



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548



PROCUREMENT AND SYSTEMS
ACQUISITION DIVISION

B-39995

AUGUST 2, 1979

The Honorable Harold Brown
The Secretary of Defense



Attention: Assistant for Audit Reports
Room 3A336
ASD (Comptroller)

Dear Mr. Secretary:

We have completed a limited review of contracts over \$100,000 identified as competitively negotiated by the Department of Defense (DOD). We wanted to determine if appropriate Government regulations were being followed by DOD contracting personnel to safeguard the Government's interest in acquiring goods and services at fair and reasonable prices. This review represents part of our continuing program to monitor DOD's procedures for negotiating contract prices.

We analyzed and summarized selected contract-related data at eight Army, Navy, and Air Force procurement offices and discussed the results with contracting officials. Although we looked at only a relatively small percentage of all procurement locations, we were able to review negotiations involving a significant percent of the dollar value of total competitively negotiated DOD fixed-price contracts for fiscal year 1978.

Eighty-eight percent of the 75 contract-related actions we reviewed were awarded to the lowest offeror. Sixty-seven percent of the total awards resulted from solicitations that brought in only two proposals. Generally, this met DOD's criteria for adequate price competition. DOD regulations provide that there must be at least two responsible offerors whose proposals are responsive, who can satisfy the Government's requirements, and who independently contend for award on the basis of the lowest evaluated price.

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Nine contracts, however, were awarded to contractors other than the low offeror. Six of these contracts were split awards to support the Defense Industrial Base. The other three contract awards were made after the other competitor was declared nonresponsive or not responsible. Therefore, we believe that DOD has little assurance that the negotiated prices for the nine contracts were fair and reasonable. In our opinion, cost analysis should have been required for the higher priced proposals to provide such additional assurance.

QUESTIONABLE SPLIT AWARDS

Six contracts of the 75 contract-related actions we reviewed were split awards to contractors other than the lowest offeror. According to contract files, the reason was to support the Defense Industrial Base. The additional cost to the Government, in awarding part of the quantity to other than the low offeror, was \$2.3 million.

The Individual Procurement Action Reports (DD Form 350), completed by the procurement office personnel, indicated that the awards were made on the basis of price competition. The records we examined, however, showed that these were split awards for the purpose of keeping the Defense Industrial Base "warm." Generally, neither cost nor pricing data was requested or used to analyze costs to determine whether the offered price was fair and reasonable.

An example of such a split award was the award of 473,000 power supplies for the M732 fuze. Two-thirds of the award was given to the low offeror and one-third, to the higher offeror. Splitting the award caused the total price to the Government to be \$6.87 million. Had the low offeror been awarded the entire 473,000 power supplies contract, the firm-fixed price would have been \$5.64 million, thus saving the Government \$1.23 million.

According to the negotiation record, two procurement sources would be in the Government's best interest. However, the procurement office requested neither cost or pricing data nor a cost analysis to determine whether the prices were fair and reasonable.

The two contractors which received the split award were the only contractors solicited for the power supplies contract. Both were requested to quote prices on several partial quantities as well as the total quantity. Because of

this, there was reason to believe that the award would be split. This became increasingly apparent when one contractor, who had not produced the item, was required to comply with first article approval procedures. Also, since the independent Government estimate was \$4.89 million, almost \$2 million less than the combined split award, a cost analysis would have given better assurance that the proposed price was fair and reasonable. Furthermore, contract files show that the higher priced contractor had sent cost or pricing data to the cognizant administrative contracting officer, who then wrote to the procurement office personnel asking whether an evaluation would be requested. A purchasing office official replied that no evaluation was required.

Although the six contract-related actions in our review related to Army and Navy purchasing offices, in fiscal year 1979 we found another example involving split awards by the Air Force. Two contractors (A and B) were requested to propose on fiscal year 1979 30-mm. ammunition requirements for 35, 50, and 65 percent of the requirements. Neither contractor was requested to propose on 100 percent of the Government's needs. Thus, although each was alerted to the intended split award, neither was asked to supply cost or pricing data or to negotiate with the Government. The lower priced contractor, A, received 65 percent while the higher priced contractor, B, received 35 percent of the approximately 11 million ammunition units. The contract amount was \$66.8 million for A, while \$47.9 million was awarded to B. Assuming both contractors are equally efficient, our computation of B's share, using A's unit prices, reveals that B received about \$12 million more than A would have received for the same quantity. The \$12 million is 25 percent of the total contract award to B. Therefore, we believe that a thorough cost evaluation of the contractors' proposals could assure greater price reasonableness rather than merely selecting the combined split award representing the least cost to the Government, as did the Air Force.

In one instance, when a split award was contemplated by the Navy to maintain the Defense Industrial Base, the request for proposal included the requirement to submit cost or pricing data in accordance with Defense Acquisition Regulation 3-807.3. Specifically, according to the regulation, this data is not required if the price negotiation is based on adequate price competition. Although the Individual Procurement Action Report indicated this was a price competitive procurement, the procurement contracting officer properly recognized that competition was too inadequate in these

circumstances to be considered an exception to the cost or pricing data requirement. Even though this contractor was the low offeror, its data was evaluated by the Defense Contract Audit Agency and negotiations were based on the evaluation. In addition, the contractor executed a Certificate of Current Cost or Pricing Data. The procedures used by this procurement office provided better assurance that the negotiated price was fair and reasonable.

QUESTIONABLE SURVIVOR AWARDS

Three contracts were awarded to contractors other than the low offeror, after the low and only other offeror in each of the three procurements was declared nonresponsive or not responsible. The additional cost to the Government totaled about \$0.5 million.

For example, the Navy contacted two potential producers (C and D) to try to obtain rocket motors for the Standard Missile. Contractor C proposed \$3.33 million, while contractor D offered to fulfill the requirement for \$3.57 million. Due to serious motor quality deficiencies, contractor C was disqualified and the contract was awarded to D. Although cost or pricing data was received, the contract files show no evidence that the data was reviewed and evaluated. The data should have been, since the surviving contractor was, in effect, the sole-source contractor for this procurement.

CONCLUSIONS

Awarding contracts to other than the low responsive and responsible offerors without evaluating cost or pricing data is contrary to good procurement practice. Situations involving split awards, where each of the offerors is assured of receiving part of the overall requirement, should be processed in a manner which gives maximum assurance that the prices are fair and reasonable. These situations should involve using cost or pricing data which is appropriately reviewed and evaluated.

RECOMMENDATIONS

To increase the assurance that the Government will negotiate fair and reasonable prices in those instances of split awards and sole-surviving contractors after attempting to obtain competition, we recommend that you emphasize to all

procurement personnel the need to obtain and evaluate cost or pricing data. Appropriately evaluating the data should usually involve the services of the Defense Contract Audit Agency and technical, engineering-type Government personnel.

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We are sending copies of this letter to the Director, Office of Management and Budget, and to the Secretaries of the Army, Navy, and Air Force. We are also sending copies to the Chairmen of the House and Senate 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 the head of a Federal agency to 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 this 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.

Sincerely yours,


for J. H. Stolarow
Director