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UNITED STATES GENERAL ACCOUNTING OFFICE
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KANSAS CITY, KANSAS 66101

May 14, 1974 093173

Space and Missile Systems Organization
Air Force Systems Command
Norton Air Force Base, California 92409

Dear Commander:

We have examined the pricing of firm-fixed price subcontract (No. 037-W20313) awarded to the Brunswick Corporation, Lincoln, Nebraska, on December 8, 1970, by the General Electric Company, Philadelphia, Pennsylvania, under its prime contract for Minuteman missiles. This examination was performed as part of a broad review of the reasonableness of subcontract estimates included in noncompetitive prime contract prices negotiated under the provisions of Public Law 87-653. The noncompetitive prime contract, number F04701-68-C-0178, amendment P00171, was awarded by the Space and Missile Systems Organization.

The price of the subcontract, which provided for 123 shrouds or component parts of the missile, was later included as an estimated cost in General Electric's proposal. We performed this examination to determine whether the subcontract estimate was reasonable in relation to cost or pricing data available to the subcontractor at the time the subcontract price was established. We examined the evaluation of the subcontractor's proposal performed by General Electric and the Government, the cost or pricing data submitted in support of proposed subcontract costs, the negotiation process between the subcontractor and General Electric, and, on a selective basis, the costs incurred.

We noted two matters which we believe warrant your attention. First, the prime contractor was not required to submit complete subcontract cost or pricing data in support of the costs included in the subcontract price; and second, the subcontractor failed to disclose pertinent information to the prime contractor relating to estimated sales, quality control cost and scrap cost. Had such information been furnished and evaluated, there would have been a sound basis to negotiate a lower price for the shrouds.

INCOMPLETE DATA SUBMITTED

Brunswick proposed a price of $1,131,075 in September 1970, for 122 shrouds, at $9,271 a shroud. General Electric made a limited review of the proposal but did not ask the Defense Contract Audit Agency to review it. Subsequently, Brunswick revised its proposal to $1,418,064 for 132 shrouds at $10,743 per shroud. During negotiations in January 1971, the

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companies agreed on a price of $1,107,000, or $9,000 each for 123 shrouds. General Electric and the Government used this price in negotiating the prime contract price.

Although General Electric submitted some subcontractor cost or pricing data in support of the subcontract price, this data did not meet the requirements of ASPR and the ASPR Manual for Contract Pricing. For example, supporting data for labor costs consisted of a schedule showing, by types of labor to be used, hours required and rates per hour. However, the bases for these estimates were not identified. Further, burden and scrap cost was simply identified as a percent of other costs. We found no indication that the contracting officer asked the contractor to provide additional subcontractor cost or pricing data prior to concluding prime contract negotiations.

As a result, the contracting officer was not in a position to determine whether the prime contractor had obtained sufficient data on which to negotiate a reasonable subcontract price. The need for greater emphasis on obtaining subcontractor cost or pricing data was reported to the Secretary of Defense on June 20, 1973.

SUBCONTRACTOR FAILED TO DISCLOSE ALL PERTINENT COST OR PRICING DATA

At the time of negotiation of the subcontract price, Brunswick had pertinent cost or pricing data which it did not furnish to General Electric. This information showed that:

- --Brunswick would have about $1 million more in 1971 sales than it used in estimating a burden rate.
- --Quality control costs had decreased during the weeks preceding negotiations.
- --Brunswick estimated scrap cost on the basis of experienced cost, about 74 percent of which resulted from the scrapping of three substantially complete shrouds under an earlier purchase order.

Estimated Sales and Burden Rate

The subcontract price included manufacturing overhead cost estimated at 200 percent of direct labor cost. Brunswick stated that this rate was based on the relationship of estimated overhead costs to direct labor costs required to support 1971 estimated sales, or the period during which the work would be performed.

Records available at the time of negotiations indicated, however, that sales would be about $1 million higher than used in calculating the 200 percent overhead rate. This higher sales estimate would have caused a corresponding increase in direct labor costs required for 1971, or the base over which overhead costs would be distributed. In fact, about 1-month after the subcontract price was negotiated, Brunswick, for the purpose of pricing other work, reduced the burden rate to 187 percent to reflect the higher sales and direct labor cost estimates.

Had this information been disclosed to General Electric, we believe that a sound basis would have existed for reducing the subcontract price by about $30,000. With the elimination of General Electric's additions for cost and profit on this amount, the prime contract price would have been reduced by about $37,600.

Quality Control Costs

Brunswick proposed quality control costs of $479 a shroud. Brunswick stated this estimate was based on costs experienced through December 31, 1970, on a previous order for shrouds. During negotiations this estimate was reduced to $312 a shroud.

The data submitted by Brunswick in support of its estimate, however, did not show an approximate 50 percent reduction in weekly quality control costs beginning December 21, 1970, 1-month before conclusion of negotiations. A Brunswick quality control official attributed the reduction to (1) release of personnel from the project because they had completed their non-recurring type effort, and (2) a substantial reduction in the number of defects found by quality control inspectors.

Brunswick did not have records to show the number of shrouds produced between the time of the reduction of quality control costs and price negotiations with General Electric. However, based on the reduced quality control costs and the average number of shrouds delivered monthly between November 15, 1970 and January 15, 1971, we believe a basis would have existed for reducing the subcontract price by about $41,000. With the elimination of General Electric's additions for cost and profit on this amount, the prime contract price could have been reduced by about $52,000.

Scrap Costs

Brunswick proposed and negotiated a scrap rate of 5 percent, or $492 a shroud. Brunswick stated that this estimate was also based on cost experienced through December 31, 1970, on a previous order. Brunswick did not disclose to General Electric, however, that about 74 percent of these costs represented three scrapped units. We believe that disclosure of this information would have provided a basis for negotiating lower scrap costs because of the unlikelihood that the rate of scrapped units mid-way through the first production run would be experienced in production of the second run of 123 units.

Eliminating the costs for the three scrapped shrouds from the base used to estimate scrap costs for order -W20313 would have reduced the subcontract price by about $39,000. With the elimination of General Electric's additions for cost and profit on this amount, the prime contract price would have been reduced by about $49,000.

Brunswick achieved a profit of about $428,600 on costs of about $678,400. This represents a profit rate of about 63 percent versus the negotiated rate of 10 percent. We believe that the Air Force should consider the above findings, along with any additional information available, to determine the extent to which the Government may be entitled to a price adjustment, and identify improvements needed in management controls to ensure that contracting officers obtain required subcontractor cost or pricing data.

We would appreciate a written reply within 45 days expressing your views and comments on matters discussed herein, as well as advice on any action taken or planned. For your information copies of this letter are being sent to the Commander, Air Force Systems Command; the General Electric Company; and the Brunswick Corporation.

Sincerely yours,

K. L. WEARY

K. L. Weary
Regional Manager