

DOCUMENT RESUME

03853 - [B2994243] (Restricted)

[Contract for the Development and Production of F-16 Aircraft].  
PSAD-78-3; B-152600. October 21, 1977. 4 pp. + enclosure (1  
pp.).

Report to General Lew Allen, Jr., Commander, Department of the  
Air Force: Air Force Systems Command, Andrews AFB, MD; by  
Richard W. Gutmann, Director, Procurement and Systems  
Acquisition Div.

Issue Area: Federal Procurement of Goods and Services:  
Reasonableness of Prices Under Negotiated Contracts and  
Subcontracts (1904).

Contact: Procurement and Systems Acquisition Div.

Budget Function: National Defense: Department of Defense -  
Procurement & Contracts (058).

Organization Concerned: General Dynamics Corp.: Fort Worth Div.

A fixed-price incentive contract was awarded without price competition to General Dynamics Corporation for the development and production of F-16 aircraft. The contract provided for a full-scale development program and firm-priced production options. The development program is currently valued at \$442 million, and three production options are priced at about \$1,130 million. Findings/Conclusions: Indications are that the F-16 program costs will increase. Contracting officers are required to obtain cost or pricing data from contractors to support proposed prices for negotiated noncompetitive contracts, and contractors are required to certify that the cost or pricing data used as a basis for negotiating contract prices is accurate, current, and complete. The Aeronautical Systems Division of the Air Force Systems Command did not strictly follow Department of Defense regulations which provided that a cost analysis be prepared to assure the reasonableness of the price proposed. Instead of conducting a cost analysis of the contractor's data, the Air Force relied heavily on its own cost estimate to determine that the offer was fair and reasonable. Such an independent analysis cannot identify inconsistencies or duplications between the contractor's cost elements or errors in his estimates. Overpricing of \$20.5 million was identified. This amount related to costs included for Government-furnished aeronautical equipment. Recommendations: The Aeronautical Systems Division should evaluate available information to determine whether the Government is entitled to a price adjustment on the F-16 development program or a reduction in the prices established for the production options as provided for by the defective pricing clause included in the contract. (SC)



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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

PROCUREMENT AND SYSTEMS  
ACQUISITION DIVISION

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B-152600

OCT 21 1977

General Lew Allen, Jr.  
Commander, Air Force Systems Command  
Andrews Air Force Base, Maryland 20334

Dear General Allen:

We have examined the price proposed and negotiated for fixed-price incentive contract F33657-75-C-0310 awarded without price competition to General Dynamics Corporation, Fort Worth Division, for the development and production of F-16 aircraft. The contract, awarded January 13, 1975, by the Air Force Systems Command, Aeronautical Systems Division, provided for a full-scale development program and firm-priced production options. The development program is currently valued at about \$442 million, and three production options are priced at about \$1,130 million.

Indications are that the F-16 program cost will increase. For example, the initial contract provided for 301 production aircraft while a total of 998 aircraft are now planned for production--348 for the European countries and 650 for the U.S. Air Force. Ultimately, the United States plans to buy 1,388 aircraft. A sale of 160 aircraft to Iran has been approved and additional sales are possible in Israel, Spain, Turkey, and Greece.

The Armed Services Procurement Regulation requires that contracting officers obtain cost or pricing data from contractors to support proposed prices for such negotiated noncompetitive contracts expected to exceed \$100,000. Contractors are required to certify that cost or pricing data used as a basis for negotiating contract prices is accurate, current, and complete.

General Dynamics executed the required certificate as of January 8, 1975. We found, however, that the Air Force did not strictly follow Department of Defense regulations which provide that where cost or pricing data is obtained, a cost analysis shall be performed to assure the reasonableness of

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the price proposed. Cost analysis includes the appropriate verification of cost data furnished by the contractor, the evaluation of specific elements of cost, and the projection of the data to determine the effect on prices. No alternative methods of evaluation are authorized. In our opinion the departure from procedures developed over the years to increase assurance of negotiating fair and reasonable prices for needed goods and services was not warranted. For a program of this size, in excess of \$1.5 billion, we believe a good cost analysis is essential. Although our review disclosed only a relatively small amount of overpricing, less than 2 percent of the contract price, we believe the procedures followed by the Air Force could have allowed substantial overpricing or underpricing to go undetected.

The Air Force relied heavily on its own cost estimate to determine that the offer was fair and reasonable. We believe that the decision to award the contract in January 1975 instead of the originally planned contract award date of May or June 1975 to improve chances of multinational participation may have contributed to the Air Force's lack of strict compliance with established regulations and procedures in awarding the contract.

The Air Force cost estimate, referred to as an independent cost analysis, was prepared using both industrywide and some contractor data. Although the estimate was extensive and included many analytical assessments to determine the expected cost, it should not have been relied on as a substitute for a cost analysis of the contractor's data. At best, an independent analysis provides a cost estimate which can be used to identify gross errors in the total price proposed. It does not, however, take into consideration management judgments unique to the contractor's proposal, trade-offs the contractor may have made, or business judgments. An independent analysis cannot identify inconsistencies or duplications between the contractor's cost elements or errors in his estimates.

The overpricing that we identified relates to costs for Government-furnished aeronautical equipment. Examination of contractor data showed that the negotiated price was overstated because the contractor did not provide the Air Force with current, accurate, and complete data. The proposal submitted to the Air Force included two prices--one including the cost

of the equipment, assuming it would be included in the contract, and one with it supposedly deleted, assuming the Government would furnish this equipment. The contractor, however, in arriving at a price without the equipment, deleted \$17 million less than the price which it had originally included for the equipment. This error resulted in a further overstatement of \$3.5 million when an additional 55 aircraft were added to the contract (see enclosure).

Thus, even though the Air Force ultimately chose to furnish the equipment to the contractor, the contract target price included \$20.5 million for the equipment. Because of the incentive cost sharing arrangement between the Air Force and the contractor (90/10 for the development program and 70/30 for the production program), the final impact of this overstatement will not be known until the contract is completed.

We found no evidence that the contracting officer was aware that the price accepted included any amount for the equipment to be furnished by the Government. Had this been made known by the contractor, the contracting officer would have had a sound basis for reducing the contract price by \$20.5 million.

#### RECOMMENDATION

We recommend that the Aeronautical Systems Division consider the information presented herein, along with any additional material available, to determine whether the Government is entitled to a price adjustment on the development program or a reduction in the prices established for the production options, as provided for by the defective pricing clause included in the contract.

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We are sending copies of this report to the Commander of the Air Force Aeronautical Systems Division, and the Vice President-Finance, General Dynamics Corporation.

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We would appreciate receiving your comments on these matters and would be pleased to discuss any questions that you may have.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "R. W. Gutmann".

R. W. Gutmann  
Director

Enclosure

COMPUTATION OF OVERPRICING  
GOVERNMENT-FURNISHED AERONAUTICAL EQUIPMENT (GFAE)  
DEVELOPMENT PROGRAM

Price (with fee) of GFAE items included in proposal to Air Force computed by GAO (\$4,146,948 recurring + \$121,799 nonrecurring)	\$4,268,747
Price (with fee) of development aircraft spares included in proposal applicable to GFAE items (11.2 percent of recurring GFAE)*	<u>464,458</u>
Price of GFAE items and spares included in proposal	\$4,733,205
Price (with fee) of GFAE items and spares deleted from proposal by General Dynamics	<u>3,157,782</u>
Overstatement (overpricing)	<u>\$1,575,423</u>

FIRM PRODUCTION PROPOSAL

246 aircraft proposed price

Price (with fee) of GFAE items included in proposal to Air Force computed by GAO	\$61,991,804
Price (with fee) of GFAE items deleted from proposal by General Dynamics	<u>46,496,891</u>
Overstatement (overpricing)	\$15,494,913
<u>Projection of GFAE error to added 55 production aircraft</u>	
Impact of error per aircraft \$62,987 x 55 (error per aircraft - 15,494,913 / 246 = \$62,987)	<u>3,464,285</u>
Total amount production proposal overstated (overpricing)	<u>\$18,959,198</u>
Total overpricing	<u>\$20,534,621</u>

\*General Dynamics proposed development aircraft spares at \$12,166,331 (then year dollars) by applying an 11.2 percent factor against the proposed air vehicle recurring cost. Since the GFAE was included as air vehicle cost, the development spares estimate included \$464,458 applicable to the GFAE items.