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United States General Accounting Office

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Report to the Commander, U.S. Air Force
Electronic Systems Division of the Air
Force Systems Command

October 1987

CONTRACT PRICING

Overpricing of AWACS Aircraft Color Monitor Subcontracts



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October 22, 1987

Lieutenant General M.F. Chubb, Jr., USAF
Commander, Electronic Systems Division
Air Force Systems Command
Hanscom Air Force Base, Massachusetts 01731-5000

Dear General Chubb:

We recently completed a review of subcontract pricing at Hazeltine Corporation, Greenlawn, New York. We examined material pricing on a Hazeltine subcontract awarded by Boeing Aerospace Company for the production of color monitors for the E-3a AWACS aircraft. The subcontract was awarded under a modification to prime contract number F19628-83-C-0004 between the Electronic Systems Division of the Air Force Systems Command and Boeing. Our objective was to determine whether Hazeltine provided Boeing accurate, complete, and current cost or pricing data as required by the Truth in Negotiations Act, Public Law 87-653.

We determined that Hazeltine did not provide Boeing with accurate, complete, and current cost or pricing data. Boeing, after analysis and negotiation with Hazeltine, included the overstated price in its proposal to the government. As a result, the price of the prime contract was overstated by \$192,222, including \$85,587 in overhead and profit.

Hazeltine officials did not agree that its proposed material prices were overstated. They stated historical pricing data was not available and that the quotes they had provided were more recent. However, historical pricing data was available in Hazeltine's computerized files. In fact, this is where we obtained the information. While it was appropriate for Hazeltine to provide the more recent quotes, implementing regulations define "cost or pricing data" as all facts that would reasonably be expected to effect price negotiations. Such facts include historical pricing data showing prices previously obtained. The prior purchases showing the great disparity of prices would be information that a prudent buyer would like to know and, absent an explanation for the price differences, would reasonably be expected to significantly effect price negotiations.

Hazeltine also cited a Defense Contract Audit Agency (DCAA) audit report as the basis for resolving pricing on one part. The DCAA audit report cited by Hazeltine did not provide the same information which we obtained. DCAA's finding was based on a purchase after Boeing and

Hazeltine had agreed on price. Our finding is based on purchase prices before price agreement had been reached.

We believe the information presented in this report provides a basis for you to initiate action to recover funds from Boeing¹ and recommend you take such action. We would appreciate being advised of any actions taken on this matter. If you or your staff need additional information, please call me at (212) 264-0961.

Copies of this report are being sent to the President, Boeing Aerospace Company, Seattle, Washington; the President, Hazeltine Corporation, Greenlawn, New York; the Department of Defense, Office of the Inspector General, Washington, D.C.; the Boston Regional Director, Defense Contract Audit Agency; and the Commander, Defense Contract Administration Services Region, New York, New York.

Sincerely yours,



Mary R. Hamilton
Regional Manager

¹Boeing, as the prime contractor and the only entity having privity of contract with the government is financially responsible for any defective pricing caused by its subcontractors.

Noncompliance With Public Law 87-653 Resulted in Overstated Subcontract Prices on Color Monitors for E-3a AWACS Aircraft

Background

The Truth in Negotiations Act, Public Law 87-653, as amended, requires that, with certain exceptions, contractors and subcontractors submit cost or pricing data to support proposed prices for noncompetitive contracts. Contractors and subcontractors are also required to certify that the data submitted are accurate, complete, and current. In cases where Public Law 87-653 is applicable, the government has a right to obtain a price reduction from the prime contractor, if it is determined that the prime's price was overstated because the data submitted by either the prime or subcontractor were not in accordance with the statute and the certification. The prime contractor, in turn, has a contractual right to obtain a reduction, for any defective pricing caused by that subcontractor.

The Electronic Systems Division of the Air Force Systems Command awarded a fixed-price incentive contract, F19628-83-C-0004, to Boeing effective in January 1983. Boeing and Hazeltine executed a memorandum of agreement in March 1983 requiring Hazeltine to produce color monitors and other equipment. Because of design changes to the color monitor and increases in the number of color monitors needed, the Air Force decided that the prime contract with Boeing had to be modified. These changes also required an amended memorandum of agreement between Boeing and Hazeltine.

Hazeltine submitted its contract pricing proposal for the modified color monitor production effort to Boeing in October 1983. Boeing analyzed the Hazeltine data in December 1983 and initiated negotiations with Hazeltine. On January 19, 1984, Hazeltine gave Boeing an updated bill of material which included the prices and the quantities of each part comprising the color monitor. Boeing and Hazeltine then executed an amended memorandum of agreement on January 26, 1984, which stated that Hazeltine would receive \$20.6 million to produce 496 color monitors. On September 20, 1984, the Air Force and Boeing agreed to modify the prime contract.

On August 14, 1984, Boeing executed a certificate of current cost or pricing data certifying that data supplied to the Air Force's contracting officer was accurate, complete, and current as of August 3, 1984. On September 26, 1984, Hazeltine executed its certificate of current cost or pricing data certifying that data supplied to Boeing was accurate, complete, and current as of January 26, 1984.

Incomplete and Inaccurate Data Caused Price to Be Overstated

Hazeltine did not provide Boeing complete and accurate cost or pricing data as required by Public Law 87-653. As a result, the price of prime contract F19628-83-C-0004 was overstated by \$192,222, including overhead and profit.¹ Table I.1 shows the overpricing associated with each part for which more complete or accurate information was available.

Table I.1: Overpricing of Individual Parts

Part number	Nomenclature	Hazeltine quantity	Proposal unit price	Available unit price	Amount of overpricing
Complete purchase history data not disclosed					
M38510/21002BJX	Integrated circuit	1,000	\$87.50	\$42.50	\$45,000
M38510/07801BJX	Integrated circuit	4,000	31.00	18.67	49,320
Subtotal					94,320
Inaccurate prices submitted					
912327 1	Integrated circuit	500	37.90	22.50	7,700
341141	Filter	500	28.00	18.77	4,615
Subtotal					12,315
Total of individual parts					\$106,635
Overhead and profit ¹					85,587
Total overpricing					\$192,222

¹Includes Boeing and Hazeltine

Complete Purchase History Data Not Disclosed

Hazeltine did not provide complete purchase history data to Boeing for two integrated circuits in the color monitor. For both circuits, the prices not disclosed to Boeing were lower than those quoted to Boeing.

- For one integrated circuit, part number M38510 21002BJX, Hazeltine proposed to purchase 1,000 units at \$87.50 each. The proposed price was based on a quote received from a supplier on January 24, 1984, prior to the execution of the memorandum of pricing agreement between Boeing and Hazeltine on January 26, 1984. Hazeltine, however, did not disclose to Boeing that in November 1983 it had purchased 140 of the same circuits from another supplier at a unit cost of \$42.50. As a result, Hazeltine's proposal was overstated by \$45,000, as shown in table I.1. The contracting officer concurred with this finding.

¹The overhead and profit figure is based on rates in effect at the time the contract was negotiated

- For the other integrated circuit, part number M38510/07801BJX, Hazeltine proposed to purchase 4,000 units at \$31.00 each. The proposed price was based on a quote received from a supplier on January 24, 1984, prior to execution of the memorandum of pricing agreement on January 26, 1984. Hazeltine failed to inform Boeing of a purchase it had made of 10 units from the same supplier in November 1983 at \$18.67 each. This resulted in a \$49,320 overstatement in Hazeltine's proposal as shown in table I.1. The contracting officer did not concur with this finding because of a disclosure made by the Defense Contract Audit Agency (DCAA). (See pages 7 and 8.)

Hazeltine officials did not agree that their proposal was overstated. They stated that: (1) the purchase history data for both circuits were not available to Hazeltine, (2) the quotes Hazeltine used were more current than the purchase history data, and (3) a DCAA report disclosed a lower price for one of the integrated circuits to the contracting officer. As described below, our analysis of the aforementioned conditions described by Hazeltine did not mitigate the defective pricing.

Availability of Purchase History Data

Hazeltine officials stated they were not aware of the November 1983 purchases because they did not appear on their material cost estimate worksheet.² This occurred because the prefix "JM" used in M38510 series part identification numbers by the supplier was recorded by Hazeltine personnel in the procurement history files as "JM" instead of "M". Hazeltine officials told us they usually use an "M" prefix—not a "JM" prefix—to identify such parts. Therefore, they extracted only purchases beginning with "M" from their procurement history records when preparing the material cost estimate worksheet. They maintained that because the parts were incorrectly coded—"JM" instead of "M"—the purchase history data were not available to Hazeltine at the time of negotiations, and therefore could not be disclosed to Boeing.

Hazeltine's procurement records showed that some parts in the M38510 series were coded with both "JM" and "M" prefixes and others were coded with either "JM" or "M". It was Hazeltine's responsibility to be sufficiently familiar with its own purchase history system to call for all parts in the M38510 series, including parts with both prefixes, when

²A material cost estimate worksheet is a computer-generated schedule which contains recent procurement history for all parts in a proposal. It is prepared by Hazeltine for each pricing proposal that it submits.

extracting purchase history data for its material cost estimate worksheet.

Use of Current Quotes

Hazeltine officials also commented that the quotes it used to support the prices for the two parts were more current than the purchase history data we found. Hazeltine officials also stated that its estimating procedures at the time required that the more recent quotes be used even if Hazeltine knew of the earlier purchases.

While disclosure of the more recent quotes was appropriate, Hazeltine was required under the act to disclose complete as well as current data. Moreover, according to DAR 3-807.1(A)(1), such data includes "all facts existing up to the time of agreement on price which prudent buyers and sellers would reasonably expect to have a significant effect on the price negotiations." The prior purchases showing the great disparity of prices would be information that a prudent buyer would like to know and, absent an explanation for the price differences, would reasonably be expected to significantly effect price negotiations.

Disclosure in DCAA's Report

Hazeltine officials contend that the Air Force's contracting officer was aware of the lower price on part number M38510-07801BJX because it had been reported by DCAA. The DCAA report was issued in June 1984 in response to the contracting officer's request for an evaluation of Hazeltine's price proposal prior to the final contract negotiations between the Air Force and Boeing in July and August 1984. Although the DCAA evaluation was after Boeing and Hazeltine had agreed on the subcontract price, it was still useful as an indicator of Boeing's analysis of Hazeltine's proposal. In its report, DCAA questioned \$49,320 in costs for part number M38510-07801BJX, an amount identical to the amount of defective pricing we identified. The costs questioned by DCAA did not result in a contract price adjustment. The contracting officer told us she could not support our finding of defective pricing on the part because the DCAA audit report provided the Air Force with knowledge of a lower price for this part.

Our review of the contracting officer's files and the June 1984 DCAA report with its supporting workpapers revealed that, while DCAA did question \$49,320 in costs, its finding was based on a purchase made by

Appendix I
Noncompliance With Public Law 87-653
Resulted in Overstated Subcontract Prices on
Color Monitors for E-3a AWACS Aircraft

Hazeltine in February 1984—after the memorandum of pricing agreement between Boeing and Hazeltine was executed. According to the contracting officer's files, the finding was discussed during the Air Force's negotiations with Boeing but no contract price adjustment was made.

Our finding is based on an earlier purchase price. The purchase price of \$18.67 by Hazeltine in November 1983 was 2 months before the memorandum of pricing agreement was executed. DCAA's report to the contracting officer does not refer to this purchase. Consequently, the failure by Hazeltine to disclose the earlier purchase price constitutes defective pricing.

Inaccurate Prices
Submitted

Hazeltine submitted incorrect prices for two parts in its color monitor proposal resulting in further overpricing of \$12,315. As shown in table I.1, Hazeltine reported the quoted unit price for 500 integrated circuits, part number 912327-1, as \$37.90 when in fact the actual quoted price was \$22.50. An incorrect price was also disclosed for a filter, part number 341141. Hazeltine reported the quoted unit price at \$28.00; the actual quoted price was \$18.77.

Hazeltine officials stated that the written quotes for the two parts were received after the updated bill of material was submitted to Boeing on January 19, 1984, but before the memorandum of pricing agreement was signed on January 26, 1984. They speculated that the initial quotes were probably obtained by telephone and that they were either incorrectly recorded by Hazeltine or changed by the supplier on the written quote. In either situation, Hazeltine commented that its purchasing system at the time did not allow it to react fast enough to provide information on minor parts to its negotiators who were meeting with Boeing in Seattle. Therefore, Hazeltine concluded, the information was not disclosed because it was not available, and, according to Public Law 87-653, data not reasonably available is not required to be disclosed.

The quotes sent to Hazeltine by its supplier were dated January 18, 1984, and January 20, 1984. The January 20, 1984, quote was stamped by Hazeltine's purchasing department as received on January 22, 1984. The date stamped on the earlier quote was not clearly legible. As noted in our earlier examples on page 5, Hazeltine's proposed prices for those two parts were based on quotes received on January 24, 1984. If Hazeltine could incorporate quotes dated January 24, 1984, quotes received earlier were also available and should have been disclosed. The contracting officer agreed with our finding.

Objective, Scope, and Methodology

Our objective was to determine whether Hazeltine complied with Public Law 87-653 by providing Boeing with accurate, complete, and current cost or pricing data for submission to the Air Force. We performed our review at Hazeltine Corporation, Greenlawn, New York; Boeing Aerospace Company, Seattle, Washington; DCAA offices at Hazeltine and Boeing; and the Air Force's Electronic Systems Division, Hanscom Air Force Base, Massachusetts.

We made a detailed review of Hazeltine's subcontract for production of color monitors under Boeing's modified prime contract number F19628-83-C-0004, including an examination of prime and subcontract file documents, negotiation records, purchase order files, related price proposals, and a DCAA audit report and related workpapers covering a review of Hazeltine's proposal. We also interviewed contractor representatives and government officials responsible for procurement, contract administration, and contract audit.

Our review included an examination of 110 purchased production material parts, totaling \$3,926,035, or about 80 percent of the \$4,899,599 production material costs proposed by Hazeltine.

Our review was performed between September 1986 and April 1987 in accordance with generally accepted government auditing standards.

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