



UNITED STATES GENERAL ACCOUNTING OFFICE

REGIONAL OFFICE

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IN REPLY REFER TO:

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Colonel L.A. Brooks  
Depot Commander  
Sacramento Army Depot  
Sacramento, California 95813

AGC00702



Dear Colonel Brooks:

As part of our continuing interest in the Sacramento Army Depot's (SAAD) procurement of Closed Circuit Shipboard Television Systems (TV systems) for the Navy, we examined SAAD's action in negotiating a firm-fixed unit price under requirement contract DAAG08-74-D-0344. On June 27, 1974, SAAD awarded International Video Corporation (IVC), Sunnyvale, California, this contract for up to 118 TV systems, parts and services. The negotiated unit price for the basic TV system totalled \$54,736, as amended, and the estimated total contract value was \$6,458,848.

Our examination was concerned with the extent your activity followed appropriate Department of Defense price negotiation policies and techniques in the procurement of TV systems from IVC. In this regard, the Armed Services Procurement Regulation (ASPR)3-801.1 states:

"It is the policy of the Department of Defense to procure supplies and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate overall cost to the Government. Good pricing depends primarily upon the exercise of sound judgment by all personnel concerned with the procurement."

We found that SAAD failed to perform the type of pricing evaluation required by ASPR to assure that the negotiated price is fair and reasonable. We further noted this occurred despite your staff being alerted by us to a similar problem in pricing an earlier procurement from IVC. Although we discussed some of our observations with Colonel Henderson and staff, we consider it prudent to summarize these apparent weaknesses so that you can evaluate them and take whatever action deemed necessary to assure future adherence to sound and required pricing techniques.

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A brief background followed by a discussion of the weaknesses are presented in the following sections.

### Background

Earlier this year we became aware that SAAD was procuring video tape recorders (825AC-VTR) from IVC under contract DAAG08-73-C-0102. Through September 1973, SAAD had procured lots of 78, 78 and 15 recorders at a \$4,830 unit price for an estimated cost totalling \$825,896. This negotiated price was based on the contractor's \$6,200 catalog price less a 22.5 percent quantity discount plus \$24 to cover the cost of source inspection. IVC claimed the recorder was a standard commercial product which was sold at a \$5,084 unit price (catalog list price less 18 percent) to the Government under a General Services Administration (GSA) federal supply schedule contract. SAAD granted IVC catalog exemption from the submission of cost and pricing data without receiving the appropriate DD Form 633-7, and accepted the proposed price even though the GSA price was limited to single orders not to exceed \$250,000 and two SAAD orders exceeded that limit by \$126,724 (51 percent). Finally, we found IVC failed to disclose to SAAD that they: (1) seldom sell the recorder in large quantities to the Government at the GSA discount price, and (2) offer original equipment manufacturers discount terms up to 38 percent for quantities comparable to the SAAD procurement.

By letter dated April 24, 1974, we brought these matters to the attention of Colonel Dukes and questioned the adequacy of SAAD's procurement practices in negotiating a reasonable price for the recorder. Also, we wanted to alert SAAD to IVC's apparent profit margin on the video equipment. In our view, this information was important background to the forthcoming SAAD negotiations with IVC involving the purchase of the previously referred to TV system which includes two recorders as components.

During the week ending October 11, 1974, we examined SAAD's action in negotiating a reasonable price for the TV system. We noted your staff's apparent failure to adequately consider our letter because they did not perform the required pricing review of the contractor's cost data to assure negotiation of a fair and reasonable unit price.

### Requirements for cost analysis

The Procuring Contracting Officer (PCO) is required by ASPR 3-807.2(a) to obtain some form of price or cost analysis.

The method and extent of analysis depends on the procurement and pricing situation. In this connection, a cost analysis must be performed whenever the contractor is required to submit cost or pricing data; whereas, a price analysis shall be used in all other cases.

The PCO required the contractor to submit cost and pricing data, but then failed to obtain the required cost analysis. According to negotiation records, the basis for the negotiated \$56,971 unit price was a local price analysis and engineering evaluation. The pricing report disclosed that the proposed price was considered reasonable because it compared favorably with the previous buy's \$48,005.60 price adjusted by a 14.9 percent cost increase resulting from a decrease in the dollar's buying power. The report disclosed other factors impacting on price, but failed to evidence an element by element analysis of the contractor's cost data. According to the PCO, SAAD performed only a price analysis because a pre-award audit was not obtained to facilitate a cost analysis.

#### Lack of field pricing support

Although the PCO has ultimate responsibility for determining the reasonableness of a contractor's proposal, he is required by ASPR 3-801.5(b) to obtain field pricing assistance to evaluate cost or pricing proposal data which contractors are required to submit unless information already available to the contracting officer is adequate to determine the reasonableness of the proposed cost or price. Field assistance is provided by the responsible Defense Contract Administration Services Region (DCASR).

SAAD requested field pricing support from DCASR on May 20, 1974. The pricing report was to include an audit, technical evaluation, and price analysis of the cost and price proposal to be supplied by IVC. The contractor submitted the proposal, but by letter dated June 11, 1974, DCASR advised SAAD that they were unable to commence the review because the contractor had refused to submit accurate, complete and current cost and pricing data to support the proposed \$54,760 unit price. For instance, DCASR pointed out that IVC had not provided the method of computation and application of overhead expenses. To that extent, DCASR requested that the contractor submit cost breakdowns, trends, and budgetary data to provide a basis for a cost analysis.

On June 17 and 18, 1974, the contractor provided SAAD with updated cost and pricing data. While this data did not meet in all respects the deficiencies listed by DCASR, the data could have provided a basis for an audit and subsequent cost analysis. Rather than pursuing this course of action, however, SAAD negotiated with IVC on June 13, 18 and 19, 1974, a price of \$56,971, which approximated the contractor's proposed price per system, as adjusted during negotiations. On June 18, 1974, one day prior to the final day of negotiations, IVC certified that the submitted cost and pricing data was accurate, complete and current as of June 18, 1974.

Inadequate justification for SAAD's failure to perform a cost analysis

According to SAAD contracting officials, the required cost analysis was not performed because there was insufficient time to complete the field pricing review before the start of contract negotiations. In this regard, we were further told that SAAD's technical division (FASA) had applied pressure to award the basic ordering agreement so that the TV systems would be available for installation on ships upon their return to port. However, our review of contract records and discussions with SAAD officials disclosed that other contractual arrangements were not considered which would have enabled SAAD to order the systems for the Navy, and at the same time provided SAAD with the additional time needed to perform the required pricing review. Despite the lack of a required cost analysis, SAAD officials stated they were convinced a fair and reasonable price had been negotiated with IVC.

We recognize that a price analysis is sometimes an appropriate pricing method; however, this case clearly demonstrates the shortcomings of such analysis and the need to follow required pricing techniques to assure the negotiation of a reasonable price. Underlying the validity of the performed comparative price analysis was SAAD's basic assumption that they negotiated a reasonable price for the previous buy of TV systems. Since that price was projected and then compared to IVC's proposed price, the price analyst saw no need to even review and verify the contractor's submitted cost data. Had the price analyst performed such a review, however, he would have noted a major discrepancy that, in turn, should have raised a question as to the reasonableness of the previous buy's price. For instance, \$9,675 of that buy's \$48,006 price was for two 825AC recorders. In sharp contrast, the contractor's cost data for the second buy disclosed only an estimated \$5,987 price including overhead for the same two recorders. This \$3,688 price differential suggests that the first buy's price was possibly excessive and therefore was not an acceptable basis for determining the reasonableness of the second buy's price without performing a more detailed cost analysis.

Finally, we also recognize the existence of time constraints and the preference for a definitized price before orders are placed by procuring activities. However, ASPR 3-410.2 provides for alternative and temporary contractual arrangements to allow for a pricing review without jeopardizing the Navy's requirements. In this case, SAAD could have protected the Government's interest by awarding IVC an undefinitized basic ordering agreement, and by temporarily ordering TV systems under unpriced delivery orders.

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We discussed some of these matters with Colonel Henderson and staff, and they agreed that the cost data submitted by IVC raised a question regarding the reasonableness of the negotiated TV system price. As a result, they have requested DCASR to perform a post-award audit, and have agreed to keep us apprised of any future developments and action taken.

In addition to these matters, however, we are concerned about how our findings relate to SAAD's total procurement system. While we did not specifically review the adequacy of the whole system, we question whether our findings are symptoms of larger problems in SAAD's procurement system. Consequently, we would appreciate your comments on this letter within 30 days.

If you have any questions, please don't hesitate to contact us.

Sincerely,

A. M. CLAVELLI

A.M. Clavelli  
Regional Manager

bc: Director, Office of Policy  
Mr. J. Thornton (FOD)  
Mr. Gutmann (PSAD)  
Mr. J. Hammond (PSAD/GP)  
Chief, Distribution Section, OAPS