

DOCUMENT RESUME

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[Pricing of Two Negotiated Noncompetitive Prime Contracts Awarded by the Naval Air Systems Command]. PSAD-77-172; E-168450. October 5, 1977. 6 pp.

Report to Secretary, Department of Defense; by Richard W. Gutmann, Director, Procurement and Systems Acquisition Div.

Issue Area: Federal Procurement of Goods and Services: Reasonableness of Prices Under Negotiated Contracts and Subcontracts (1904).

Contact: Procurement and Systems Acquisition Div.

Budget Function: National Defense: Department of Defense - Procurement & Contracts (058).

Organization Concerned: Department of the Navy: Naval Air Systems Command; McDonnell Douglas Corp.; Hughes Aircraft Co., Culver City, CA.

Congressional Relevance: House Committee on Armed Services; Senate Committee on Armed Services.

Authority: Truth in Negotiations Act (P.L. 87-653). A.S.P.R. 3-807.1(b) (2).

A limited survey was conducted of the pricing of two negotiated noncompetitive prime contracts awarded by the Naval Air Systems Command (NACAIR) during fiscal years 1975 and 1976. The objective of the survey was to determine the extent of compliance with the requirements of the Truth in Negotiations Act and the implementing provisions of the Armed Services Procurement Regulation. This effort was part of a nationwide survey of the Department of Defense noncompetitive prime contracts to determine whether more intensive examinations of the reasonableness of the pricing were warranted.

Findings/Conclusions: Applicable defense procurement procedures were effectively implemented except that: (1) an exemption from the submission of cost or pricing data was granted to one contractor without an adequate determination having been made that the end items had been sold in substantial quantities to the general public to justify the exemption and the reasonableness of the contract price was not established; and (2) contract price negotiations were significantly delayed until a substantial amount of costs had already been incurred or committed. The delay resulted in a large number of updated cost submissions and additional Government evaluations of the cost information. (Author)



UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

03847
PROCUREMENT AND SYSTEMS
ACQUISITION DIVISION

OCT 05 1977

B-168450

The Honorable
The Secretary of Defense

Dear Mr. Secretary:

We have completed a limited survey of the pricing of two negotiated noncompetitive prime contracts awarded by the Naval Air Systems Command (NAVAIR) during fiscal years 1975 and 1976. The objective of the survey was to determine the extent of compliance with the requirements of Public Law 87-653, the Truth-In-Negotiations Act, and the implementing provisions of the Armed Services Procurement Regulation (ASPR). This effort was part of a nationwide survey of Department of Defense noncompetitive prime contracts to determine whether more intensive examinations of the reasonableness of the pricing were warranted.

We found that applicable defense procurement procedures were effectively implemented except that:

- an exemption from the submission of cost or pricing data was granted to one contractor without an adequate determination having been made that the end items had been sold in substantial quantities to the general public to justify the exemption. Accordingly, the reasonableness of the contract price was not established.
- contract price negotiations were significantly delayed until a substantial amount of costs had already been incurred or committed. The delay resulted in a large number of updated cost submissions and additional Government evaluations of the cost information.

NAVAIR comments are included in this report along with our evaluation. These matters are being brought to your attention in the interest of improving the procurement process at NAVAIR.

PSAD-77-172
(950321)

CONTRACT NO0019-75-C-0082

Contract -0082 was awarded in October 1974 to McDonnell Douglas Corporation, Douglas Aircraft Company, Long Beach, California, on a firm fixed-price basis by NAVAIR for \$41,481,000 for six C-9B aircraft. Douglas initially submitted a price proposal on June 25, 1974, for seven C-9B aircraft at a total price of \$46,000,009. On July 2, 1974, Douglas submitted a DD Form 663-7, Claim for Exemption from Submission of Certified Cost or Pricing Data, which constituted its price substantiation for the initial proposal. The basis for the claimed exemption was that the price offered was based on an established market price for a commercial item sold in substantial quantities to the general public.

In justifying the exemption, Douglas stated that the C-9B was a derivative of the DC-9 aircraft which had been in production since 1965 with more than 700 units having been sold to commercial customers. Douglas further stated that the C-9B aircraft was similar to the commercial DC-9 series 30 convertible freighter. Two price quotations to commercial customers dated March and May 1974 for series 30 convertible freighters were listed for comparison to the proposed C-9B unit price. The price quotations amounted to \$6,480,254 and \$6,842,844. After adjustment for additional fuel capacity and general price increase for 1975 delivery, the comparable prices were \$7,166,436 and \$7,550,782 compared with the C-9B proposed unit price of \$6,614,287.

The NAVAIR contracting officer approved the Douglas claimed exemption from submission of cost or pricing data. The contracting officer relied on a price analysis performed by the Naval Plant Representative Office (NAVPRO) administrative contracting officer who considered the claimed exemption valid because DC-9 type aircraft had been sold in substantial quantities to the general public, and that the price quoted to the Navy was lower than prices quoted to commercial customers. The NAVAIR contracting officer also made a comparative analysis with the price of three C-9C aircraft procured on a competitive basis by the Air Force in December 1973.

Prior to the contract award, the quantity of C-9B's was reduced by the Chief of Naval Operations from seven to six. The decrease in quantity resulted in Douglas submitting a revised proposal on September 3, 1974, for six aircraft at a unit price of \$6,913,500 and a total price of \$41,481,000. The contracting officer accepted the higher unit price on the basis that the price was still lower than that quoted to select commercial customers.

Public Law 87-653 provides for exemption from requirements for submission of certified cost or pricing data if the price is based on an established market price of commercial items sold in substantial quantities to the general public. The Armed Services Procurement Regulation 3-807.1(b)(2) provides guidance with respect to the implementation of this exemption. If sales to the general public are less than 35 percent of total sales, an exemption would not normally be granted. To justify the

market price exemption, the item must be identical to the commercial item or so similar that any price differences can be evaluated by price analysis.

Our review of sales data disclosed that Douglas had sold DC-9 series 30 passenger aircraft in substantial quantities to commercial customers. However, Douglas had not sold any DC-9 series 30 convertible freighters to commercial customers for more than 3 years prior to the award of contract -0082. Also, the DC-9 series 30 convertible freighter price quotation identified in the Douglas DD Form 633-7 to substantiate the market price exemption had not resulted in aircraft sales.

The modification of the DC-9 series 30 to a C-9B configuration consists of 99 specification change notices (SCN's). Major SCN's involve (1) installation of a main cabin cargo door, (2) increased load capacity of the floor substructure, (3) increased design and operating weight, (4) convertible cargo/passenger interior, (5) increased fuel capacity, and (6) larger engines. The proposed price of all C-9B SCN's for the six aircraft amounted to about \$6.8 million, or about 16 percent of the value of contract -0082.

We found that sales data did not substantiate the current market price of the SCN's included in the C-9B configuration. A review of DC-9 aircraft sales disclosed that for 10 of the SCN's valued in excess of \$50,000 each, none had been included in DC-9 aircraft sold to commercial customers. Three of the SCN's were similar to those included in aircraft sold to commercial customers for the 3-year period prior to the award of contract -0082. However, less than 10 percent of DC-9 commercial aircraft sales incorporated those similar SCN's.

We do not question the reasonableness of the price of contract -0082 since our survey did not include an analysis of the proposed cost of SCN's. However, we do not believe that the price analysis performed by the contracting officer established the reasonableness of the contract price. We believe that the NAVAIR contracting officer should have requested cost data in support of the proposed SCN prices and obtained a cost analysis of the data. Had the NAVPRO administrative contracting officer reviewed recent sales of DC-9 aircraft similarly configured to the C-9B's and SCN's incorporated into aircraft sold to commercial customers, we do not believe that the claim for exemption would have been approved.

Agency comments and our evaluation

NAVAIR did not agree with our assessment of this procurement. NAVAIR stated that the contracting officer granted the exemption from submission of cost or pricing data only after performing a thorough price analysis. The analysis confirmed that DC-9 aircraft had been sold in substantial quantities to commercial customers and that the base price quoted to the Navy was lower than the prior year commercial sales prices and firm quotations made to commercial customers in 1974. A comparative analysis of the C-9B aircraft price with the Air Force procurement of C-9C aircraft under

competitive conditions indicated the proposed price was fair and reasonable. Also, the proposed prices of SCN's were considered reasonable after a comparison with changes on the C-9C aircraft, previous C-9B procurements, and commercial sales or quotations where similar SCN's were offered.

We found that the \$6.8 million proposed SCN prices were not subjected to an adequate price analysis. The Navy's comparative analysis consisted of adding the proposed SCN prices to the price of the Air Force C-9C aircraft. The resulting figure was compared with the \$5,614,287 proposed unit price for seven C-9B aircraft. In our opinion, the Navy's acceptance of the proposed SCN prices in the comparative analysis in no way established the reasonableness of the SCN prices. The comparative analysis with the previous C-9B procurement was limited to a determination that the proposed price was 34 percent higher. The analysis identified several factors which caused the increase, but did not establish the reasonableness of the price differential. In addition, the comparative analysis of the proposed C-9B price with those quoted to commercial customers was not an adequate basis for the claimed exemption since the quoted prices did not result in actual sales.

In our opinion, the reasonableness of the proposed C-9B prices should have been established through a comparison of the DC-9 series 30 base price plus a cost analysis of the proposed SCN prices.

CONTRACT N00019-75-C-0352

Contract -0352 was awarded in March 1976 to Hughes Aircraft Company, Culver City, California, on a fixed-price incentive basis by NAVAIR. The initial contract award was \$131,500,000 for 87 AWG-9 Weapon Control Systems and six AWM-23 Ground Support Equipment hardware, spares, and related services and material.

The contractor submitted a price proposal dated December 16, 1974, for the contract. Technical evaluations, cost and price analyses, and preaward audits were performed on the contractor's price proposal by the cognizant Air Force Plant Representative Office (AFPRO) and Defense Contract Audit Agency (DCAA) offices. The results of these reviews were furnished to the contracting officer in June 1975 for use in negotiating the contract price. However, the final price negotiations were not completed until February 6, 1976. Incurred contract costs and commitments as of December 26, 1975, were 70.3 percent of the final negotiated cost of \$160.5 million.

The lengthy delay in price negotiations necessitated the submission of considerable updated cost and pricing information to the contracting officer. Between August 1975 and the date of contract negotiations, Hughes submitted 154 separate items of updated information, principally historical data on the fiscal years 1971-1975 programs. The requirement for updated information was principally dictated by the extensive delay in contract negotiations.

We also found that the updated submissions superseded most of the initial AFPRO/DCAA pricing recommendations. Generally, the contracting officer did not rely on the initial AFPRO recommendations in a number of cost areas. Also, the contracting officer requested supplemental DCAA reviews of proposed material attrition costs and updated bill of materials for the AWG-9 system in September 1975 and January 1976. Additional burdens were imposed on contractor personnel in submitting updated cost information, and on agency personnel in performing supplemental evaluations.

We were advised by Hughes officials that untimely negotiations have occurred on prior and subsequent fiscal year procurements of AWG-9 and AWM-23 systems.

In our opinion, more timely negotiations by NAVAIR would have minimized the need for updated cost submission and supplemental Government evaluations.

Agency comments and our evaluation

NAVAIR did not agree with our assessment of this procurement. NAVAIR stated that extensive updated information was required to comply with Public Law 87-653 since the submitted data was a year old at the start of negotiations. In addition, not all of the 154 separate data submissions reflected updates nor were due to the delay in contract negotiations, but rather were necessary supporting information omitted or inadequately stated in the original price proposal.

We found that a majority of the additional data submissions reflected updated costs incurred subsequent to the initial proposal submissions. We recognize that the most timely contract negotiations frequently require updated cost submissions prior to and during negotiations to comply with the requirements of Public Law 87-653. In the case of contract -0352, however, the voluminous updated submissions, supplemental Government data analyses, and significant incurred costs at the date of contract negotiations, did not contribute to the effective use of procurement resources nor to the integrity of the fixed-price form of contracting.

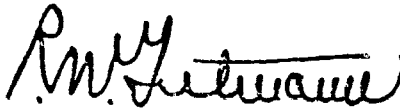
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While we are not making any formal recommendations, your staff may wish to review these matters with senior NAVAIR procurement officials and determine whether the conditions cited herein warrant a broader review of the procurement process, particularly with respect to the timeliness of contract negotiations.

Copies of this report are being sent to the Secretary of the Navy. We are also sending copies to the Senate and House Committees on Appropriations and Armed Services; the House Committee on Government Operations, the Senate Committee on Governmental Affairs, and the Office of Management and Budget.

We would appreciate receiving your comments on these matters and would be pleased to discuss any questions you may have.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "R. W. Gutmann".

R. W. Gutmann
Director