

**DOCUMENT RESUME**

04144 - [ B3154412 ]

[ Pricing of a Noncompetitive, Fixed-Price Incentive Contract for Maintenance and Modification of Three Special Purpose Aircraft ]. PSAD-78-9; B-168450. November 10, 1977. 3 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 Air Force; E-Systems, Inc.

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

Authority: P.L. 87-653.

Examination of the pricing of a negotiated, noncompetitive, fixed-price incentive contract awarded to E-Systems, Inc., by the Aeronautical Systems Division of the Air Force Systems Command indicated that the contract target price was overstated by as much as \$1.4 million because contracting personnel did not adequately evaluate the proposal. The contract provided for the maintenance and modification of three special purpose C-135 aircraft, including programmed depot maintenance as well as design, fabrication, and installation of special electronic systems and equipment. Findings/Conclusions: The Government evaluators accepted, without adequate evaluation, questionable allowances for labor hours and an understated sales forecast as the basis for overhead rates. The questionable labor hours were related to a break in production and other schedule changes. The evaluators also did not identify inconsistencies in E-Systems' application of learning curves. About \$100,000 of the overstated cost resulted because E-Systems did not adequately disclose estimating methods. Air Force officials believe that the outcome of this contract, an underrun of slightly over 8%, is within the bounds of a well-evaluated and negotiated incentive contract. They also recognize opportunities for improving evaluation of priced proposals. The Air Force has initiated a review to determine whether E-Systems' failure to adequately disclose certain estimating procedures should entitle the Government to an adjustment in contract price. (Authcr/SC)



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20543

PROCUREMENT AND SYSTEMS  
ACQUISITION DIVISION

NOV 10 1977

B-168450

04144

The Honorable  
The Secretary of Defense

Dear Mr. Secretary:

We have examined the pricing of contract F33657-74-C-0597--a negotiated, noncompetitive, fixed-price incentive contract--awarded to E-Systems, Inc., Greenville, Texas, by the Aeronautical Systems Division, Air Force Systems Command. This contract, awarded July 29, 1974, provided for maintenance and modification of three special purpose C-135 aircraft including programmed depot maintenance as well as design, fabrication, and installation of special electronic systems and equipment. A target price of \$14,990,000 was negotiated.

The objective of the review was to determine whether (1) the contracting officer obtained cost or pricing data to support the proposed contract price, (2) data obtained was evaluated and relied on in negotiating the contract price, and (3) the price negotiated was reasonable based on cost or pricing data available to the contractor at the time of negotiations.

With certain exceptions, Public Law 87-653 and the Armed Services Procurement Regulation require that contracting officers obtain from contractors cost or pricing data to support proposed prices for negotiated noncompetitive contracts expected to exceed \$100,000. Contractors are required to certify that cost or pricing data used as a basis for negotiating contract prices is accurate, current, and complete. A clause inserted in the contracts giving the Government a right to recover from contractors any amount by which the contract price is overstated due to its reliance on inaccurate, noncurrent, or incomplete data (cost or pricing data).

We believe the contract target price was overstated by as much as \$1.4 million because contracting personnel did not adequately evaluate E-Systems' proposal. The Government evaluators accepted, without adequate evaluation, questionable allowances for labor hours and an understated sales forecast as the basis for overhead rates. The questionable labor hours were related to a break in production and other schedule changes. The evaluators also did not identify

inconsistencies in E-Systems' application of learning curves. Approximately \$100,000 of the overstated cost resulted because E-Systems did not adequately disclose estimating methods.

Details of our observations, findings, and analysis were provided to officials of the Headquarters 2750th Air Base Wing, Air Force Logistics Command, current manager of the contract. For this reason, details are not being restated in this report.

The Air Force officials believe the outcome of this contract, an underrun of slightly over 8 percent, is within the bounds of a well evaluated and negotiated incentive contract. These officials also recognized opportunities for improving evaluation of priced proposals. Specifically, they stated:

"Procedures under which evaluation of this contract were accomplished have been improved. As a result later technical evaluations have been steadily more penetrating and comprehensive. Since we recognize the need for continuity of the methods employed and for a basis upon which to build improved techniques, our evaluations of major contract proposals are now accomplished by a team based upon a cadre of two officers and one senior NCO."

"In addition to the solid core of experience and evaluation methodology resulting from this cadre, the project engineer and quality assurance inspector for the contract being evaluated participate to provide specific technical guidance on the project-oriented details of the proposal. We are confident that this system will provide for continuous improvement of the effectiveness of the technically cognizant agency of the collocated Government team."

Additionally, the Commander of the Headquarters 2750th Air Base Wing informed us that a review has been initiated to determine whether E-Systems' failure to adequately disclose certain estimating procedures should entitle the Government to an adjustment in contract price.

E-Systems officials reviewed our findings on its supporting cost or pricing data and acknowledged that its use of certain improvement curves in estimating cost for the proposal had not been disclosed. E-Systems does not acknowledge, however, the Government's entitlement to a price adjustment because of the error. Rather, E-Systems believes a basis for offset may exist.

B-168450

We would appreciate receiving a copy of the report, and your assessment thereof, on the review initiated to determine whether the Government is entitled to a price adjustment for contract F33657-74-C-0597.

- - - -

We are sending copies of this report to the Secretary of the Air Force, and the Commander of the Air Force Aeronautical System Division. We are also sending copies of this report to the Chairmen of the House Committee on Government Operations and the Senate Committee on Government Affairs, and to the Chairmen of the House and Senate Committees on Appropriations and Armed Services.

Sincerely yours,

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

R. W. Gurnann  
Director