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November 16, 1978

[Review of the Pricing of Purchase Order]

Brigadier General Merton W. Baker, USAF
Headquarters, Air Force Contract Management Division
Kirtland Air Force Base, New Mexico 87117

AGC00773

Dear General Baker:

The General Accounting Office has completed a review of the pricing of Purchase Order R60697 awarded to Hughes Aircraft Company on February 1, 1971, by Bell Helicopter Company under the U.S. Army Aviation Systems Command Contract DAAJ01-74-C-0122. The subcontract was for the initial production of 291 XM65 TOW Missile Subsystems, at a target price of \$80,475,000. The prime contract was awarded on January 31, 1974, at a target price of \$113,800,000. Procurement responsibility for the contract was transferred to the Army Troop Support and Aviation Material Readiness Command (ATSAMRC) on July 1, 1977.

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This subcontract was selected as part of a survey of the reasonableness of the pricing of noncompetitive negotiated subcontracts under Department of Defense prime contracts. Our objective was to determine the reasonableness of the subcontract price in relation to the subcontractor's supporting cost or pricing data, and whether the requirements of Public Law 87-653 were effectively implemented.

We were unable to determine the reasonableness of the pricing of Purchase Order R60697 primarily because Hughes failed to retain certain records used in preparation of the forward pricing rates that were used at the time of the negotiations of the subcontract. As a result, we believe that Hughes was in violation of Defense Acquisition Regulation (DAR) Appendix M, Records Retention Requirements.

Hughes' proposal for Purchase Order R60697 included a material burden rate of 9.0 percent and an Aerospace Group G&A rate of 7.3 percent. The rates had been previously approved for forward pricing by the Air Force Plant Representative (AFPR). Prior to negotiations of the purchase order, Hughes revised its forward pricing material burden rate to 9.7 percent and its Aerospace Group G&A rate to 7.6 percent and requested AFPR approval of the rates. However, the rates were not approved. Hughes revised its purchase order proposal to include the new rates in November 1973. The price for the purchase order was negotiated in December 1973, and according to Hughes' records, included the revised rates.

10/27

During our review of the purchase order we requested the proposals and supporting documents used in preparation of the 9.7 percent material burden rate and the 7.6 percent Aerospace Group G&A rate. Hughes provided us copies of the proposals and attachments that had been submitted to the AFPR for approval. The attachment for the material burden rate, for example, was a 2-page document which listed material receipts forecast by program and material expense forecast by expense category. We were advised by Hughes officials that the documents used to prepare the forecasts for the rates could not be located.

DAR Appendix M requires Hughes to retain and make available to the Department of Defense and the General Accounting Office, any directly pertinent books, documents, papers, and records involving transactions related to the subcontract generally until expiration of three years after final payment under the subcontract. Final payment has not been made. Hughes officials were of the opinion that they met the requirements by retaining the proposals and attachments for the forward pricing rates. They were unaware that they needed to retain the supporting documents. They also expressed concern over the extent of the detailed documentation they needed to retain.

In our view, documentation used in support of forward pricing rates included in contract and subcontract proposals is subject to the provisions of DAR Appendix M, and that Hughes' failure to retain the documentation was a violation of the conditions of Purchase Order R60697. Further, we fail to see how an adequate postaward audit of the subcontract negotiations could be performed without that documentation.

We recommend that you direct the AFPR to meet with Hughes officials to work out an agreement that will satisfy the provisions of DAR Appendix M for future forward pricing rate proposals.

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We are sending copies of this letter to the Commander, AFSAMRC; the AFPR, Hughes Aircraft Company; and the Resident Auditor, Defense Contract Audit Agency, Hughes Aircraft Company.

We would appreciate receiving your comments on this matter.

Sincerely yours,

D. F. Ruggie
for J. T. HALL, JR.
Regional Manager