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UNITED STATES GENERAL ACCOUNTING OFFICE

REGIONAL OFFICE

502 U S CUSTOMHOUSE 2D AND CHESTNUT STREETS

PHILADELPHIA, PENNSYLVANIA 19106

March 9, 1971

Commanding Officer
U.S. Navy Ships Parts Control Center
Mechanicsburg, Pennsylvania 17055

Dear Sir:

We have reviewed the pricing of MK 14 fin assemblies purchased under negotiated firm fixed-price contract N00104-68-C-0816, which was awarded by the U.S. Navy Ships Parts Control Center, Mechanicsburg, Pennsylvania, to Lasko Metal Products, Incorporated, West Chester, Pennsylvania, on October 5, 1967. Our review was directed primarily toward determining whether a fair and reasonable price had been obtained in relation to cost or pricing information available to the contractor at the time of negotiation.

Our review showed that the \$7.3 million negotiated price was about \$840,000 higher than justified because current cost or pricing information available to Lasko was not used during negotiation. The Government negotiator was unaware that (1) the costs per pound being incurred for certain aluminum raw material during performance under letter contract -0816 were lower than costs included in the final pricing proposal, and (2) the quantity of aluminum raw material for each MK 14 assembly already purchased under the letter contract was less than the quantity included in the final pricing proposal.

The contract overpricing amount is comprised of the following:

Table with 4 columns: Part, Lower costs for aluminum raw material, Lesser requirements for aluminum raw material, and Total. Rows include Retarding fin, Link, Fin support, Clevis, Collar, Direct costs, General and administrative expense at negotiated rate, Total costs, Profit at negotiated rate, and Total.

See attachment

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We were informed by the Government negotiator that during negotiation on February 7, 1968, the contractor provided no updated information concerning its proposed raw material costs for contract -0816, although it was given an opportunity to do so. As a result, the Government negotiator relied upon data submitted by the contractor in September 1967 as evaluated by audit and technical analysis by the Government. The Government negotiator further advised us that an updated audit of the contractor's proposal was not requested because of time limitations.

On February 19, 1968, subsequent to negotiation, the contractor certified to the accuracy, completeness, and currency of the cost or pricing information submitted to the Government. The contract includes a defective pricing data clause that provides for decreasing the contract price if the Government determines that the price has been significantly increased because cost or pricing information submitted by the contractor was not accurate, complete, or current.

Our findings are set forth below.

LOWER COSTS FOR
ALUMINUM RAW MATERIAL

Lasko's price proposal for contract -0816, submitted on September 12, 1967, included raw material costs which were based on then-current vendor quotations. The contract price negotiated several months later, on February 7, 1968, included estimated raw material costs determined by using the same costs shown in these quotations. Prior to negotiation, however, Lasko had issued purchase orders for substantial quantities of aluminum raw material. Purchase orders issued to one vendor on October 1, 1967, showed costs per pound for the collar, clevis, retarding fin, and fin support which were lower than costs used in the contractor's proposal. The vendor's invoices received prior to negotiation showed costs not in excess of purchase order costs. An unpriced purchase order for the link was issued to another vendor on October 13, 1967. This vendor's invoices received prior to negotiation also showed a cost lower than that used in the contractor's proposal.

Lasko did not disclose to the Government the lower costs for aluminum raw material, nor did it revise its proposal to reflect these lower costs. We found that these lower costs remained in effect for all shipments received for contract -0816.

Our calculation of the contract overpricing relating to lower costs for aluminum raw material is presented in an attachment to this letter. For illustrative purposes, the retarding fin is discussed below.

made such request. His supervisor stated that it is the contractor's responsibility to furnish such information. Agency procedures generally provide for examination of purchase orders in reviewing a contractor's proposal.

LESSER REQUIREMENTS FOR
ALUMINUM RAW MATERIAL

Lasko's proposal included costs which were based on estimated quantities of aluminum raw material needed to fabricate three parts of the MK 14 assembly--the retarding fin, link, and clevis. These quantities were accepted as proposed in the determination of the raw material cost included in the negotiated price for contract #0816. However, information available to Lasko prior to negotiation indicated that the quantities of aluminum needed for these parts were substantially less than included in its proposal. Lasko did not disclose this information to the Government, nor did it revise its proposal to reflect these lesser quantities.

Since the circumstances differed for the three parts in question, each is discussed below.

Retarding fin

Each MK 14 assembly required four retarding fins. Lasko's proposed costs included a requirement of 5.5564 pounds of aluminum per retarding fin, exclusive of a 2 percent scrap allowance.

On October 1, 1967, Lasko issued a purchase order for the aluminum needed for the retarding fins. The aluminum was ordered in pieces (blanks) with one piece required per retarding fin. The purchase order specified an approximate weight per piece of 5.12 pounds. Lasko received 23 shipments under this purchase order prior to contract negotiation. Vendor invoices for these shipments showed that Lasko had received 160,378 pieces which weighed a total of 816,600 pounds, an average of 5.0917 pounds per piece.

We calculated this overpricing as follows:

Number of MK 14 assemblies to be produced	135,449
Number of retarding fins per MK 14 assembly	X 4
Number of retarding fins required (excluding scrap)	541,796
Allowance for scrap--2 percent	10,836
Number of retarding fins required	552,632
Aluminum needed per retarding fin	
--proposed and negotiated	5.5564 lbs.
--current invoice data	<u>5.0917 lbs.</u>
Overstatement of aluminum needed	
per retarding fin	X <u>0.4647</u> lb.
Total overstatement of	
aluminum needed	256,808 lbs.
Cost per pound--current invoice	X <u>\$0.465</u>
Overpricing (exclusive of general and	
administrative expense and profit)	<u>\$119,416</u>

The Defense Contract Administration Services evaluated the contractor's proposed aluminum requirement for the retarding fin in October 1967. In his report dated November 2, 1967, the technical analyst stated:

"An original blank was not available, however, a formed fin was weighed and calculations made on estimated basis for scrap (2%) factor and it was decided the weight and factor as proposed were considered reasonable." (under-scoring supplied)

With respect to our request for an explanation of his procedure for evaluating the proposed aluminum requirement for the retarding fin, the technical analyst stated that he could not comply because his original files were no longer available. He stated, however, that an examination of invoices is not generally included in a technical evaluation.

Link

Eight links were required for each MK 14 assembly. Lasko's proposed costs included a requirement of 0.91826 pound of aluminum per link, exclusive of a 2 percent scrap allowance. Contractor personnel informed us that this aluminum had previously been purchased from two vendors and that the aluminum supplied by these vendors had different weights. The proposed requirement, we were informed, was based upon use of the heavier aluminum.

On October 13 and November 27, 1967, Lasko awarded purchase orders to the supplier of the lighter weight aluminum. This aluminum was received in the form of extruded bars, which Lasko cut to yield 10 links per bar. Lasko received five shipments of aluminum prior to contract negotiations. Information was available on four shipments; these totaled 41,092 bars weighing 324,441 pounds, an average of 7.8955 pounds per bar. Each link produced from these bars, therefore, required an average of 0.78955 pound of aluminum, 0.12871 pound less than proposed.

We calculated this overpricing as follows:

Number of MK 14 assemblies to be produced	135,449
Number of links per MK 14 assembly	X 8
Number of links required (excluding scrap)	<u>1,083,592</u>
Allowance for scrap--2 percent	<u>21,672</u>
Number of links required	1,105,264
Aluminum needed per link	
--proposed and negotiated	0.91826 lb.
--current invoice data	<u>0.78955 lb.</u>
Overstatement of aluminum needed per link	X 0.12871 lb.
Total overstatement of aluminum needed	<u>142,259 lbs.</u>
Cost per pound--current invoice	X \$0.523
Overpricing (exclusive of general and administrative expense and profit)	<u>\$74,401</u>

An evaluation of the contractor's proposed aluminum requirement for the link was made by the Defense Contract Administration Services. In his report, the technical analyst stated.

"A formed link was weighed and calculations made on an estimated basis for scrap (2%) factor and it was decided that the weight and scrap factor as proposed was considered reasonable." (under-scoring supplied)

The report did not indicate whether the technical analyst had evaluated the link material prior to its being formed by the contractor or whether the formed link used in his calculations was of the lighter or heavier weight. With regard to our request for an explanation of his procedure for evaluating the proposed aluminum requirement for the link, the technical analyst again stated that he could not comply because his files were not available.

Clevis

Each MK 14 assembly required one clevis. Lasko's proposed costs included a requirement of 1.8333 pounds of aluminum per clevis, exclusive of a 2 percent scrap allowance. Lasko personnel informed us that the proposed requirement was based upon the method of procurement employed under the previous contract. Under this method, Lasko procured aluminum bars, usually 8 feet in length, and cut them to yield 47 clevises per bar.

Prior to the negotiation of contract -0816, however, Lasko changed its method of procurement. On October 1, 1967, Lasko issued a purchase order which called for delivery of clevises already cut to required length by the vendor. Three shipments of pre-cut clevises were received by Lasko prior to contract negotiation. Vendor invoices showed that these shipments totaled 18,675 clevises weighing 25,762 pounds, an average of 1.3795 pounds per clevis, 0.4548 pound less than proposed. The cost per pound was no higher than included in Lasko's proposal.

We calculated this overpricing as follows:

Number of clevises required (excluding scrap)		135,449
Allowance for scrap--2 percent		<u>2,709</u>
Number of clevises required		138,158
Aluminum needed per clevis		
--proposed and negotiated	1.8333 lbs.	
--current invoice data	<u>1.3795</u> lbs.	
Overstatement of aluminum needed per clevis		X 0.4538 lb.
Total overstatement of aluminum needed		<u>62,696</u> lbs.
Cost per pound--current invoice		X \$0.800
Overpricing (exclusive of general and administrative expense and profit)		<u>\$50,157</u>

The technical analysis report of the Defense Contract Administration Services did not comment on the contractor's proposed aluminum requirement for the clevis. In response to our question as to why this requirement was apparently not evaluated, the technical analyst could offer no explanation. As stated previously, however, the analyst's files were unavailable for inspection.

Contractor officials contended that the vendor invoices did not accurately reflect the average weights of the retarding fin, link, and clevis because the number of pieces shown represented an estimated rather than an actual count. Vendors' billings were based on the actual weights shipped rather than the number of pieces. However, contractor officials could not demonstrate any inaccuracy of quantities shown on invoices.

Conclusions

We believe that the price negotiated for MK 14 fin assemblies procured under contract -0816 was about \$840,000 higher than justified. The failure of the contractor to provide current cost or pricing information meant that the Government did not possess all pertinent facts available at the time of negotiation. With these facts, the Government should have been able to negotiate a substantially lower price.

In view of the time elapsed between the audit and negotiation, the Government negotiator, in our opinion, should have requested an updated audit of the contractor's proposed costs. An updated audit should have disclosed the existence of current cost or pricing information.

We also believe that the Government technical analyst should have more critically evaluated the contractor's proposed aluminum raw material requirements. In our opinion, an evaluation based on inspection of finished parts was insufficient in this instance for proper verification of proposed requirements. A physical inspection of the raw material and an examination of related purchase orders, receiving reports, and invoices should have shown that the proposed requirements were overstated.

Recommendation

We recommend that Navy procurement officials determine the extent of the Government's legal entitlement to a price adjustment under the contract.

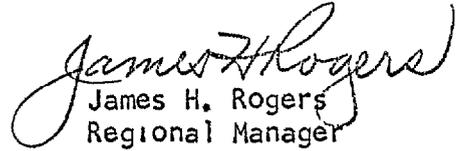
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We would be glad to furnish additional information on the above matters. We would appreciate being advised of actions taken or to be taken by your agency as a result of this review.

Copies of this letter are being sent to the following:

Comptroller of the Navy
Commander, Naval Air Systems Command
Commander, Naval Supply Systems Command
Director, Defense Contract Audit Agency
Regional Manager, Defense Contract Audit Agency, Philadelphia
Commander, Defense Contract Administration Services Region,
Philadelphia

Sincerely yours,


James H. Rogers
Regional Manager

Attachment

CALCULATION OF OVERPRICING RELATING TO LOWER COSTS
FOR ALUMINUM RAW MATERIAL
CONTRACT N00104-68-C-0816

Cost or pricing information not used during
contract negotiation on February 7, 1968

<u>Part</u>	<u>Included in negotiated contract price</u>		<u>Purchase order date</u> (3)	<u>Quantity received prior to negotiation</u> (4)	<u>Purchase order/ invoice cost</u> (5)	<u>Excess of negotiated over current cost</u> (6) (2) minus (5)	<u>Overpricing</u> (7) (1) times (6)
	<u>Quantity</u> (1)	<u>Cost</u> (2)					
Retarding fin	3,070,629 lbs.	\$0.536/lb.	10- 1-67	816,600 lbs.	\$0.465/lb.	\$0.071/lb.	\$218,015
Fin support	138,158 ea.	9.083/ea.	10- 1-67	31,371 ea.	8,208/ea. ^a	0.875/ea.	120,888
Link	1,014,920 lbs.	0.610/lb.	(10-13-67 (11-27-67)	435,887 lbs.	0.523/lb.	0.087/lb.	88,298
Collar	311,533 lbs.	1.000/lb.	10- 1-67	53,732 lbs.	0.900/lb.	0.100/lb.	31,153
Clevis	253,290 lbs.	0.900/lb.	10- 1-67	25,762 lbs.	0.800/lb.	0.100/lb.	<u>25,329</u>
						Total	<u>\$483,683^b</u>

^aIncludes purchase order and invoice cost of \$8.15/ea. and freight of \$0.058/ea.

^bExclusive of general and administrative expense and profit.

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ATTACHMENT