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# GAO Pricing Reviews at Selected Subcontractor Locations

Statement of
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Before the
Subcommittee on Legislation and National Security of the Committee on Government Operations
United States House of Representatives


Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before the Subcommittee to discuss the results of GAO's pricing reviews at selected defense subcontractors. We reviewed the pricing of selected elements of 9 subcontracts at 6 defense subcontractors, focusing on subcontractors' compliance with the Truth in Negotiations Act (Public Law 87-653). Although these subcontracts were awarded between April 1982 and November 1985, most are still active.

We found problems in all 9 subcontracts. We believe the prices of eight subcontracts, which were included in the prime contract prices ultimately paid by the government, may have been overstated by as much as $5.2 million because subcontractors did not disclose accurate, complete and current cost or pricing data to prime contractors. In one instance, when subcontractor personnel did not provide the prime contractor complete access to certain records, the subcontractor included unallowable costs in the price paid by the prime contractor and ultimately by the government. The subcontractors we visited and the amounts of the potential overstatement associated with each are shown in attachment I.

## THE TRUTH IN NEGOTIATIONS ACT

In fiscal year 1986, noncompetitive prime contracts awarded by DOD totaled $82 billion. About 50 percent of the prime contract

dollars, or $41 billion, are subcontracted to first tier subcontractors. The price proposals submitted by subcontractors to prime contractors therefore play a critical role in establishing the prices paid by the government. Subcontracts negotiated on price proposals that exceed a reasonable approximation of the ultimate cost of performance may result in unjustified gains or enrichment at the expense of the government.

Recognizing the government's vulnerability in negotiating noncompetitive contract prices, the Congress passed the Truth in Negotiations Act in 1962. The Act requires contractors and subcontractors to submit cost or pricing data to support certain noncompetitive price proposals and to certify that the data submitted are accurate, complete, and current. It also provides for price reductions if it is later found that any defective data in proposals significantly increased the contract price.

In passing the Act, Congress sought to place the government on an equal footing -- an informational parity -- with contractors and subcontractors. During negotiations, government contracting officers should have knowledge of all facts affecting the pricing of the contract to ensure reasonable prices are negotiated.

Subcontractors, covered by the act, are required to provide cost or pricing data in support of their proposals to prime contractors. The Federal Acquisition Regulation requires prime

contractors to perform cost or price analysis of subcontractor proposals. The prime contractors are also responsible for analyzing updated information to support subcontractors' original proposals. Thus, the government relies on prime contractors to insure fair and reasonable subcontract prices.

## FURNISHING DATA IN COMPLIANCE WITH THE TRUTH IN NEGOTIATIONS ACT

Our work showed that subcontractors did not always provide pertinent and timely cost or pricing data. In fact, in eight of the nine subcontracts we reviewed, we found subcontractors had information that indicated lower prices were available than those disclosed to prime contractors. For example, we found that subcontractors did not disclose more current vendor price quotations or purchase order data, changes in make or buy decisions, and documentation indicating lower prices. We believe the nondisclosure of such data caused prices to be overstated by about $5.2 million. If prime contractors had the data, we believe they would have had a sound basis for negotiating lower subcontract prices.

For example, at Sundstrand Data Control, Inc.,(Sundstrand), a subcontractor to Boeing, we examined the pricing of 2 subcontracts for offensive avionics on the B-1B and the B-52. Sundstrand's proposals were overstated by $1 million when add-ons are considered. The overpricing on one of the subcontracts

resulted because Sundstrand did not disclose to Boeing

-- its decision to buy two parts from a vendor at lower prices, rather than making the parts; and

-- a one-page document that showed amounts by which purchase order prices were lower than prior disclosed quotes.

On the other subcontract, overpricing occurred because Sundstrand

-- used higher-priced quotations for parts when it had already issued lower-priced purchase orders;

-- proposed prices that did not reflect available quantity discounts; and

-- used higher-priced quotations when it had less costly quotations available.

In addition, Sundstrand charged Boeing, and in turn the government, twice for one part. The duplicate charges involved the B-1B and totaled $177,055. Sundstrand agreed that in some instances it did not provide complete, current, and accurate cost or pricing data to Boeing. It attributed some of the failure to disclose accurate data to its manual estimating system which is currently being automated. Sundstrand noted, however, that

extensive fact finding will have to be conducted with Boeing and the Defense Contract Audit Agency (DCAA) before agreement on liability is reached. Sundstrand stated once agreement is reached any monies due will be paid.

In another example, we examined the pricing of 18 parts that accounted for 68.9 percent of the total production material proposed by Loral Systems Group to Martin Marietta Orlando Aerospace. The prime contract was awarded by the Army to Martin Marietta for Perishing II missiles. We found the prices of 14 of the 18 parts to be inaccurate. Of the 14 inaccurate prices, 9 were overstated and 5 understated resulting in a net overstatement of $622,330. The understatements resulted because Loral had information indicating that it should have proposed higher prices for the 5 understated parts. The overpricing occurred because Loral did not disclose to Martin Marietta that it had negotiated firm prices on some parts; had obtained more current quotes on others; and had established lower target prices for quotes it considered excessive.

Loral does not agree with the results of our review. Loral officials stated that a settlement offer was made during subcontract negotiations with Martin Marietta, and this settlement offer included a reduced price for one of the major parts in question. Loral officials initially stated that documentation on the negotiations with Martin Marietta had been

lost or destroyed. However, Loral subsequently located the records. Our review of these documents did not disclose evidence of a reduced offer. Nevertheless, we also reviewed Martin Marietta's records of negotiations, and these records did not show that an adjustment or offer was made. Martin Marietta personnel confirmed there was nothing in their records to support Loral's contention nor could they recall such an offer being made. We concluded, therefore, that Loral did not furnish accurate, complete, or current information and that its proposal was overstated.

In another example, we reviewed two subcontract proposals at United Technologies Corporation's Chemical Systems Division. Chemical Systems Division is a subcontractor to Boeing for production of solid rocket motors. Chemical Systems Division's prices were overstated by about $2.1 million because it did not disclose accurate information on quotations obtained from its vendors. In three cases, these quotations were lower than the prices included in the proposal to Boeing. In one case, the quote was higher.

In addition, Chemical Systems Division did not disclose the reduction historically achieved when it negotiated final prices with a vendor. In this instance, Chemical Systems Division recommended a six percent reduction to Boeing. We calculated the historical reduction achieved and found a 19.6 percent reduction

was more appropriate.

Chemical Systems Division officials agreed that more current or accurate information was available on vendor quotations. They attributed their failure to provide the information to mistakes and oversights that occurred during a series of significant revisions to its original proposal. These revisions were requested by Boeing and involved revised quantities, specifications, and procedures. Chemical Systems Division officials stated that they have changed operating procedures to improve their submission of cost or pricing data. These officials also agreed that Chemical Systems Division should have included information on the reductions historically achieved when negotiating with vendors. They did not agree with our calculation of 19.6 percent and believe a more accurate figure is 12.4 percent. The Air Force and Boeing indicated agreement with our position and stated recovery action will be taken upon receipt of our report.

## UNALLOWABLE COSTS INCLUDED IN SUBCONTRACTOR'S PROPOSAL

We found one instance where Mal Tool & Engineering, a subcontractor to G.E. included unallowable costs in its proposal. Mal Tool included these costs in its overhead, a portion of which, was included in its proposal to G.E. and ultimately paid by the government. We estimate that the unallowable costs total

$190,000. A G.E. cost analyst stated that he had visited Mal Tool and conducted fact finding during the analysis of Mal Tool's overhead costs. The analyst stated he was not given complete access to Mal Tool's records and therefore, asked Mal Tool's vice president for finance if there were any unallowable costs included in its overhead. The analyst stated he was told that no unallowable costs were included. However, Mal Tool's president stated the access issue was never brought to his attention by G.E. and had it done so he would have provided any necessary access.

Mal Tool gave us the necessary access to its data, and we found that Mal Tool had included $94,432 in its overhead for the operation and maintenance of a 44-foot yacht at North Palm Beach, Florida and $39,585 for a lodge located in a ski area in Vermont. In addition $17,876 was included for an exhibit and providing low cost promotional items including sports visors and toy planes at Pratt & Whitney's West Palm Beach facility during its 25th birthday open-house celebration. There were other unallowable costs such as a hotel hospitality suite, a golf club membership, tickets to sports events, and contributions.

We discussed this matter with the DCAA and the Air Force and they generally agreed that the costs were unallowable subject to final administrative determination. G.E. withheld any opinion. Mal Tool does not agree that these costs are unallowable. We believe

that the contracting officer should seek recovery of these costs when making final contract settlement.

## IMPROVEMENT NEEDED IN PRIME CONTRACTORS' ANALYSES

We have previously testified before this Subcommittee that improvements are required in the analyses performed by prime contractors of proposals submitted by subcontractors. This review shows that improvements are still required.

Mr. Chairman, we are issuing reports on the subcontracts we reviewed and recommending price reductions where subcontractors did not comply with the Act. This concludes my statement and I will be pleased to answer any questions you or the Subcommittee members may have.

ATTACHMENT I

Results of GAO Subcontract
Pricing Audits

| Subcontractor | No. of Subcontracts Reviewed | POTENTIAL OVERPRICING* Subcontractor Nondisclosure | POTENTIAL OVERPRICING* Unallowable Costs |
|---|---|---|---|
| Mal Tool | 1 | | $190,000 |
| Loral Systems Group Akron, OH | 1 | $ 622,330 | |
| HR Textron | 2 | 1,276,331 | |
| Chemical Systems Division of United Technologies Corp. | 2 | 2,123,203 | |
| Sundstrand Data Control, Inc. | 2 | 1,018,543 | |
| Hazeltine | 1 | 192,222 | |
| Total | 9 | $5,232,629 | $190,000 |

*Amounts recovered will depend ultimately on relevant administrative and judicial actions or decisions.