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UNITED STATES GENERAL ACCOUNTING OFFICE
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JUL 19 1974 093156

Commander, Naval Air Systems Command
Department of the Navy
Washington, D.C. 20360

Dear Commander

As part of a broad review of the reasonableness of non-competitive prime contract prices negotiated under the provisions of Public Law 87-653, we have examined into the prices proposed and negotiated for fixed-price incentive contract N00019-72-C-0154, awarded to Columbus Aircraft Division, Rockwell International (formerly North American Rockwell Corporation, Columbus, Ohio), by the Naval Air Systems Command, Washington, D.C. The contract, awarded June 30, 1972, at a target price of $20,484,468, included an 80/20 sharing arrangement for overruns or underruns of target cost, with a ceiling price of $23,062,632. The contract provided for the production of 36 T-2C aircraft and associated equipment.

We wanted to find out whether the price negotiated was reasonable in relation to cost or pricing data available to the contractor at the time the price was established. We examined the Government's evaluation of the contractor's proposal, the cost or pricing data submitted in support of proposed costs, the negotiation process, and, on a selective basis, the costs incurred.

We found that the contractor failed to disclose to the Navy negotiator, pertinent information on (1) its plans for facilities rearrangement, for which costs were included in its fiscal year 1972 manufacturing overhead pool, and (2) its estimated business base for fiscal year 1973. Had such information been furnished and evaluated, we believe there would have been a sound basis for negotiating lower overhead rates for both fiscal years, with a resulting decrease of about $381,000 in target price. Details follow.

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FISCAL YEAR 1972 OVERHEAD RATE

Rockwell and the Naval Plant Representative's Office, on March 31, 1972, negotiated a manufacturing overhead rate of $7.25 a direct labor hour for pricing all proposals for work to be performed during Rockwell's fiscal year 1972 (October 1, 1971 through September 30, 1972). This rate was based in part on the recovery through manufacturing overhead, of the estimated cost of over $1,000,000 to be incurred for "facility consolidation", or rearrangement of manufacturing facilities within the plant, during fiscal year 1972.

The Defense Contract Audit Agency (DCAA), evaluated Rockwell's overhead rate proposal prior to negotiations. DCAA, on March 13, 1972 notified the Naval Plant Representative's Office that Rockwell's proposed rate of $7.42 a direct labor hour included $1,034,000 for consolidation expense in the overhead pool, but that Rockwell's expenditures for consolidation were lagging from the amount proposed by about 15 percent. DCAA believed the contractor would spend no more than $879,000 for consolidation during fiscal year 1972, and questioned $155,000 of overhead expense.

The Naval Plant Representative's Office, in its memorandum of overhead negotiations, indicated that DCAA's observation concerning the consolidation expense incurred was valid. During our audit, we were unable to determine what adjustment was made for the $155,000 questioned by DCAA in arriving at the negotiated rate of $7.25.

Rockwell, on May 16, 1972, proposed, and the Navy negotiator accepted, at the completion of negotiations on May 19, 1972, this previously established rate for fiscal year 1972 work on contract -0154. The Navy negotiator indicated that he accepted the rate of $7.25 because (1) the contractor's fiscal year was half completed at the time of negotiations and actual costs for 6 months were available to make projections of business activity for the next 6 months, and (2) the Naval Plant Representative had the benefit of DCAA's evaluation for the negotiation.

Through April 1972, after 7 months of the fiscal year, Rockwell's records showed that less than $300,000 had been spent for consolidation effort. The President of the Columbus Aircraft Division informed the Executive Director for Material Management of Naval Air Systems Command on May 1, 1972, that further rearrangement efforts would be limited because of an improving business profile.

We found no evidence that the Navy negotiator requested nor that Rockwell offered additional data concerning the consolidation plan and its impact on fiscal year 1972 rates, during negotiation of contract -0154 in May 1972. Had this information been made available to the negotiator and evaluated, we believe the negotiator would have had a sound basis for reducing the manufacturing overhead rate for fiscal year 1972 effort on contract -0154 from $7.25, perhaps to as low as $7.00. This would have resulted in a reduction of about $74,000 in the contract target price.

In retrospect, by the end of the fiscal year Rockwell had spent only about $450,000 on rearrangement efforts as compared with its estimate totaling over $1,000,000.

FISCAL YEAR 1973 OVERHEAD RATE

Rockwell on May 16, 1972, proposed a $7.60 manufacturing overhead rate for pricing fiscal year 1973 work on contract -0154. A key factor in developing a manufacturing overhead rate is the anticipated business base for the period, or the total manufacturing labor hours over which overhead expenses would be allocated. Rockwell did not provide detailed support for the proposed rate, thus, there was no audit of that rate by DCAA. Rockwell contended that its business base would remain relatively stable at about 2,328,620 manufacturing labor hours for fiscal years 1972 through 1974.

During negotiations, the Navy negotiator asked Rockwell for a breakdown, by program, of the estimated manufacturing labor hours for fiscal year 1973. Rockwell, in response, submitted the following data:

Program	Fiscal year 1973 manufacturing labor hours
Venezuelan OV-10	219,750
Thailand OV-10	281,650
Venezuelan T-2C	198,800
Fiscal year 1972 Navy T-2C	458,500
Aircraft program tooling	80,000
Fiscal year 1973 Navy T-2C	161,189
Other aircraft	300,000
Missiles	550,000
Total hours	2,249,889

Rockwell officials advised us that this data was not represented to be an estimate of its fiscal year 1973 business base, but rather was an estimate made at the negotiating table for "known business." The Navy negotiator, however, indicated in his Business Clearance that he relied on this data in negotiating a manufacturing overhead rate of $7.58 for fiscal year 1973 work. The Navy negotiator did not request DCAA to evaluate the above data which was submitted by Rockwell during final negotiations.

<u>Higher business base estimate not furnished to the Navy</u>

Rockwell had prepared a forecast on March 27, 1972, which reflected an estimated business base for fiscal year 1973 of 4,126,800 manufacturing hours. This was significantly higher than the 2,328,620 hours represented to the Navy as the "stable" base for fiscal years 1972 through 1974. In explaining the difference between these estimates, Rockwell officials advised us that the 4,126,800 hour estimate was not information which should have been furnished the Navy since it was developed for sales goal purposes and not for calculation of an overhead rate. Rockwell officials further stated that this estimate was simply too optimistic and could not have been used to develop a realistic overhead rate. DCAA officials told us that Rockwell, until recently, did not permit DCAA access to budgetary forecasts, and those forecasts were generally not made available to the Government.

At our request to identify those hours in the estimate that were too optimistic, Rockwell officials reevaluated all the programs included in the 4,126,800 hour estimate. The reevaluation indicated that 2,844,300 hours would have been a realistic forecast of the fiscal year 1973 business base as of March 30, 1972. The following schedule compares the business base data submitted to the Navy in May 1972 with Rockwell's March 1972 forecast and the reevaluation of that forecast.

Manufacturing Hour Forecasts for Fiscal Year 1973

Systems	Submitted to Navy May 1972	March 1972 forecast	Rockwell reevaluation of March 1972 forecast
Aircraft			
RA-5C	a/	722,000	291,100
V/STOL fighter	-0-	223,400	-0-
Combat support (OV-10)	501,400	896,800	491,100
Command support (IOIC)	a/	89,600	89,100
T-2C and T-2D	818,489	859,500	860,000
B-1	a/	668,700	445,800
Program tooling	80,000	-	-
Other	300,000	151,000	151,600
Subtotal	1,699,889	3,611,000	2,328,700
Missiles	550,000	515,800	515,600
Total	2,249,889	4,126,800	2,844,300

a/ These programs were to be included in the "other" category according to Rockwell officials.

Rockwell's revised forecast of 2,844,300 hours did not include any recognition of the V/STOL program. Between March 30, and May 19, 1972, there were apparently a number of changes in the business outlook for fiscal year 1973, particularly in reference to this program. Our review of Navy files on V/STOL indicated that actions had been taken by the Navy before May 19, 1972, to approve the V/STOL program and to select Rockwell as the contractor for that program. We estimate that, to reflect the most accurate, current and complete data as of May 19, 1972, Rockwell's revised estimate should be increased about 223,000 hours to provide for anticipated work on the V/STOL during fiscal year 1973, or to about 3,067,300 hours.

Had Rockwell disclosed all pertinent information regarding the anticipated business base for fiscal year 1973, we believe the Navy negotiator would have had a sound basis for reducing the manufacturing overhead rate for fiscal year 1973 effort on contract -0154 from $7.58, perhaps to about $7.09. This would have resulted in a reduction of about $307,000 in the target price.

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We believe Rockwell's practice of denying budgetary forecasts to Navy and DCAA personnel may have contributed to the possible overstatement of the fiscal year 1973 manufacturing overhead rate negotiated for contract -0154. The Naval Plant Representative told us the Navy now has access to all the information necessary to ensure that the Government is negotiating a reasonable price, and fair forward pricing rates. The DCAA Resident Auditor stated, however, that he was not certain he was being given access to all the data pertinent to overhead negotiations. In connection with the fiscal year 1972 rate, we believe Rockwell's failure to notify the negotiator of changes in the plan for consolidation contributed to acceptance of a forward pricing rate which may not have been valid for contract -0154.

We recommend that the Navy 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 on contract N00019-72-C-0154 and to identify procurement procedures that need to be improved. In addition, we recommend that the Navy determine the applicability of our findings to other pricing actions negotiated between May 1 and September 30, 1972, which involved manufacturing effort during Rockwell's fiscal years 1972 and 1973.

We would appreciate a written reply within 30 days expressing your views and comments on the matters discussed in this letter. Copies of this letter are being sent to Columbus Aircraft Division, Rockwell International, the Naval Plant Representative, and the Resident Auditor, Defense Contract Audit Agency, Rockwell International.

Sincerely yours,

ROBERT W. HANLON

Robert W. Hanlon
Regional Manager