

134131

United States General Accounting Office

GAO

Report to the Commander, U.S. Army
Missile Command, Department of the
Army

October 1987

CONTRACT PRICING

Material Prices Overstated on Ground/ Vehicular Laser Locator Designators



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B-219741

October 13, 1987

Major General Thomas D. Reese
Commander, U.S. Army Missile Command
Department of the Army
Redstone Arsenal, Ala. 35898-5740

Dear General Reese:

We completed a review of the pricing of contract DAAH01-82-C-A240 and modification P00056 to contract DAAH01-81-C-A155 awarded to Hughes Aircraft Company, El Segundo, California, for Ground/Vehicular Laser Locator Designators (G VLLDs), by the U.S. Army Missile Command (MICOM). Our objective was to determine whether Hughes complied with the Truth in Negotiations Act (Public Law 87-653) in providing accurate, complete, and current cost or pricing data and whether fair and reasonable prices were negotiated by the contracting officer.

Target prices for contract -A240 and modification P00056 were overstated by \$2,339,601, including overhead and profit, because Hughes (1) did not disclose accurate, complete, and current material prices, (2) made a computation error, and (3) did not disclose an updated bill of material.

Hughes officials do not agree with our calculation of overstated material prices or that a computation error was made. However, they do agree that the updated bill of material was not disclosed. Hughes officials also believe the overpricing we found should be offset because lower material costs may have been negotiated by the Army contracting officer and other proposed material costs were understated. MICOM officials agree that current material prices were not disclosed and a computation error was made.

We believe this information provides a basis for you to initiate action to recover these funds from Hughes and we recommend you take such action.

Contract prices were overstated by an additional \$1,777,396, including overhead and profit, because the Army contracting officer (1) did not rely on a Defense Contract Audit Agency (DCAA) recommendation regarding anticipated material price reductions between Hughes and its

Schedule of Overstated Material Prices

Part number	Nomenclature	Prime contract	Proposed unit price	Latest pricing information	Quantity	Contract price difference
11507305	Plenum assembly	A240	\$575.00	\$542.00 (2)	225	\$7,425
11507418 2	Lithium crystal	A240	1,063.00	952.67 (1,3)	225	24,824
11507453	Laser rod	A240	3,450.00	2,616.04 (1,3)	225	187,641
11507485	Eyepiece assembly	A240	456.00	451.00 (1)	225	1,125
11507657	Semiconductor	A240	524.00	475.00 (2)	225	11,025
11507688	Converter	A240	720.00	665.00 (1)	225	12,375
		A155	720.00	695.00 (1)	125	3,125
11507727	Objective lens assembly	A240	958.00	966.07 (1,3)	225	[1,816]
	Implementation cost	A240	0	15,600.00	•	[15,600]
11507758	Pump cavity	A240	1,020.08	973.11 (1)	225	10,568
11507885	Dampers	A240	1,074.18	910.38 (2)	225	36,855
11507950	Dampers	A240	1,074.85	910.95 (2)	225	36,878
11508247	Beamsplitter	A240	3,100.00	1,026.00 (2)	225	466,650
	Implementation cost	A240	0	61,340.00	•	[61,340]
11508252	Optical bench	A240	683.00	532.48 (1)	225	33,867
11559405	Circuit card assembly	A240	850.00	999.00 (1,2)	225	[33,525]
	Implementation cost	A240	0	2,070.00	•	[2,070]
11559717	Housing assembly	A240	2,350.00	2,170.31 (1)	225	40,430
	Implementation cost	A240	0	9,600.00	•	[9,600]
13090430	Housing assembly	A240	1,615.00	1,190.00 (1)	225	95,625
		A155	1,615.00	1,442.51 (1,4)	295	50,885
	Implementation cost	A155	22,550.00	41,400.00	•	[18,850]
13090442	Printed wiring boards	A240	375.00	375.00	225	0
		A155	375.00	375.00	295	0
13090450	Harness assembly	A240	709.51	798.34 (4)	225	[19,987]
		A155	709.51	747.90 (2)	295	[11,325]
	Implementation cost	A155	8,600.00	8,600.00	•	0
13090476	Transceiver housing	A240	1,850.00	1,755.98 (1,4)	225	21,155
13090478	Harness assembly	A240	653.28	699.27 (4)	225	[10,348]
		A155	674.39	605.36 (1)	295	20,364
		A155	674.39	605.36 (1)	33	2,278
13090497	Cable, low volt	A240	529.63	595.23 (2)	225	[14,760]
Total						\$863,874

Legend

- (1) Actual purchase order price or negotiation results
- (2) Revised price quotation
- (3) Original price quotation
- (4) Not to exceed letter subcontract

contracting officer, during negotiations, relied on Hughes' data rather than DCAA's recommendation.

We do not believe the contracting officer should have accepted Hughes' study because it did not consider price reductions Hughes was likely to negotiate with its vendors. In fact, we found Hughes purchased parts for contract -A240 for about 8.9 percent less than vendor quotations.

Escalation of Material Prices

Hughes escalated proposed material costs of \$11,396,122 by 2.5 percent, or \$284,903. The escalation was for price increases anticipated during a 3-month period from the expiration of vendor quotations to actual purchase order placements. The contracting officer negotiated escalation in the contracts at 2.04 percent, or \$202,821.

Since about 86 percent of Hughes' proposed material costs was based on firm vendor quotations, we believe the contracting officer should not have negotiated any escalation. Instead, the contracting officer should have held negotiations on the premise that Hughes would likely obtain price reductions from its vendors. Because the contracting officer accepted material escalation, we believe contract target prices were overstated by \$351,481, including overhead and profit.

MICOM officials believe escalation was appropriate for vendor price quotations which had expired. The MICOM representatives stated they did not allow escalation on vendor quotations that were known to be current at the time of prime contract negotiations. We disagree with MICOM's position because we found, in most cases, Hughes' vendors either extended quotation periods or updated quotations at no price increase.

Objective, Scope, and Methodology

Our objective was to determine whether Hughes complied with Public Law 87-653 in providing accurate, complete, and current cost or pricing data for material cost estimates included in the contract price proposal. We also assessed whether the contracting officer negotiated fair and reasonable contract prices.

We did our review at Hughes Aircraft Company, Electro-Optical and Data Systems Group, El Segundo, California and the resident DCAA and Air Force Plant Representative Offices at Hughes. Relevant contract negotiation information was also obtained from MICOM.

**Appendix I
Material Prices Overstated on G/VLLD
Contracts With Hughes Aircraft Company**

The updated bill of material also included a reduction of \$92,981 in the prices of 144 low-dollar value parts we did not review. Since Hughes did not disclose the update, material prices were overstated by an additional \$92,981 as shown in table I.4. Since MICOM acquired only 225 of the 240 proposed G/VLLD units for contract -A240, the overstatement amounted to \$87,055.

Table I.4: Nondisclosure of Updated Bill of Material Prices

	Amount
Disclosed bill of material prices -- December 16, 1981	\$11,493,081
Undisclosed bill of material prices -- April 28, 1982	10,571,707
Overstated material costs	921,374
Less. Computation error	\$287,866
Lower prices for 20 parts	540,527
Overstatement - 240 proposed units	92,981
Overstatement - 225 negotiated units	\$87,055

Hughes officials agree the April 28, 1982, updated bill of material was not submitted but attribute the nondisclosure to an administrative oversight. Company officials stated that updated prices were provided to MICOM during negotiations. However, the company did not provide evidence to support its position.

MICOM representatives agree the updated bill of material was not disclosed and told us the contracting officer relied on the December 16, 1981, bill of material prices.

Offsets Claimed by Hughes

Hughes believes the overpricing we found should be offset by \$132,905 because the MICOM contracting officer may have adjusted proposed material prices by 1.9 percent. MICOM documents, however, show material prices were not reduced by 1.9 percent. On the contrary, MICOM accepted Hughes' proposed material prices.

The Hughes representatives believe the overpricing we found should be further offset by \$1,401,081 because the company understated proposed material attrition costs. Company officials stated material attrition experienced on an earlier contract (DAAK40-78-C-0078) for laser target designators was 25.6 percent of material costs and a study supporting this rate was submitted to DCAA before contract -A240 negotiations. Hughes officials believe the 25.6-percent rate rather than the 10-percent proposed rate should have been used to negotiate the contract.

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Table I.1: Overstated Material Prices

	Contract -A240	Modification P00056 to contract -A155	Total
Nondisclosure of current material prices	\$817,397	\$46,477	\$863,874
Computation error	269,874	0	269,874
Nondisclosure of updated bill of material	71,417	15,638	87,055
Total	1,158,688	62,115	1,220,803
Overhead and profit	1,038,491	80,307	1,118,798
Total	\$2,197,179	\$142,422	\$2,339,601

**Nondisclosure of Current
Material Prices**

We reviewed 20 parts valued at \$6,995,366, or 61 percent of proposed material costs. We found Hughes did not disclose accurate, complete, and current cost or pricing data for 19 of the 20 parts. Prices for 15 items were overstated and 4 were understated. Hughes did not disclose it had already purchased the items at lower prices or obtained lower vendor quotations. As a result, material prices were overstated by a net amount of \$863,874 as shown in appendix II.

The following illustrations show the conditions we found.

**Beamsplitter-Part Number
11508247**

Hughes proposed to provide beamsplitters at \$3,100 a unit based on an October 27, 1981, quotation from vendor A. Hughes, however, had solicited and obtained substantially lower quotations from three other vendors in November 1981 which were not disclosed. Prior to prime contract negotiations, all four vendors submitted updated quotations which are listed in table I.2.

Table I.2 Vendor Quotations

Contract requirement (percent)	Vendors (unit prices)			
	A	B	C	D
100	\$(a)	\$1,352.50	\$1,026.00	\$(a)
60	2,500.00	1,434.78	1,043.94	913.50
40	2,800.00	1,543.37	1,059.92	962.50

^aUpdated quotations did not include prices for 100 percent requirement

In February 1982, Hughes' Procurement Review Committee disqualified vendor D and decided to purchase the items from vendors C and B on a 60/40-percent basis. On June 23, 1982, Hughes purchased 60 percent

While Hughes intended to purchase the 40-percent share from vendor B at \$1,543.37 a unit, the bid was withdrawn before prime contract negotiations. At that point, Hughes had quotations of \$2,800 and \$1,059.92 a unit from qualified vendors A and C, respectively.

We do not believe the \$2,800 unit price was a reasonable estimate for the 40-percent share considering the substantially lower quotation from vendor C. In fact, after prime contract negotiations, Hughes purchased the 40-percent share from vendor D at \$962.50 a unit after assurance that the vendor could produce an acceptable beamsplitter.

Hughes officials also believe our calculation of overpricing on the laser rods is incorrect because we used a price quotation from an unqualified vendor. We believe the quotation was pertinent cost or pricing data because, at the time of prime contract negotiations, Hughes had purchased and received qualification units from the vendor for testing. Furthermore, Hughes had decided before prime contract negotiations to qualify the vendor and to solicit competitive price proposals. In fact, after prime contract negotiations, Hughes qualified the vendor and competitively purchased the laser rods at an average unit price of \$1,724.03.

The Hughes representatives do not agree with our calculation of overpricing on two damper parts because we used a quotation for an unapproved configuration. (See app. II.) While the configuration was not approved before prime contract negotiations, Hughes' purchasing documents show the company solicited the quotation with the intent of receiving government approval. Therefore, we believe the quoted prices were pertinent cost or pricing data and should have been disclosed. After prime contract negotiations, the configuration was approved and Hughes purchased the dampers at \$900 a unit.

More Current Material Pricing Information Not Identified in DCAA Audit

DCAA reviewed Hughes' proposal and reported the audit results on March 31, 1982. During the audit, DCAA asked Hughes to provide the most recent quotations supporting prices for 98 parts. The contractor provided quotations supporting the proposed material costs but did not disclose other lower quotations.

The 20 parts we reviewed were in the 98 audited by DCAA. When DCAA did its audit, lower quotations were available in Hughes' purchasing files for 9 of the 20 parts. The quotations were solicited from qualified vendors or those Hughes intended to qualify. If DCAA had reviewed the purchasing files rather than rely on information provided by Hughes, a

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October 13, 1987

Major General Thomas D. Reese
Commander, U.S. Army Missile Command
Department of the Army
Redstone Arsenal, Ala. 35898-5740

Dear General Reese:

We completed a review of the pricing of contract DAAH01-82-C-A240 and modification P00056 to contract DAAH01-81-C-A155 awarded to Hughes Aircraft Company, El Segundo, California, for Ground/Vehicular Laser Locator Designators (G.VLLDs), by the U.S. Army Missile Command (MICOM). Our objective was to determine whether Hughes complied with the Truth in Negotiations Act (Public Law 87-653) in providing accurate, complete, and current cost or pricing data and whether fair and reasonable prices were negotiated by the contracting officer.

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