed in the cost proposal. According to the record of negotiation, these costs were accepted by the contracting officer since they were audited and found reasonable. In this regard, DCAS, in its price/cost analysis report, advised the contracting officer that the bar premium costs were acceptable provided the contracting officer considered this item as a necessary part of the contract requirements. However, we found no evidence that either DCAS or DCAA had reviewed the 3,500-ton press production scheduling records or had otherwise evaluated the propriety of the bar premium costs.

It does not appear that the propriety of including the bar premium costs in the pricing of contract -0092 was adequately evaluated by the Government representatives during the proposal review process. We believe that the production scheduling records should have been reviewed to determine whether the capacity of the 3,500-ton press was such as to require the procurement of extruded bar stock from outside vendors in the quantity and prices proposed.

Need to update cost proposal

In addition to the examples previously noted, we identified other elements of the cost proposal which were not based on the most current information. Although the use of more current cost data would not have resulted in a significant change in the proposed costs, we believe that such data should have been disclosed by the contractor during negotiations.

Contractor officials generally agreed with a need to update the cost proposals in those cases where significant time lags exist between the original submission of a cost proposal and the final price negotiations and indicated that action would be taken to improve this condition.

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We believe that the contracting officer should consider the above findings, along with any additional information available, to determine the extent to which the Government may be legally entitled to a price adjustment. With respect to proposed tool maintenance costs, you may wish to consider whether the "set off" principles of understated cost or pricing data contained in Defense Procurement Circular No. 77 are applicable.

We would appreciate being advised of actions taken or contemplated with regard to the matters discussed in this letter. Copies of this letter are being sent to the Regional Manager, Defense Contract Audit Agency, and to the Commander, Defense Contract Administration Services Region, for their information.

Sincerely yours,

H. L. Krieger

H. L. KRIEGER
Regional Manager

cc: Regional Manager, DCAA, Los Angeles
Commander, DCASR, Los Angeles