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UNITED STATES GENERAL ACCOUNTING OFFICE
REGIONAL OFFICE
ROOM 1903 JOHN F. KENNEDY FEDERAL BUILDING
GOVERNMENT CENTER
BOSTON, MASSACHUSETTS 02203

May 22, 1975

Mr. William Melymuka
Regional Manager
Defense Contract Audit Agency
424 Trapelo Road
Waltham, Massachusetts 02154

Dear Mr. Melymuka:

The General Accounting Office is examining the reasonableness of noncompetitive prime contract prices negotiated under the provisions of Public Law 87-653. As part of this examination, we reviewed the prices proposed and negotiated for firm fixed price contract DAAA21-72-C-0856 awarded by the Department of the Army, Picatinny Arsenal, Dover, New Jersey, to Raymond Engineering, Inc., Middletown, Connecticut. The contract provides for the production of XML20 arm/safe defices. The results of our review were discussed with your Bridgeport Branch Office staff.

Enclosed for your information is a copy of our letter report to the Commander, Picatinny Arsenal, Dover, New Jersey, which summarizes the results of the review.

In conjunction with our evaluation of proposed fabrication costs of 26 parts, we noted that the preaward audit did not include a verification to historical data available in the contractor's cost accounting system. The Arsenal, in its audit request, stated a technical evaluation was being performed by its engineering personnel. DCAA did not review direct labor hours and qualified its report, stating the technical evaluation had not been received. Also, the contractor prepared its proposal on the basis of making four other parts that it had purchased for the prior contract at a unit price which was less than the proposed make costs and included costs to make as well as costs to buy three other parts. The contractor continued to buy these seven parts under contract -0856. In our opinion, the preaward audit should have included an evaluation of proposed labor hours.

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The Bridgeport Branch Office staff is performing a postaward review of contract -0856. This review, started in October 1973, had not been completed as of April 30, 1975. The staff advised us that they are waiting for the Contracting Officer to furnish additional detailed back-up information supporting the direct labor hours negotiated.

You may wish to consider the results of our review in future audits at this location. Any comments you may wish to make on the matters discussed in this letter will be appreciated. We would also like to acknowledge the courtesy and cooperation extended to our representatives by your staff during this review.

Sincerely yours,

JOSEPH EDER

Joseph Eder
Regional Manager

Enclosure



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Enclosure

May 22, 1975

Colonel Jonathan L. Holman, Jr.
Commander, Picatinny Arsenal
Department of the Army
Dover, New Jersey 07801

Dear Colonel Holman:

The General Accounting Office is performing a broad examination of the reasonableness of noncompetitive prime contract prices negotiated under the provisions of Public Law 87-653. As part of this examination, we have reviewed firm fixed price contract DAAA21-72-C-0856 awarded on June 30, 1972, by the Department of the Army, Picatinny Arsenal, Dover, New Jersey, to Raymond Engineering, Inc., Middletown, Connecticut. The contract provides for the production of 177 XM120 arm/safe devices at a total price of \$586,202 and includes an option to purchase additional units. The Government exercised the option for 110 units at a total price of \$317,350.

We wanted to find out whether the price negotiated was reasonable in relation to cost or pricing data available to Raymond at the time the price was negotiated. We examined the Government's evaluation of Raymond'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 Raymond failed to disclose to the Army negotiator pertinent information relative to fabrication labor costs. Specifically, Raymond failed to (1) disclose that actual cost experience was available for certain parts to be manufactured and (2) that certain parts which were proposed as "make" items were previously purchased at substantially less cost. In addition, Raymond's proposal included the cost to make three items as well as the cost to buy the same three items.

Had this information been furnished by Raymond and evaluated by the Army negotiator, we believe there would have been a sound basis for reducing the contract prices by about \$135,000 including overhead, general and administrative expense, and profit. The following schedule summarizes our computation.

	<u>Basic</u> <u>Contract</u> (177 units)	<u>Option</u> (110 units)	<u>Total</u> (287 units)
Overstated Fabrication Labor	\$35,770	\$22,190	\$57,960
Add: Factory Overhead @ 128%	<u>45,786</u>	<u>28,403</u>	<u>74,189</u>
Total Overstated Fabrication Cost	81,556	50,593	132,149
Less: Offset for Material	<u>17,499</u>	<u>16,102</u>	<u>33,601</u>
Net Overstated Manufacturing Cost	64,057	34,491	98,548
Add: General and Administrative Expense @ 25%	<u>16,014</u>	<u>8,623</u>	<u>24,637</u>
Total Overstated Cost	80,071	43,114	123,185
Add: Profit @ 10%	<u>8,007</u>	<u>4,311</u>	<u>12,318</u>
Total Overpricing	<u>\$88,078</u>	<u>\$47,425</u>	<u>\$135,503</u>

FABRICATION LABOR

An analysis of the overpricing of fabrication labor follows:

	<u>Basic</u> <u>Contract</u>	<u>Option</u>	<u>Total</u>
Excess of proposed costs over experienced cost data for 26 parts	\$8,486	\$5,273	\$13,759
Excess of proposed "make" costs over "buy" costs for 4 other parts	26,075	16,168	42,243
Duplication because proposal included "buy" as well as "make" costs for 3 other parts	<u>1,209</u>	<u>749</u>	<u>1,958</u>
Total Overstated Fabrication Labor	<u>\$35,770</u>	<u>\$22,190</u>	<u>\$57,960</u>

The option price for the 110 units was based on the same data as the proposal for the basic contract quantity of 177 units. Accordingly, the following discussion of the overpricing of the 177 units also applies to the option quantity of 110.

Experienced costs available for 26 parts

Contract DAAA21-72-C-0856 was a follow-on contract to DAAA21-72-C-0374 which was the initial production contract providing for 8 first article

samples and 102 production units. At the time of proposing for the follow-on contract on June 8, 1972, actual fabrication costs under the initial contract were available for 26 of the approximate 50 parts that Raymond proposed to fabricate for the XM120 arm/safe device. Raymond based its proposal on engineering estimates and did not use the available experienced cost data.

Raymond's cost accounting system includes a Piece Part Cost Report which shows the total manufacturing hours and costs for each part. This report also shows the quantity and date that parts are transferred to stores after inspection. The cost accounting system also includes a Labor Distribution Report which identifies the manufacturing hours and costs by specific types of labor such as fabrication. This report is arranged by work order number and manufacturing control code numbers (phase and traveler numbers). The control codes, used in both reports, provide the means for identifying the specific type of labor expended on a particular part.

By examining the transfer-to-stores dates on the Piece Part Cost Report, we identified 26 parts having cost experience at the time of the proposal for contract -0856. Tracing the control codes to the Labor Distribution Report revealed the available cost experience under contract -0374 for these 26 parts. After computing the unit cost experience, we determined that the cost to fabricate the 26 parts for the 177 units required by contract -0856 amounted to \$3,909 which is \$8,486 less than the proposed amount of \$12,395. A schedule of the \$8,486 overstatement is shown on attachment I to this letter.

Of the \$8,486 overstatement, \$7,171 is due to overestimating the number of hours and \$1,315 is due to overestimating the labor rate. See attachments II and III for details.

Proposed "make" costs more
than purchased price

For four other parts, Raymond prepared its proposal on the basis of making these parts. At that time, Raymond had already purchased these parts for the prior contract at a unit price which was less than the proposed make costs. Raymond did not disclose this information to the Contracting Officer. Moreover, Raymond continued to buy these parts under contract -0856. The following schedule shows the proposed number of hours and labor cost to make these parts at the proposed and negotiated hourly rate of \$4.74.

<u>Part Number</u>	<u>Hours</u>	<u>Amount</u>
RP8880014	1,609	\$7,627
RP8880015	1,806	8,560
RP8880022	605	2,868
RP8880043	<u>1,481</u>	<u>7,020</u>
Totals	<u>5,501</u>	<u>\$26,075</u>

Raymond purchased these parts at a cost of \$17,499 as shown in the Material section of this letter.

When one considers the related overhead on the \$26,075 at the proposed and negotiated rate of 128 percent, the proposed make costs amount to \$59,451 which is \$41,952 more than the buy costs of \$17,499. Raw material costs were not added to the \$59,451 since we considered them insignificant.

Duplication of proposed costs

Raymond proposed to make three other parts at a total direct fabrication labor cost of \$1,209. Raymond's proposal also included buy costs for these same three parts. Since Raymond had previously purchased these parts and continued to purchase these parts under contract -0856, we consider the fabrication costs to be overstated. Following is a summary of the proposed number of hours and cost to make these parts at the proposed and negotiated hourly rate of \$4.74.

<u>Part Number</u>	<u>Hours</u>	<u>Amount</u>
RP8880004	53	\$251
RP8880057-1	101	479
RP8880057-2	101	479
Totals	<u>255</u>	<u>\$1,209</u>

OVERHEAD

The overstated amount of \$74,189 was computed by applying the proposed and negotiated overhead rate of 128 percent to the overstated fabrication labor.

MATERIAL

The prices paid to vendors for the four parts that Raymond proposed to make are summarized below.

<u>Part Number</u>	<u>Basic Contract</u>	<u>Option</u>	<u>Total</u>
RP8880014	\$1,833	\$2,460	\$4,293
RP8880015	4,089	2,422	6,511
RP8880022	1,853	1,208	3,061
RP8880043	<u>9,724</u>	<u>10,012</u>	<u>19,736</u>
Totals	<u>\$17,499</u>	<u>\$16,102</u>	<u>\$33,601</u>

Since Raymond's proposal did not include these costs for materials, the above amounts are offset against the related overstated make costs.

GENERAL AND ADMINISTRATIVE EXPENSE (G&A)

The \$24,637 overstated G&A was computed by applying the proposed and negotiated rate of 25 percent to the net manufacturing cost overstatement.

PROFIT

The overstated profit of \$12,318 was computed by applying the proposed and negotiated profit rate of 10 percent to the total overstated costs.

RECOMMENDATION

We recommend that you consider the above findings, along with any additional information available, to determine the extent to which the Government may be entitled to price adjustments and to identify procurement procedures that need to be improved.

We would appreciate a written reply within 30 days expressing your views and comments on the matters discussed in this letter.

Sincerely yours,

JOSEPH EDER

Joseph Eder
Regional Manager

CONTRACT DAAA21-72-C-0856
OVERSTATED FABRICATION LABOR COSTS

ATTACHMENT I

Part Number	Proposed and Negotiated Hours	Proposed and Negotiated ^{a/} Labor Cost	Adjusted Experienced Hours ^{b/}	Experienced Hourly Rate	Experienced Cost ^{c/}	Excess of Proposed and Negotiated Cost over Experienced Cost
RP8880005	29	\$137.46	20.4	\$3.752	\$76.54	\$60.92
RP8880019	94	445.56	55.6	3.609	200.66	244.90
RP8880024	57	270.18	31.8	3.416	108.63	161.55
RP8880028	192	910.08	113.4	3.270	370.82	539.26
RP8880029	130	616.20	33.4	3.503	117.00	499.20
RP8880031	192	910.08	149.4	3.647	544.86	365.22
RP8880032	144	682.56	50.4	3.445	173.63	508.93
RP8880034	200	948.00	121.4	3.227	391.76	556.24
RP8880035	120	568.80	34.8	3.442	119.78	449.02
RP8880046-1)						
RP8880046-2)	166	786.84	50.8	3.661	185.98	600.86
RP8880046-3)						
RP8880046-4)						
RP8880047	58	274.92	49.0	3.293	161.36	113.56
RP8880056	89	421.86	26.6	3.069	81.64	340.22
RP8880058-1)						
RP8880058-2)	463	2,194.62	68.8	4.600	316.48	1,878.14
RP8880058-3)						
RP8880059	455	2,156.70	140.6	3.618	508.69	1,648.01
RP8880061	28	132.72	20.8	3.921	81.56	51.16
RP8880063	94	445.56	89.2	3.464	308.99	136.57
RP8880067-1)						
RP8880067-2)	67	317.58	26.2	3.238	84.84	232.74
RP8880067-3)						
RP8880067-4)						
RP8880070	37	175.38	19.6	3.872	75.89	99.49
Totals	<u>2,615</u>	<u>\$12,395.10</u>	<u>1,102.2</u>		<u>\$3,909.11</u>	<u>\$8,485.99</u>

^{a/} At proposed and negotiated fabrication labor rate of \$4.74 per hour.

^{b/} Experienced hours for contract DAAA21-72-C-0374 adjusted to proposed quantities for DAAA21-72-C-0856.

^{c/} Adjusted experienced hours multiplied by experienced rate.

CONTRACT DAAA21-72-C-0856
EFFECT OF OVERSTATED FABRICATION HOURS

<u>Part Number</u>	<u>Hours</u>			<u>Amount^{a/}</u>
	<u>Proposed</u>	<u>Available Experience</u>	<u>Overstatement</u>	<u>Overstated</u>
RP8880005	29	20.4	8.6	\$ 40.76
RP8880019	94	55.6	38.4	182.02
RP8880024	57	31.8	25.2	119.45
RP8880028	192	113.4	78.6	372.56
RP8880029	130	33.4	96.6	457.88
RP8880031	192	149.4	42.6	201.92
RP8880032	144	50.4	93.6	443.66
RP8880034	200	121.4	78.6	372.56
RP8880035	120	34.8	85.2	403.85
RP8880046-1)				
RP8880046-2)	166	50.8	115.2	546.05
RP8880046-3)				
RP8880046-4)				
RP8880047	58	49.0	9.0	42.66
RP8880056	89	26.6	62.4	295.78
RP8880058-1)				
RP8880058-2)	463	68.8	394.2	1,868.51
RP8880058-3)				
RP8880059	455	140.6	314.4	1,490.26
RP8880061	28	20.8	7.2	34.13
RP8880063	94	89.2	4.8	22.75
RP8880067-1)				
RP8880067-2)	67	26.2	40.8	193.39
RP8880067-3)				
RP8880067-4)				
RP8880070	37	19.6	17.4	82.48
Totals	<u>2,615</u>	<u>1,102.2</u>	<u>1,512.8</u>	<u>\$7,170.67</u>

^{a/} At proposed and negotiated fabrication labor rate of \$4.74 per hour.

CONTRACT DAAA21-72-C-0856
EFFECT OF OVERSTATED FABRICATION LABOR RATE

<u>Part Number</u>	<u>Available Experience</u> ^{a/}		<u>Overstatement of Rate</u>	<u>Amount Overstated</u> ^{b/}
	<u>Hours</u>	<u>Rate</u>		
RP8880005	20.4	\$3.752	\$0.988	\$20.16
RP8880019	55.6	3.609	1.131	62.88
RP8880024	31.8	3.416	1.324	42.10
RP8880028	113.4	3.270	1.470	166.70
RP8880029	33.4	3.503	1.237	41.32
RP8880031	149.4	3.647	1.093	163.29
RP8880032	50.4	3.445	1.295	65.27
RP8880034	121.4	3.227	1.513	183.68
RP8880035	34.8	3.442	1.298	45.17
RP8880046-1)				
RP8880046-2)	50.8	3.661	1.079	54.81
RP8880046-3)				
RP8880046-4)				
RP8880047	49.0	3.293	1.447	70.90
RP8880056	26.6	3.069	1.671	44.45
RP8880058-1)				
RP8880058-2)	68.8	4.600	0.140	9.63
RP8880058-3)				
RP8880059	140.6	3.618	1.122	157.75
RP8880061	20.8	3.921	0.819	17.04
RP8880063	89.2	3.464	1.276	113.82
RP8880067-1)				
RP8880067-2)	26.2	3.238	1.502	39.35
RP8880067-3)				
RP8880067-4)				
RP8880070	<u>19.6</u>	3.872	0.868	<u>17.01</u>
Totals	<u>1,102.2</u>			<u>\$1,315.33</u>

^{a/} These are apparently class B and class C rates. However, Raymond's proposed rate of \$4.74 was based on an estimated rate for class A employees.

^{b/} Available experienced hours multiplied by overstatement of rate.