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UNITED STATES GENERAL ACCOUNTING OFFICE
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JUL 17 1974

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Vice Admiral K L Lee
Commander, Naval Air Systems Command
Department of the Navy
Washington, D C

AGC 455

Attention NAIR-602

Dear Admiral Lee:

As part of our review of the negotiation of contract prices under the provisions of Public Law 87-653, we have examined into the reasonableness of the subcontract estimate for E-2C passive detection systems included in the price of fixed-price incentive contract N00019-71-C-0450. The contract was awarded to the Grumman Aerospace Corporation, Bethpage, New York, on September 30, 1971, by the Naval Air Systems Command (NAVAIR) at a target price of \$156,800,000 for 11 Model E-2C aircraft and related tests, bill of materials, and technical data. The passive detection system subcontract was performed by the Amecom Division, Litton Systems, Inc.

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Our examination was primarily concerned with the reasonableness of the price negotiated in relation to cost or pricing data available at the time of contract negotiations and the adequacy of technical and audit evaluations of the estimated cost of the subcontract included in the prime contractor's cost proposal.

We found that the subcontract costs proposed by the prime contractor and accepted by the Navy during negotiations were higher than warranted by current, complete, and accurate cost data available at the time of negotiation by about \$615,000 including add-on pricing factors and profit

BACKGROUND

Grumman developed the E-2C aircraft under developmental contract N00019-68-C-0542 awarded by NAVAIR in June 1968. It was under this contract that Grumman awarded a subcontract to Amecom on February 16, 1970, for the preproduction effort to develop a passive detection system to be used in the E-2C aircraft. This subcontract also provided options for the future purchase of production quantities of the passive detection system and related data. Amendment number 1 to that subcontract, dated March 24, 1970, provided a not-to-exceed option unit price which varied with the number of basic systems to be ordered.

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On July 21, 1970, NAVAIR submitted request for quotation N00019-70-Q-0129 to Grumman for the first production buy of the E-2C aircraft. Grumman responded with a fixed-price incentive proposal, dated August 18, 1970, for 11 Model E-2C aircraft and related tests, bill of materials, and design data at a target price of \$164,845,983.

The Defense Contract Audit Agency (DCAA) performed a preaward audit of the price proposal and submitted its report on November 30, 1970.

Grumman's price proposal included a cost of \$4,279,686 for 11 passive detection systems and related data. This proposed cost was increased to \$5,700,000 in August 1971 because of engineering changes.

NAVAIR completed negotiations with the contractor on September 17, 1971. Both parties agreed to a reduced target price of \$156,800,000 on the basis of a bottom line negotiation. The contractor executed a Certificate of Current Cost or Pricing Data on September 27, 1971, certifying the cost data through September 17, 1971.

RESULTS OF REVIEW

We found that

- The proposed and accepted subcontract costs for the passive detection systems included in the prime contractor's proposal were about \$147,700 higher than indicated by cost data available to the contractor at the time of negotiations.
- The proposed and accepted subcontract costs for production data relating to the passive detection systems were overstated by about \$467,300 in the contractor's proposal.

Details of these findings are discussed below.

Passive detection systems

The proposed and accepted subcontract cost for the 11 passive detection systems was higher than warranted by available cost information by about \$147,700 because the contractor did not disclose to the Navy negotiators the most current purchase price for the basic systems.

Amendment number 1 of the purchase order, dated March 24, 1970, which Grumman awarded to Amecom for the passive detection systems provided for a not-to-exceed option price of \$350,000 per unit for an 11-system buy and \$340,000 per unit for a 14-system buy.

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In its August 18, 1970, proposal to NAVAIR, the contractor included the price of the passive detection systems at \$352,161 per unit. During its review of the proposal in the fall of 1970, the DCAA auditors questioned that unit price and were given information by Grumman relating to an old option price offered by Amecom on February 16, 1970, under the original purchase order. We found no indications that Grumman had told DCAA that the option was revised on March 24, 1970, to provide for a unit price of \$350,000 for 11 systems and \$340,000 for 14 systems.

On July 21, 1971, Grumman exercised the option under the purchase order at the 14-system unit price of \$340,000. Eleven of the systems were to be installed in the aircraft, one was to be used for training purposes, and the remaining two were weapons replaceable assemblies (spares).

On August 20, 1971, 1 month after Grumman had already bought the systems for \$340,000 a unit, it supplied NAVAIR with a July 15, 1971, cost analysis report which referred to the \$350,000 unit price for an 11-system buy but failed to also mention that the \$340,000 unit price was available for a 14-system buy. Based on the above cost data, NAVAIR prepared a business clearance memorandum on September 3, 1971, using \$350,000 as the unit price for the basic system.

The Certificate of Current Cost or Pricing Data was executed by Grumman on September 27, 1971. On the same date, NAVAIR prepared a memorandum justifying the reasonableness of the negotiated price for the contract. That memorandum indicates that Grumman had not, again, informed NAVAIR of the \$340,000 unit price.

We believe that Grumman should have told NAVAIR during contract negotiations that the price of the system would be \$10,000 per unit less than the price included in its proposal. Including pricing factors and profit, we estimate that a total of about \$147,700 is involved in Grumman's failure to advise NAVAIR of the lower price.

Subcontract production data
cost estimate was overstated

The proposed and accepted subcontract costs for the production data were higher than warranted by complete and accurate cost data by about \$467,300 because the contractor included costs for subcontract data which should not have been included in the target price being negotiated.

Grumman's August 18, 1970, proposal to NAVAIR pointed out that the proposed target price did not include costs for certain production data items, these items included provisioning data, technical manuals, and a certain type of design data--namely, data decks. We found, however, that

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Grumman's estimate of the proposed cost of the subcontract for passive detection systems included costs for 24 production data items, but that the costs for 14 of those items should not have been included

Grumman's proposal included \$405,915 for subcontract production data relating to the passive detection systems. This amount was based on a not-to-exceed option price which the subcontractor agreed to under purchase order 6-73039 issued by Grumman on February 16, 1970. This production data consisted of 24 data items--10 for provisioning data, 3 for technical manuals, and 11 for design data (one of the design data items was a data deck). However, according to the proposal, the 10 provisioning data items, the three technical manuals, and the data deck would be separately priced at increased cost to the contract when ordered by the administrative contracting officer.

In performing its preaward audit, DCAA was apparently not aware that the \$405,915 included the costs for provisioning data, technical manuals, and a data deck. Grumman furnished DCAA only those pages of the purchase order containing the original option provisions, these pages did not describe the type of data making up the \$405,915. It also appears that NAVAIR was not aware of the type of data making up that price. The cost analysis report which Grumman gave NAVAIR in August 1971, showed that the subcontractor had proposed \$570,036 for production data as compared to the not-to-exceed price of \$405,915 but did not disclose that both these prices included the costs for provisioning data, technical manuals, and a data deck. Moreover, a Grumman August 27, 1971, memorandum reiterated that the cost of the production data for the system would be \$405,915 without disclosing the type of data included.

Based on the above cost data, NAVAIR prepared a business clearance memorandum on September 3, 1971, using the \$405,915 proposed cost but rounding it down to \$400,000. The Certificate of Current Cost or Pricing Data was executed on September 27, 1971. The memorandum which NAVAIR prepared on that date to justify the reasonableness of the negotiated target price indicates that Grumman had not informed NAVAIR that the \$405,915 included the costs of provisioning data, technical manuals, and a data deck. Our discussion with NAVAIR's negotiator indicated that he had not questioned the \$405,915 and was unaware of its makeup.

We found that some of the production data items which should not have been included in Grumman's cost proposal were subsequently ordered by the administrative contracting officer, separately priced and added to the contract price as modifications. For example, Modification No. A023, dated June 14, 1973, added \$158,076 to the contract target price for provisioning data on subcontracted items including the passive detection system. Also, Modification No. A035 dated June 29, 1973, added another \$707,000 to the

contract target price for data decks including a data deck for the passive detection system

We believe that Grumman's proposal for the passive detection system should not have included costs for provisioning data, technical manuals, and a data deck since these production data costs were to be provided for as separate items of cost under the contract.

We did not obtain a detailed price list of the 24 production data items which made up the \$405,915 option price. However, basing our calculations on the prices of technical data items per the subcontractor's \$570,036 proposal, we believe that the amount which should have been considered during negotiations as the cost for the subcontract's technical data was \$51,863. We estimate, therefore, that the proposed cost of the subcontract data accepted by NAVAIR was about \$348,100 higher than warranted by complete and accurate cost data, or about \$467,300 higher with pricing factors and profits included.

We discussed the above findings with Grumman officials and members of your staff at the completion of our audit. Although Grumman officials promised to reply promptly to our finding, we have received no such reply even though several weeks have passed.

We believe NAVAIR should have its contracting officer consider the above findings, along with any additional information available to determine whether the Government is legally entitled to a price adjustment under prime contract N00019-71-C-0450. In this regard, we will be pleased to provide you or your staff with further details on the foregoing if you so desire.

We would appreciate being advised of actions taken or contemplated with regard to the matters discussed in this letter. Copies of this letter are being sent to the Naval Plant Representative at Grumman and the Regional Manager, DCAA, New York.

Sincerely yours,



H. L. Krieger
Regional Manager