



UNITED STATES GENERAL ACCOUNTING OFFICE
REGIONAL OFFICE
ROOM 7068, FEDERAL BUILDING
300 NORTH LOS ANGELES STREET
LOS ANGELES, CALIFORNIA 90012

092939

MAR 19 1971

Brigadier General Peter G. Olenchuk
Commanding Officer
U. S. Army Ammunition Procurement
and Supply Agency
Joliet, Illinois 60436



Dear General Olenchuk:

As part of our review of the negotiation of contract prices under the provisions of Public Law 87-653, we have examined into the prices proposed and negotiated for firm fixed-price contracts DAAA09-68-C-0317 and DAAA09-69-C-0107 awarded to Alcan Aluminum Corporation, Riverside, California, by the U. S. Army Ammunition Procurement and Supply Agency (APSA). Contract -0317 was awarded on January 31, 1968, in the amount of \$1,191,970 and provided for the contractor to furnish 346,000 Rocket Motors; HE,66MM,M54,MPTS. Contract -0107 was awarded on December 30, 1968, in the amount of \$4,631,031 and provided for the contractor to furnish 1,390,700 M54 Rocket Motors. Contract -0107 was negotiated by the Los Angeles Procurement Agency (LAPA) at APSA's request.

Our examination was primarily concerned with the reasonableness of the price negotiated in relation to cost or pricing data available at the date of contract negotiations and the adequacy of technical and audit evaluations of the contractor's cost proposals.

We found that proposed costs for contract -0317 were based on the most current, complete, and accurate cost or pricing data at the time of contract negotiations with the exception of tool maintenance costs which were apparently understated. With respect to contract -0107, we found that proposed labor costs were higher than indicated by cost information available at the date of contract negotiations by about \$31,400, including applicable overhead and profit. Also, proposed tool maintenance costs may have been understated. The evaluations of the contractor's cost proposals were not performed in sufficient depth to determine whether the proposed contract prices were based on the most current, complete, and accurate cost or pricing data.

The results of our review are discussed below.

~~74453~~

092939

MAR 19 1971

CONTRACT DAAA09-68-C-0317

Alcan submitted a price proposal in the amount of \$1,358,396 on September 19, 1967, in response to APSA's request for proposal number DAAA09-68-R-0045. A revised proposal was submitted on December 29, 1967. APSA performed a technical evaluation of the original cost proposal and the Defense Contract Audit Agency (DCAA) performed a preaward audit of the revised cost proposal.

Contract negotiations were concluded on January 23, 1968, and resulted in a total contract price of \$1,191,970 or \$3.445 a unit. Final contract negotiations were on a total price basis; therefore, the amounts negotiated for each element of cost could not be determined. The negotiated price reduction amounted to \$166,426. Alcan executed a Certificate of Current Cost or Pricing Data on the negotiation date. A defective pricing clause was incorporated into the contract.

Tool maintenance costs

The contractor proposed \$34,500 for tool maintenance based on historical costs experienced in the production of units under prior contracts during July to November 1967 as follows:

<u>Cost element</u>	<u>Unit cost</u>	<u>Amount based on contract quantities</u>
Material	\$.03221	\$11,100
Labor	.05913	20,500
Overhead	.00852	2,900
	<u>\$.09986</u>	<u>\$34,500</u>

We found that the contractor, in computing the unit cost for material and labor, incorrectly matched historical costs for June to November 1967 with units produced during July to November 1967. As a result, we estimate that proposed material and labor costs were higher than indicated by available cost information by about \$6,600. We also found that the contractor did not propose tool maintenance overhead costs on a basis consistent with the existing method of allocating overhead costs.

Other proposed overhead costs for this contract were based on the existing allocation method. We estimate that proposed tool maintenance overhead costs were understated by about \$12,100 as a result

MAR 19 1971

of the inconsistent treatment of these costs. The net understatement amounted to about \$5,500, or about \$6,400 including applicable administrative costs and profit.

Contractor officials agreed with our observations and stated that there had been an oversight in the estimating process.

Neither the overstatements nor understatements of proposed tool maintenance costs were identified during the preaward audit performed by DCAA.

CONTRACT DAAA09-69-C-0107

Contract -0107 was issued as a letter contract on September 16, 1968, with a ceiling price of \$3.347 a unit. The contractor's proposal to definitize the contract was submitted on December 6, 1968. LAPA performed a technical evaluation and DCAA performed a preaward audit of the cost proposal.

Negotiations were concluded on December 16, 1968, and resulted in a total contract price of \$4,631,031 or \$3.33 a unit. The contractor executed a Certificate of Current Cost or Pricing Data on the negotiation date, and a defective pricing clause was incorporated into the contract.

Direct labor costs

We estimate that proposed labor costs were higher than indicated by available cost information by about \$26,700, or \$31,400 including applicable overhead and profit. This resulted because the proposed labor rate of \$3.96 an hour for the assembly operation was based on a higher pay job classification than was appropriate. A labor rate of \$3.36 an hour should have been proposed for the assembly operation.

Contractor officials agreed with our observations and stated that the higher proposed labor rate resulted from an administrative error.

We found that DCAA did not review the basis for the contractor's proposed labor rates. Had a review been performed, we believe that the error in the proposed labor rate would have been identified.

MAR 19 1971

Tool maintenance costs

The contractor proposed \$163,800 for tool maintenance on the basis of historical costs of \$0.12 a unit experienced under prior production contracts during the period June 1967 to June 1968. We found that the contractor was experiencing a higher tool maintenance rate at the time of contract negotiations than had been proposed as shown below. However, the contractor did not update the cost proposal to reflect the higher rate.

<u>Period</u>	<u>Unit cost</u>	<u>Amount based on contract quantities</u>
June 1967 - October 1968	\$.1585	\$220,400
January - October 1968	.1766	245,600
July - October 1968	.2073	288,300

We were unable to determine the reasons for the increased tool maintenance rate because the financial records did not provide adequate visibility as to the composition of such costs. As a result, we could not determine whether the costs experienced in the latter months would have been more representative of what the contractor could expect to incur during performance of contract -0107. It does, however, appear that the proposed tool maintenance costs may have been understated based on the most current data available at negotiations.

Contractor officials advised us that their policy has been not to update cost proposals at negotiations unless the more current cost data varies significantly from proposed costs. The officials acknowledged that they did not update the cost proposal although the more current data varied significantly.

We found that the DCAA preaward audit of the contractor's cost proposal did not include a review of proposed tool maintenance costs. Had a review been performed, we believe that the higher rate would have been disclosed to the contracting officer for consideration during negotiations.

MAR 19 1971

Need to update cost proposal

In addition to the preceding example regarding tool maintenance costs for contract -0107, we identified other elements of the cost proposal which were not based on the most current information. Although the use of more current cost data would not have resulted in a significant change in the proposed costs, we believe that such data should have been disclosed by the contractor during negotiations.

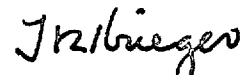
Contractor officials generally agreed with a need to update the cost proposals in those cases where significant time lags exist between the original submission of a cost proposal and the final price negotiations and indicated that action would be taken to improve this condition.

- - - -

We believe that the contracting officer should consider the above findings, along with any additional information available, to determine the extent to which the Government may be legally entitled to a price adjustment to contract -0107. With respect to proposed tool maintenance costs under this contract, you may wish to consider whether the "set off" principles of understated cost or pricing data contained in Defense Procurement Circular No. 77 are applicable.

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 Regional Manager, Defense Contract Audit Agency, and to the Commander, Defense Contract Administration Services Region, for their information.

Sincerely yours,



H. L. KRIEGER
Regional Manager

BEST DOCUMENT AVAILABLE

cc: Regional Manager, DCAA, Los Angeles
Commander, DCASR, Los Angeles