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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

MISSION ANALYSIS AND
SYSTEMS ACQUISITION DIVISION

MARCH 9, 1981

B-202277

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The Honorable Caspar W. Weinberger
The Secretary of Defense

Attention: Assistant for Audit Reports

Dear Mr. Secretary:

Subject: [Expedited Yearend Contract Award Resulted in Shortcutting Established Regulations and Procedures and Overpricing] (MASAD-81-14)

We have completed a review of contract F 26600-78-C0104 awarded to Martin Marietta Corporation, Denver Division, Denver, Colorado, by the Contracting Division, Tactical Fighter Weapons Center, Nellis Air Force Base, Nevada. This firm-fixed-price contract provides for the procurement of 34 modular instrumentation packages, data, and peripheral equipment to instrument radar threat simulators, and command and control simulators at a negotiated price of $1,047,500. This was a first-time procurement for these items. Subsequent contract modifications provided for additional quantities and increased the contract price to $1,357,755.

Our examination of this contract was part of a nationwide review of the pricing of negotiated noncompetitive contracts awarded at fiscal yearend by the Department of Defense activities. This report is our fourth and final report that resulted from this review.

The objectives of this review were to determine (1) whether contracting officers were following Public Law 87-653 and the Truth-in-Negotiations Act and implementing the Defense Acquisition Regulation in negotiating contract prices and (2) the reasonableness of the contract prices in relation to cost or pricing data available to the contractor at the time of contract negotiations.

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Our review was performed at the contractor's facility, where we reviewed pertinent documents and held discussions with contractor personnel. We also reviewed procurement files and held discussions with personnel at the procurement activity.

Details on the results of our review are included in enclosure I. In summary, we found that the contracting officer, to assure award before fiscal yearend, took several shortcuts in negotiating the contract. Because of these shortcuts

--the contractor's price proposal was incomplete and lacked support for $268,000 of cost;

--the contracting officer failed to request a required revised proposal;

--price proposal reviews were waived; and

--the contract was overpriced by about $104,850 because current, accurate, and complete cost or pricing data was not disclosed.

Accordingly, we recommend that you

--reemphasize to contracting officers the requirement to obtain, evaluate, and use cost or pricing data in negotiating noncompetitive contract prices and

--require the procurement office to establish controls that will preclude future procurement procedure shortcuts.

We also recommend that you have the contracting officer consider the information presented herein, along with any additional information available, to determine if the Government is entitled to a contract price adjustment.

Contractor and agency comments are included as enclosures II and III, respectively. These comments did not provide a basis for materially changing our report or altering our conclusions and recommendations. Our specific responses to the comments are included as enclosure IV.

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We are sending copies of this letter to the President, Martin Marietta Corporation; the Director, Office of

Management and Budget; the Secretary of the Air Force; and the chairmen of the Senate and House Committees on Appropriations and Armed Services, the House Committee on Government Operations, and the Senate Committee on Governmental Affairs.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires that the head of a Federal agency submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

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

Sincerely yours,

W. H. Sheley, Jr.
Director

Enclosures - 4

EXPEDITED YEAREND CONTRACT AWARD RESULTED IN SHORTCUTTING ESTABLISHED REGULATIONS AND PROCEDURES AND IN OVERPRICING MARTIN MARIETTA CONTRACT F 26600-78-C0104

INTRODUCTION

Public Law 87-653 requires that, with certain exceptions, contractors and their subcontractors be required to submit cost or pricing data in support of proposed prices for noncompetitive contracts and contract modifications expected to exceed $100,000. Also, contractors are required to certify, at the time of negotiations, that the data submitted is current, complete, and accurate. A clause is inserted in the contract which gives the Government a right to a price reduction where it is determined that the price was increased because the data submitted was not in accordance with the certification. The Defense Acquisition Regulation (DAR) and the Armed Service Procurement Manual for Contract Pricing (ASPM No. 1) provide procedural guidance to the Department of Defense contracting officers for effective evaluation of contractor proposals, establishment of prenegotiation and negotiation objectives, and negotiations of reasonable price.

Firm-fixed-price contract F 26600-78-C0104 was awarded to Martin Marietta Corporation (MMC) on September 29, 1978, after telephone negotiations during the period September 13, 1978, through September 21, 1978. The Certificate of Current Cost or Pricing Data was executed on September 26, 1978, for data as of September 21, 1978. The contractor's proposal was not subjected to cost or technical evaluation.

The Government's Request for Proposal, sent to the contractor on August 11, 1978, called for the award of a requirements contract with an initial order quantity of 25 modular instrumentation packages. However, subsequent requirements for increased quantities and different configurations prompted the negotiations and award of a firm-fixed-price contract to obtain the maximum units with the funds available.

To avoid the loss of about $714,000 in obligation authority, the contracting officer took substantial shortcuts and did not comply with DAR procedures normally required for procurements of this type. The shortcuts taken may have contributed to overpricing of about $105,000.

ACQUISITION PROCEDURE SHORTCUTS

The contracting officer took the following shortcuts in evaluating the contractor's proposal and negotiating the contract price:

--Did not obtain a complete proposal from the contractor.

--Did not request or obtain revised cost or pricing data where such appeared to be appropriate.

--Did not request or obtain field pricing support or establish a formal negotiation plan or Government price objective.

Instead, the contracting officer used the contractor's incomplete initial proposal as a benchmark for pricing and used a 1-year old unsolicited proposal (from a different division of the contractor) for price comparison.

Incomplete proposal

The contractor's proposal accepted by the contracting officer was incomplete because it did not

--explain the estimating method and bases for the proposed price and

--provide support for equipment which was proposed at a cost of $268,000.

MMC provided the contracting officer a price proposal, dated September 8, 1978, for an initial order quantity of 25 units for $633,650 and various follow-on order options. This proposal was, in essence, a unit pricing proposal with no additional cost or pricing data included. Contractor representatives subsequently hand-carried a revised proposal (dated September 12, 1978) to a contract negotiation session held at Nellis Air Force Base on September 13, 1978. However, this revised proposal was only for the initial and follow-on option quantities of the basic units only. Furthermore, the proposals that were provided were not accompanied by written support describing the estimating methodology, the basis used to arrive at proposed prices, or written identification concerning where this information could be found. We found no evidence that such data was ever provided to the

Air Force. The contract was negotiated for 34 Modular Instrumentation Systems (MIPS) at $1,047,500.

DAR 3-807.3 (a) states:

> "The contracting officer shall require the contractor to submit, either actually or by specific identification in writing, cost or pricing data in accordance with 16-206 and to certify, * * * the cost or pricing data he submitted was accurate, complete, and current * * *."

DAR 3-807.3 (i) further stipulates:

> "The requirement for submission of cost or pricing data is met when all accurate cost or pricing data reasonably available * * * to the contractor at the time of agreement on price is submitted, either actually or by specific identification in writing to the contracting officer or his representative. * * *"

Instructions to offerors for completing DD Form 633-4 (contract proposal) in part provide:

> "2. As part of the specific information required by this form, the offeror must submit with this form, and clearly identify as such, cost or pricing data * * *."

Also, he must submit with this form any information reasonably required to explain the offeror's estimating process, including:

> "a. The judgmental factors applied and the mathematical or other methods used in the estimate including those used in projecting from known data, and
>
> "b. The contingencies used by offeror in his proposed price."

Further, we found no evidence that DD Forms 633-4 for peripheral equipment, valued at about $268,000, were ever requested or provided.

<u>Failure to obtain a revised proposal</u>

Because of limited time for awarding a contract, the contracting officer did not request or obtain a revised proposal even though the originally contemplated contract type and unit quantities had been substantially changed.

The DAR stipulates that where there are substantial changes in the Government's requirements or modification in scope, the initial solicitation should be canceled and a new one issued. Such action would require a request for a revised proposal.

Because the Air Force anticipated recurring requirements, a requirements contract to allow ordering over a 12-month period was established. Subsequent to receiving the contractor's proposal, the contracting officer changed his objective from awarding a requirements contract to obtaining the maximum units for the available dollars. He changed his objective because of changed requirements (configuration mix and quantities). As a result, he negotiated a firm-fixed-price, definite quantity contract for 34 units plus a short-term option for a fixed-price quantity that was considered a known requirement. The negotiations were conducted without the benefit of a revised contractor proposal. Instead, the contracting officer used the contractor's initial proposal as a benchmark for pricing even though the quantities had increased, the configuration mix had changed, and a firm-fixed-price contract was used instead of a requirement contract.

We believe the changed conditions existing before negotiations were substantial enough to require the request for a new proposal, especially when considering the incompleteness of the contractor's first proposal.

Price proposal reviews waived

Because of the short period allowed for the award of the contract, the contracting officer did not comply with preaward procedures required by DAR. He did not require price/cost analysis and audit nor did he establish a Government price objective.

The contracting office received the purchase request on August 2, 1978, which called for the award of a contract not later than September 30, 1978. Upon receipt of the request, the assigned buyer established a preliminary procurement plan with an estimated leadtime requirement of 4 months. It was recognized that in order to award the contract by September 30, the plan would need to be compressed by 2 months. Thus several preaward procedures including field pricing support, specifically price/cost analysis and audit, were eliminated.

The plan was approved by the contracting officer on August 7, 1978. On September 15, 1978, the contracting officer officially waived the requirement for field pricing support.

Instead of obtaining field pricing support and establishing a Government price objective, the contracting officer used purchase request estimates that were based on an unsolicited 1-year old proposal from MMC's Orlando Division (not the Denver Division). This proposal had not been audited. Also, it was for items which were not comparable to those being contemplated for the current procurement, and no purchases were made as a result of that proposal.

Since this was the first time these items were being purchased and because of the incompleteness of the contractor's proposal, we believe the (1) contracting officer could not have established an adequate negotiation plan or Government price objective without field pricing support and (2) price/cost analysis and audit were inappropriately waived.

DAR 3-801.2 (a) stipulates:

> "* * * The contracting officer shall avail himself of all appropriate organizational tools such as the advice of specialists in the fields of contracting, finance, law, contract audit, packaging, engineering, traffic management, and price analysis."

DAR 3-801.5 (b) (1) further requires:

> "Prior to negotiation of a contract or modification resulting from a proposal in excess of $100,000 for firm fixed price and * * * when the price is based on cost or pricing data (3-807.3) submitted by the contractor, the contracting officer or his authorized representative shall request a field pricing support report (which includes an audit review by the contract audit activity) * * *."

Pricing guidance included in the ASPM No. 1 provides that a conclusion concerning the reasonableness of price must be based on some form of analysis, either price or a combination of cost and price analysis. It goes on to say that price analysis is made by using past prices, quantities, delivery rates, and similar noncost information. It further provides that for procurements over $100,000, cost or pricing data will be required from the would-be seller and cost analysis will be performed except in specific circumstances. The reason provided is that cost analysis provides a means for viewing the estimating methods and assumptions used by the contractor and for evaluating whether these anticipate the normal efficiencies you would expect to find in a price competitive environment.

OVERPRICING

Contract F 26600-78-C0104 was overpriced by $104,850 because MMC did not disclose current, complete, and accurate cost or pricing data. The overpricing and its effect on contract cost, profit, and price is shown below.

	Contract overpricing		
	Cost	Profit	Price
Overpricing due to use of manufacturing overhead rate that improperly included 1,441 hours of other technical services direct labor	$11,159	$ 1,451	$ 12,610
Overpricing due to inclusion of unsupported contingency for delivery schedule risk	5,670	737	6,407
Overpricing due to inclusion of an undisclosed and unsupported 10-percent flat rate contingency on all contract items except peripheral equipment	70,902	9,217	80,119
Overpricing due to estimating errors in material prices	5,057	657	5,714
Total	$92,788	$12,062	$104,850

Application of incorrect overhead rate

MMC's proposed prices were overpriced by $12,610 (including add-ons) because 1,441 hours of other technical services labor were erroneously included as manufacturing quality control labor; consequently, a higher than warranted overhead rate was applied. The direct quality labor effort for the 34-unit buy was estimated at 1,993 hours, and the manufacturing overhead rate of 172.36 percent was applied. However, 1,441 hours for program planning and test inspection were included in manufacturing overhead but should have been included as other technical services and priced with the engineering overhead rate of 101.5 percent. The effect was to overprice total overhead, general administrative expense, and profit.

MMC officials stated that the estimator failed to check department numbers against the cost distribution manual to verify the correct class of cost and overhead. As a result, the estimate inadvertently included all quality effort as a manufacturing class of cost subject to the manufacturing overhead rate.

Unsupported contingencies

The contractor's proposed prices were overpriced by $86,526 because they included two unsupported contingencies: schedule risk ($6,407) and management reserve ($80,119). These contingencies were included in the proposed unit prices as part of the several elements of cost and were not disclosed separately. Even though contingencies of this nature are not a normal part of the contractor's estimating system, MMC did not provide the contracting officer with documentation disclosing the amount, description, or supporting information. Further, we found no evidence that these contingencies were specific subjects of negotiations.

The ASPM No. 1 provides that the existence of performance uncertainties does not, in itself, preclude negotiation of a pricing arrangement that imposes significant cost responsibility upon a contractor. What is important is the ability to analyze and agree upon what the uncertainties are, the likelihood of their happening during performance, and the possible effect on costs if they do occur.

Schedule risk

The contractor's proposed price was overpriced by $6,407 (including add-ons) because it included an undisclosed and unsupported contingency for a revised delivery schedule.

We found that $270 of unit cost (on 21 units) for production costs was not supported with cost or pricing data. Contractor personnel said that the $270 per unit was for additional risk due to a revised delivery schedule on five units. The contractor did not provide any supporting data for including the schedule risk contingency in the unit cost and he did not disclose, in writing, the contingency to the contracting officer. There was no evidence showing that this contingency was the specific subject of negotiation.

Management reserve

MMC's proposed price was overpriced by $80,119 because it included a "management reserve" contingency calculated as a flat percentage (10 percent) of recurring and nonrecurring costs added to total proposed costs. The contractor did not provide the contracting officer with cost or pricing data disclosing the amount, description, or supporting calculations and information concerning the contingency. Also, there was no evidence showing that this contingency was the specific subject of negotiation. The $80,119 includes $70,902 for contingency and $9,217 profit at 13 percent.

We found no evidence that information concerning the 10-percent contingency had been disclosed to the contracting officer or that the contingency was the specific subject of negotiation. Further, we believe that if a flat rate contingency of this nature deserves any consideration it must be separately disclosed and subjected to independent negotiation such as described in DAR 15-205.7 (c) (ii).

Materials

We reviewed the pricing of 40 parts, about 20 percent of the 207 parts included on the contractor's bill of materials, and found that 4 parts were overpriced by $5,714. The bill of materials was developed in June 1978 for a 15-unit buy anticipated by the contractor. Because of insufficient time allowed for developing a proposal in response to the Air Force August 1978 Request for Proposal, the contractor used the outdated bill of materials as his base for the materials cost estimate.

The four parts, the reasons for overpricing, and the amount of overpricing are identified on the following page.

Part number	As priced	Correct price	Over-pricing	Estimated quantity	Total overpricing
SN74LSO4N	$ .67	$ .19	$ .48	629	$ 301.92
JMT-233	4.05	2.59	1.46	35	51.10
TMS-27LO8JL	37.37	27.05	10.32	351	3,622.32
M39003/01-2257	.93	.42	.51	184	93.84
Subtotal					4,069.18
Materials variance rate (7%)					284.84
					4,354.02
General and administrative expense (16.136%)					702.56
					5,056.58
Profit (13%)					657.36
Total materials overpricing					$5,713.94

Part number SN74LSO4N was overpriced because the contractor's estimator used the purchase order price of a different part number (SN74LSO4N2). The price of the correct number was available but not used.

Part number JMT-233 was overpriced because the contractor's estimator used the catalog price for a quantity of one instead of using the catalog price for quantities over nine.

Part number TMS-27LO8JL was overpriced because the estimator used a 15-month old catalog price instead of a current quotation. The MMC material manual requires estimators to obtain current prices, but in this case he failed to do so. The correct price of $27.05 shown is the manufacturer's best estimate of the June 1978 price as compared to the $37.37 price used.

Part number M39003/01-2257 was overpriced because the estimator used the average catalog price for two different parts instead of the catalog price for this part. The price of this part was available but not used.

CONCLUSIONS AND RECOMMENDATIONS

We concluded that to avoid the loss of obligation authority due to expire at yearend, the contracting officer took substantial procurement procedure shortcuts and did not follow Public Law 87-653 and the implementing DAR for negotiating contract prices. Also, we concluded that the contract was overpriced by about $105,000 because the contractor did not provide current, complete, and accurate cost or pricing data. Had the shortcuts not been taken, there is a high probability that the overpricing would have been identified during the omitted field pricing reviews.

We recommend that you

--reemphasize to contracting officers the requirement to obtain, evaluate, and use pricing data in negotiating noncompetitive contract prices and

--require that the procurement office establish controls that will preclude future procurement procedure shortcuts.

We also recommend that you have the contracting officer consider the information presented herein, along with any additional information available, to determine if the Government is entitled to a contract price adjustment.

MARTIN MARIETTA AEROSPACE

DENVER DIVISION
POST OFFICE BOX 179
DENVER, COLORADO 80201
TELEPHONE (303) 973-3000

16 June 1980

Refer to: 80-Y-15205

To: U. S. General Accounting Office
2420 West 26th Avenue
Denver, Colorado 80211

Attn: Mr. Charles Goetz
Supervisory GAO Auditor

Subj: GAO Review of Contract F26600-78-C-0104, Modular Instrumentation Packages

1. We appreciate the opportunity to review the subject report and offer the following comments thereto:

   (1) The conclusions stated with respect to "Acquisition Procedure Shortcuts" are not supported by the facts. Although the conclusions are primarily directed towards activities of the Contracting Officer, Martin Marietta submitted a complete model contract, technical proposal, cost proposal and the appropriate certifications.

   (2) The conclusion that a "piece meal" proposal ultimately led to negotiation of an incomplete proposal is also not supported by the facts. As stated in the report appropriate DD Forms 633-4 were provided during fact-finding. The only forms not submitted related to the peripheral equipment. However, the price of such equipment has been tested and established in the commercial market place. These facts were stated in the proposal and available to the GAO auditors during their investigation.

   (3) The allegation that the proposal "was not prepared in accordance with their (Martin Marietta Corporation) usual proposal standards" is unfounded. The proposal preparation was in accordance with company estimating standards. We understand that the draft GAO report will be revised accordingly.

ENCLOSURE II

Refer to: 80-Y-15205
Page 2

(4) Concerning the "failure" of the Contracting Officer to obtain a revised proposal. This allegation can best be responded to by the contracting officer. However, the justification supporting the allegation seems highly judgmental in view of the extent of the actual changes experienced. The objective of the negotiation process is one of compromise and change. It is curious that in hind-sight the investigators applied a standard different from those of the contracting officer.

(5) Concerning "Overpricing". The statement that an estimate inadvertently included all quality effort as a manufacturing class of cost is accurate.

(6) Concerning "Unsupported Contingencies". The fundamental policy of fixed price contracting is to encourage contractor efficiency. Martin Marietta did in fact disclose the contingencies during the negotiation and agreement was reached thereon. The report seems to rely upon an assumption that the units being procured are priced like commercial products or commodities with a price that is fairly certain, and concludes that any amount over the assumed price is, in fact, defective pricing. Such assumption would penalize Martin Marietta for good performance under the contract. Through our response to Log Item 009, we provided the rationale to mitigate the risks we foresaw with the solicitation. The fact that Martin Marietta Denver had never produced these units presented a position of considerable risk on a fixed price contract. Since the design and testing was not complete, a substantial amount of non-recurring effort was to be undertaken which is sufficient reason for a more pessimistic estimate. To mitigate the risk associated with redesign, fabrication problems, test failures, vendor rework and material procurement schedule delays, the estimates were increased. In a fact-finding telephone conversation with the customer, Martin Marietta and the customer agreed that contingency pricing was appropriate on a fixed price contract. This data was essentially the same as provided to the buyer via telephone conversation on September 21, 1978 by R. S. Shepler of Martin Marietta. These contingencies were again revealed to the buyer and discussed during the fact-finding and during the final agreement on the price. As a consequence, the proposed profit was reduced by 2% with the agreement that the contingencies would be retained. Martin Marietta did disclose to the Contracting Officer accurate, complete and current pricing information including supporting calculations for the associated risk.

(7) Concerning "Materials". The requirement is to submit accurate, complete and current cost or pricing data as of the date agreement is reached and negotiations are concluded, and certainly does not impose an obligation on the contractor to accurately forecast the future upon completion of the contract. It is true that the estimate was prepared from an advanced bill of material, and that during

 ENCLOSURE II

Refer to: 80-Y-15205
Page 3

performance of the contract the material list changed insignificantly. There were both increases and decreases. However, at the required time the cost and pricing data was appropriately certified and was in fact accurate, complete and current.

2. Should you have any further questions, contact T. R. Callan, extension 7431, Mail No. D2400.

Very truly yours,

MARTIN MARIETTA CORPORATION

Thomas R. Callan
Director of Contracts

 ENCLOSURE III

DEPARTMENT OF THE AIR FORCE
HEADQUARTERS TACTICAL AIR COMMAND
LANGLEY AIR FORCE BASE, VA 23665

13 JUN 1980

REPLY TO ATTN OF: AC

SUBJECT: Contract F26600-78-C0104, GAO Proposed Report to the Secretary of Defense

TO: U.S. General Accounting Office
ATTN: Mr Charles M. Goetz
Suite 300-D
2420 West 26th Avenue
Denver CO 80211

1. The Tactical Fighter Weapons Center response to your proposed report is attached.

2. Nellis did not send the response direct to you because Air Force policy requires the major air command review it first.

3. If you need further assistance, our focal point for audits in TAC is Capt Koski, (804) 764-4223.

A. M. D'Arcangelo

ARCANGELO M. D'ARCANGELO, COL, USAF
Asst Deputy Chief of Staff, Comptroller

Readiness is our Profession

 ENCLOSURE III

DEPARTMENT OF THE AIR FORCE
HEADQUARTERS, USAF TACTICAL FIGHTER WEAPONS CENTER (TAC)
NELLIS AIR FORCE BASE, NV 89191

OFFICE OF THE COMMANDER

6 JUN 1980

SUBJECT: Contract F26600-78-C0104, GAO Proposed Report to the Secretary of Defense

TO: HQ TAC/ACF

1. The following responses are provided to findings included in GAO draft report:

a. FINDING #1: The Contracting Officer did not obtain a complete proposal from the Contractor.

(1) Initial submission of Martin Marietta Corporation (MMC) Proposal number P78-63493-3 was received by the contracting office on 8 Sep 78. The proposal due date had been extended to 3:00 PM (PT) 12 Sep 78 by the Contracting Officer. The initial submission did not include the DD Form 633 or necessary backup. On 11 Sep 78 the buyer called MMC and requested the DD Forms 633, a list of materials and a detailed breakout of the estimated labor hours. The requested documentation was delivered to the buyer on 13 Sep 78.

(2) The additional data delivered did not include DD Forms 633 for the peripheral equipment (ultimately awarded at $159,786). The peripheral equipment consisted of four units of commercially available off-the-shelf equipment. MMC was requested to and provided the Estimated Cost Analysis (ECA) sheet for the most expensive peripheral, the tape recorder.

(3) This document is normally used backup data for the DD Form 633 by MMC. A review of the vendor quote to MMC and the ECA sheet established the estimating methodology.

b. FINDING #2: The Contracting Officer did not request or obtain revised cost or pricing data.

(1) The quantity changes were as follows:

DESCRIPTION	INITIAL ORDER QUANTITY	CONTRACT QUANTITY
MIPS-SCU	1	0
MIPS-RIU(OPT1)	1	0
MIPS-MIN(OPT1)	18	21
MIPS-MIN(OPT2)	1	0
MIPS-S	0	1
MIPS-T	2	2
MIPS-B	2	10
TOTAL	25	34

Readiness is our Profession

Contract F26600-78-C0104, GAO Proposed Report to the Secretary of Defense, con't.

Considering the technical differences among the configurations deleted and the configurations increased, this was not considered a substantial change in the Government's requirement.

(2) The solicitation contemplated a Requirements type contract with a specified initial quantity. In essence, this would have been a firm fixed price contract for the initial quantity with ordering provisions for future quantities at a fixed price. The actual award was made on a firm fixed price basis with a short term, fixed price option for a single configuration. The only difference in contract type was the future ordering provisions, and; therefore, was not considered a substantial change.

(3) The contractor's proposal did in fact provide prices for quantities specified in the initial order. In addition, the proposal did include pricing for the future quantities in the range of 6-10 each.

c. FINDING #3: The Contracting Officer did not obtain or request field pricing support.

(1) The contractor's technical proposal submitted on 8 Sep 78 was evaluated on 10 Sep 78. The evaluation team consisted of two Engineers from TFWC Range Group, one Engineer from the Electronic Warfare During Close Air Support (EWCAS) Joint Test Force and the buyer (who holds a degree in Engineering and has seven years production experience). After MMC submitted the additional documentation on 13 Sep 78 requested by the Contracting Office, this same group reviewed the data and provided specific inputs which were used during negotiations.

(2) A Price Analysis Report, Martin Marietta Corp, Denver Division (Case #780184 dtd 1 Sep 78) had recently been received in the Contracting Office. This report included an audit report (No. 7501-21-8-0222 dated 30 Aug 78) which stated that proposed labor rates were established on a historical basis and the escalation factor used was appropriate. Further, the report stated all overhead, G&A and CAS 414 rates used were in accord with the Forward Pricing Rates effective 17 Jul 78.

(3) The Contracting Officer's decision to waive Field Pricing support was based on 1) the fact that the proposed rates were accepted Forward Pricing Rates, 2) a thorough technical review had been accomplished by competent engineering personnel and 3) the buyer had reviewed the backup data for selected items from the list of materials to determine the basis of the estimate. The review of items from the list of materials included vendor quotes, previous purchases and catalog prices. These factors were considered sufficient to support the decision to waive Field Pricing support as outlined in DAR 3-801.5(b).

2. The following comments are provided in response to your discussion concerning overpricing:

a. Application of incorrect overhead rate.

Your letter states MMC officials have acknowledged the estimate inadvertently included all quality effort as a manufacturing cost subject to

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Contract F26600-78-C0104, GAO Proposed Report to the Secretary of Defense, con'td

the higher overhead rate. Therefore, the only remaining area to be established would be the number of hours to which the incorrect overhead rate was applied.

b. Unsupported contingency for schedule risk.

(1) The EWCAS JTF testing and equipment interface requirements resulted in a request to have five units of CLIN 0004, MIPS-MIN(OPT 1) delivered on or before 1 May 79. Considering the anticipated leadtime associated with obtaining necessary Printed Circuit Boards (PCB), MMC offered to provide the initial five units by 1 May 79, but with wire wrapped boards rather than PCBs.

(2) The additional costs associated with this production technique over the PCBs result from the additional direct labor effort required and the higher probability of rejection and necessary rework. Rather than separately identifying these unique units, the contracting office requested the additional costs be allocated over all 21 units.

c. Unsupported contingency for "management reserve."

(1) The "management reserve" was included in the initial proposal and was identified during negotiation. This was the first production buy of a unit that previously only existed in breadboard form.

(2) During negotiations it was determined that the "management reserve" was an estimating factor which included any necessary redesign required to correct electrical or mechanical difficulties and rework or replacement of rejected items which can logically be anticipated during the initial production of any complex piece of equipment. However, we do not agree that the final price includes a 10 percent "management reserve." During negotiations this element was identified, and it was pointed out that the Air Force considered this to be excessive. Following this discussion MMC proposed lower unit prices on the configurations to be purchased. The primary area of difficulty here was inadequate documentation in the Price Negotiation Memorandum.

d. Materials. The buyer requested and MMC provided documentation of the basis of estimate on ten specific items. These included vendor quotes, catalog prices, and previous purchases. Estimated prices were comparable to information available in the contracting office on similar equipment purchases. It is interesting to note, this office has been advised on an after-the-fact basis that some required items were not included in the original estimate, specifically, some cable sets. No additional consideration was requested or provided as a result of these omissions.

3. The GAO report highlights some deficiencies in documenting the negotiation process. This office is aware of the need to continually improve efforts in this area and will continue to emphasize the same.

JAMES N. MCCLELLAND, Colonel, USAF
Vice Commander

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OUR REPLY

TO CONTRACTOR AND AGENCY COMMENTS

REPLY TO CONTRACTOR COMMENTS

As a result of Martin Marietta's response, paragraph 1.(3), we have revised our report to eliminate reference to Martin Marietta officials stating that their proposal was not prepared in accordance with their usual proposal standards. In their response (paragraph 1.(6) "Unsupported Contingencies") Martin Marietta contends that their proposed profit was reduced by 2 percent with an agreement that contingencies would be retained. They also stipulate that supporting calculations for the associated risk (contingencies) were disclosed to the contracting officer. We found no documentation, nor was Martin Marietta able to provide any documentation, that supports these stipulations. The remainder of the contractor's response disagrees with our conclusions but does not introduce new factual material sufficient to warrant altering our conclusions or recommendations.

REPLY TO AIR FORCE COMMENTS

The Air Force has not disagreed with the factual data presented in our report; however, it appears to disagree with our conclusions, and we view its response as an attempt to further explain its position in support of its actions.

Finding 1, incomplete proposal

The Air Force does not disagree with the facts presented in our report. However, it stipulates that upon its request, the contractor provided a list of materials and a detailed breakout of estimated labor hours. Also, it stated that the peripheral equipment was commercially available off-the-shelf equipment and that the contractor provided an Estimated Cost Analysis sheet as backup data for the most expensive peripheral. The Air Force response implies that the list of materials and labor hour breakout was sufficient to constitute a complete proposal, and since the peripheral equipment was off-the-shelf, the absence of DD Form 633 and supporting cost or pricing data were of no consequence. We disagree because:

--The list of materials referred to constituted only 14 of about 207 parts, and at no time did the Air Force receive a complete bill of materials summarizing the part numbers, quantities, and prices.

--The detailed breakout of estimated labor hours referred to is in matrix format for line items and is essentially the same as provided on the DD Form 633. It does not provide or identify the basis or methodology used in developing labor hours and proposed prices.

--The contractor did provide an Estimated Cost Analysis sheet on one of the peripheral equipment items; however, that item (a dual-drive tape recorder) exceeded the Air Force requirements and was not purchased. Instead, a less expensive, single-drive recorder was purchased, and we found no evidence that any written cost or pricing data was provided. Furthermore, the contractor's Estimated Cost Analysis sheets contain essentially the same data as included in DD Forms 633 and do not provide the basis or methodology used in developing proposed prices.

--We found no data which provides evidence that an exemption from cost or pricing data had been granted for peripheral equipment or that the contracting officer had made a determination that the price was based on an established catalogue or market price of commercial items sold in substantial quantities to the general public as required by DAR.

Finding 2, failure to request and obtain revised cost or pricing data (revised proposal)

The Air Force does not disagree with the facts presented in our report; however, its response implies disagreement with our conclusion that changed conditions were significant enough to require a revised proposal.

The customer requirement, which initiated the Request for Proposal for a requirements contract, assumed that the contractor had conceived, designed, developed, and built (in the form of a prototype) a MIPS meeting the customer requirements. However, the contractor had only a preliminary design and only a breadboard unit had been developed. A substantial amount of design effort and construction and test of a prototype was necessary before manufacturing deliverable units. It should also be noted that the only DD Form 633 provided to the Air Force was for 25 various MIPS totaling $633,650, while the negotiated contract price was $1,047,500.

We believe the contracting officer should have required a revised proposal upon becoming aware of the circumstances surrounding the development of MIPS, the change in contract type, and the contractor's unacceptable "worst case basis" pricing for option quantities. The Air Force response does not alter our conclusion.

Finding 3, field pricing support

The Air Force response attempts to provide additional detail on the same three reasons provided in their September 15, 1978, memorandum of field pricing support waiver. It ignores the file documentation showing that field pricing support was omitted from the preliminary and final procurement plans to permit compression of the normal leadtime to meet the September 30, 1978, award date (the last day for obligating about $714,000).

The audit report (No. 7501-21-8-0222) referred to by the Air Force was an audit of Martin Marietta's proposal for Engineering Operations and Maintenance Support at Nellis Air Force Base and is unrelated to MIPS production. Further, the audit report stipulated that

--the proposal was not considered an acceptable basis for negotiation of a price;

--the audit was conducted without benefit of a technical review;

--cost or pricing data was not adequate in all respects; and

--the proposal was not, in all respects, prepared in accordance with applicable Cost Accounting Standards or DAR sections 2 and 15.

The Air Force response stipulates that the audit report stated that proposed labor rates were established on a historical basis and the escalation factor was appropriate; thus, implying that the conclusion could be directly transferred to labor rates used for the MIPS proposal. However, the proposed direct labor rates were for plant-wide actual rates escalated at 6.1 percent annually. For the MIPS proposal, the contractor used a combination of July and August 1978 unaudited actuals for named individuals and departmental average rates escalated to contract midpoint using various factors.

The Air Force also states that the field pricing support waiver was based on (1) the fact that forward pricing rates were accepted, (2) a thorough technical review was made, and (3) the buyer's review of backup data was made on selected items of material. During our review we noted that:

--The accepted (approved) forward pricing rates exclude direct labor.

--The technical review accomplished concerned the contractor's technical proposal dealing with product specifications and functions as opposed to technical acceptability of proposed labor hours, materials, and production methods (no plant visits were made by representatives of the contracting officer).

--The buyer reviewed pricing support for only 14 of about 207 parts and had not received a priced bill of materials from the contractor. Prices for the 14 items were based on an anticipated buy of 15 MIPS, as contrasted to the Request for Proposal requirement of 25 and the 34 MIPS contracted for.

The Air Force response does not alter our conclusion.

Overpricing

The Air Force in their response 2.b(2), implies that the schedule risk contingency was discussed and agreed upon during negotiations. Also, in their reply 2.c.(1) they stipulate that the management reserve was included in the initial proposal and was identified during negotiations. We found no documentation, nor was Nellis Air Force Base able to provide any documentation, that supports these contentions.