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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548



PROCUREMENT AND SYSTEMS
ACQUISITION DIVISION

B-159724

JUN 20 1973

The Honorable
The Secretary of Defense

Attention: Assistant Secretary of
Defense (Comptroller)

Dear Mr. Secretary:

We completed a selective examination of subcontract estimates included in prime contract prices negotiated on the basis of cost or pricing data submitted and certified as required by Public Law 87-653, the Truth-In-Negotiations Act. Effective January 1, 1970, contracting officials were required to have prime contractors who submit cost or pricing data with their proposals obtain cost or pricing data from prospective subcontractors in support of major subcontract estimates. We wanted to find out whether contracting officials had required prime contractors (1) to support major subcontract estimates with subcontractor cost or pricing data, (2) to fully justify requests for exemption from the requirement to furnish such data, and (3) to make a cost analysis of subcontractors' proposals and to use this information in evaluating the reasonableness of subcontract estimates.

We performed the examination at five procurement offices selected because they had awarded a significant number of high-value contracts during the first half of fiscal year 1972. We reviewed 61 subcontract estimates, valued at about \$177 million, included in the prices of 30 prime contracts, valued at about \$1.1 billion. The procurement offices responsible for the awards and the prime contracts reviewed are identified in the enclosure to this report.

In the majority of cases, contracting officers did not require the contractors to submit or identify supporting subcontractor cost or pricing data to the extent required by the Armed Services Procurement Regulation (ASPR). Other

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problems involved contracting officers' lack of emphasis on (1) reviewing and approving prime contractor requests for exemption from submitting subcontractor cost or pricing data, (2) obtaining and using prime contractor cost analyses of subcontractor proposals as an aid in negotiations, and (3) retaining subcontractor cost or pricing data after completing negotiations with the prime contractors. We believe that improvements in these areas will further insure that subcontract estimates included in prime contract prices are reasonable and that the Government's rights under the defective pricing clause will not be impaired.

BACKGROUND

Requirements for submitting cost or pricing data

Public Law 87-653 was enacted in 1962 because prices of negotiated contracts often were higher than indicated by cost or pricing data available to the contractors at the time of negotiations. In essence, the law provides that prime contractors and subcontractors be required, subject to specific conditions and exemptions, to submit cost or pricing data in support of proposed prices for noncompetitive contracts and subcontracts expected to exceed \$100,000 and to certify that this data is accurate, complete, and current. Contract prices can be adjusted when the price to the Government has been increased significantly because the contractor or subcontractor furnished data that was inaccurate, incomplete, or noncurrent as certified.

While Public Law 87-653 requires subcontractors to furnish cost or pricing data before a noncompetitive subcontract is awarded, such awards usually occur after the prime contract is awarded. Under the law, the prime contractor is not required to obtain cost or pricing data in support of a prospective subcontractor's proposed price. Since in many instances a significant portion of the prime contractor's proposal represents subcontract effort, the Department of Defense (DOD) moved to insure that the contracting officer would know the basis of major subcontract cost estimates.

On October 10, 1969, DOD issued Defense Procurement Circular (DPC) 74, effective January 1, 1970. This DPC,

which was incorporated into ASPR dated April 30, 1971, provides that prime contractors who are required to submit cost or pricing data under Public Law 87-653 must obtain and submit to the contracting officer cost or pricing data from prospective subcontractors in support of each subcontract estimate included in the prime contractor's submission that is (a) \$1 million or more, (b) both more than 10 percent of the prime contractor's proposed price and more than \$100,000, or (c) considered by the contracting officer to be necessary for proper pricing of the prime contract. Exemption from this requirement is granted when the subcontract price will be based on adequate price competition, established catalog or market price of a commercial item sold to the general public in substantial quantities, or prices set by law or regulation. The prime contractor is required to certify that the subcontractor's cost or pricing data is accurate, current, and complete.

Definition of cost or pricing data

ASPR defines cost or pricing data as "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." ASPR states that this includes, besides historical accounting data, such factors as vendors' quotations, nonrecurring costs, changes in production methods and in production or procurement volume, unit cost trends, make or buy decisions, or any other management decisions which could reasonably be expected to significantly affect the pricing. Further, the ASPR "Manual for Contract Pricing" states that the contracting officer must obtain all the data used to develop the offer or proposal and that he is responsible for insuring that the data submitted is adequate for contract pricing.

ASPR provides that the requirement for submitting cost or pricing data will be met if the contractor physically submits or identifies in writing the specific data. The ASPR manual states that, to be complete, identification of data will have to cover (1) what it is, (2) where it is, (3) what it represents, and (4) how it is used. The ASPR manual also presents a number of detailed examples of what represents an adequate submission or identification of cost or pricing data.

Need for adequate submission of
cost or pricing data

Whenever we could not find a record of subcontractor cost or pricing data, we concluded that contracting officials may not have been fully aware of the basis of the subcontract estimates and, accordingly, had less than adequate assurance that such costs were reasonable. Further, if it later developed that the subcontract estimate was higher than indicated by data available to the prime contractor or subcontractor, the Government's right to price adjustment might be impaired.

We recently reported to you the results of our review of DOD's practices in settling Defense Contract Audit Agency (DCAA) postaward audit reports recommending reductions in contract prices that DCAA believed had been increased because contractors had submitted cost or pricing data that was not accurate, complete, or current. (See B-159724, Mar. 22, 1973.) That report shows that contracting officials were determining that they did not have a basis to reduce contract prices in the amounts proposed by DCAA. One of the major factors contributing to the contracting officers' inability to uphold DCAA's recommendations was their failure, initially, to require contractors to submit cost or pricing data that (1) identified the data, (2) stated what the data represented, and (3) described how the data was used in arriving at the proposed price. When the contracting officer failed to obtain data meeting these criteria or had no record of the data submitted and when DCAA reported that estimated costs were higher than indicated by data available to the contractor at the time of negotiation, the contracting officer could not determine with certainty that the available data had, in fact, not been disclosed to the Government.

INADEQUATE SUBMISSION OR IDENTIFICATION
OF SUBCONTRACTOR COST OR PRICING DATA

For 37 of 51 major subcontract estimates we reviewed,¹ contracting officers did not obtain adequate subcontractor

¹In addition to these 51, we reviewed 10 subcontract estimates valued at \$15 million which were exempted from the requirements for submitting subcontract cost or pricing data because the price would be based on adequate price competition or catalog price. (See p. 8.)

cost or pricing data from prime contractors. For each of these subcontract estimates, subcontractors' cost or pricing data was required because the estimate was over \$1 million or was both more than 10 percent of the prime contractor's proposal and over \$100,000.

In a number of instances, the prime contractor submitted the cost or pricing data in support of these major subcontract estimates to Government personnel other than the contracting officer, such as DOD auditors or administrative or technical personnel at the contractor's plant. Whenever we found a written record of the data submitted to these sources, we concluded that this data was submitted and disclosed to contracting officials.

The 37 estimates not adequately supported represented about 73 percent of the number and 77 percent of the value of subcontract estimates reviewed. A summary of our findings follows.

Procurement office (note a)	Submissions reviewed		Subcontractor cost or pricing data			
	Number	Value	Adequate		Inadequate	
			Number	Value	Number	Value
SAMSO	20	\$ 52.7	13	\$36.9	7	\$ 15.8
AVSCOM	5	29.1	1	0.6	4	28.5
NAVAIR	10	47.3	-	-	10	47.3
NAVSHIPS	8	20.5	-	-	8	20.5
ASD	8	12.3	-	-	8	12.3
Total	<u>51</u>	<u>\$161.9</u>	<u>14</u>	<u>\$37.5</u>	<u>37</u>	<u>\$124.4</u>
Percent	100	100	27	23	73	77

^aSee enclosure for names of procurement offices.

In 3 of the above 37 cases, cost or pricing data was not obtained for any of the cost elements comprising the subcontract estimates. In the remaining 34 cases, some subcontractor cost or pricing data was obtained in support of most cost elements in the estimates. We considered this data inadequate, however, because not all of the information required by ASPR was provided. Examples follow.

1. The Space and Missile Systems Organization awarded a \$34 million prime contract for guidance and control systems that included a subcontract estimate of \$6,295,829. Subcontractor cost or pricing data obtained generally consisted only of cost estimates without descriptions of factual data or explanations of the estimating methods used. DCAA had advised the contracting officer that the cost or pricing data submitted with the subcontractor's proposal was not adequate as a basis for price negotiations.

2. The Aviation Systems Command (AVSCOM) awarded a \$21.5 million prime contract for helicopters. The prime contractor's proposal included a subcontract estimate of \$1,227,519 for bonded panels. The prime contractor, however, submitted no subcontractor cost or pricing data to AVSCOM or to DCAA. Although DCAA had evaluated the subcontract estimate at the subcontractor's plant and had reported that the cost or pricing data submitted was adequate for negotiation purposes, neither the contractor's submission nor the DCAA audit report identified the cost or pricing data on which the subcontract estimate was based.

3. The Aeronautical Systems Division awarded a \$3.1 million prime contract. The prime contractor's proposal included estimates of \$87,480, \$87,840, \$95,760, and \$128,160 for parts to be purchased from one supplier without competition on the basis of specifications and drawings provided by the prime contractor. Added together, the value of the four parts totaled about \$400,000, which was both more than \$100,000 and 10 percent of the prime contractor's proposal. The only support obtained for the estimated cost of these parts was a price quotation from the prospective subcontractor.

We discussed the absence of subcontractor cost or pricing data in support of this subcontract estimate with the contracting officer and he said that, since the prime contractor had listed the cost of these parts on the DD 633 (Contract Pricing Proposal) under the heading "purchased parts" rather than under "subcontract items," there was no requirement for the prime contractor to submit subcontractor cost or pricing data. The DD 633, however, describes subcontracted items as parts, components, assemblies, and services to be produced or performed by other than the prime contractor in accordance with the prime contractor's design, specifications, or directions and to apply only to the prime contract. Since these parts

were to be produced according to specifications and drawings furnished by the prime contractor, we concluded that the contracting officer should have required the prime contractor to obtain and submit subcontractor cost or pricing data in support of the cost estimate for these parts.

Reasons for not obtaining required subcontractor cost or pricing data

In a number of instances, the contracting officer was not concerned with the adequacy of the prime contractor's submission of subcontractor cost or pricing data because the data was not relied on in establishing the reasonableness of the subcontract estimates. Instead, reliance was placed on information obtained from DCAA, the Defense Contract Administration Service, and technical or administrative personnel at the prime contractor's plant. One contracting officer advised us that he prefers to rely on DCAA because he is more confident of the quality and accuracy of DCAA's audit than of the subcontractor's information. The DCAA audit is unquestionably a tool which the contracting officer should use in evaluating the reasonableness of the contractor's proposal. This work, however, should not be viewed as a substitute for submission by the prime contractor of the required cost or pricing data. The advisory audit report contains information on the reasonableness of the contractor's proposal but usually does not provide an authoritative record of the data certified by the contractor.

In a number of cases, the prime contractor submitted subcontractor cost or pricing data to administrative personnel at its plant or to other members of the pricing team, such as DCAA, rather than to the contracting officer. In most of these cases the contracting officer did not receive from the team members an overall evaluation of the adequacy of the subcontractor cost or pricing data. To insure that such evaluations are made, the Commander, Space and Missile Systems Organization, issued local instructions requiring contracting officers, as part of the request for field pricing support, to obtain a determination as to whether subcontract pricing proposals contain adequate identification of the basis for cost estimates.

Another reason for the lack of emphasis placed on adequate submission of subcontractor cost or pricing data appears to be the failure of the procurement offices to adequately publicize DPC 74. Five contracting officers said they were unaware that prime contractors were required to support their major subcontract estimates with subcontractor cost or pricing data.

REASONS NOT ADEQUATELY DOCUMENTED
FOR GRANTING EXEMPTIONS FROM SUBMITTING
SUBCONTRACTOR COST OR PRICING DATA

For 10 subcontract estimates we selected for review, contracting officers determined that supporting subcontractor cost or pricing data was not required because the estimates were based on either adequate price competition or catalog prices. ASPR states that subcontractor cost or pricing data will be obtained unless the prime contractor's submission demonstrates to the satisfaction of the contracting officer that a prospective subcontract will be based on adequate price competition or on an established catalog or market price of a commercial item sold in substantial quantities to the general public. We concluded, however, that in none of the 10 cases did the prime contractor adequately demonstrate this; neither did the contracting officers explain in the records of negotiations the reasons for their determinations that cost or pricing data was not required.

After reviewing available information, we concluded that the contracting officers' decisions in three of these cases seemed reasonable. We could not find evidence, however, which would support the granting of an exemption from furnishing cost or pricing data for the remaining seven subcontract estimates. Five of these cases concern adequate price competition and two cases involve catalog pricing. Examples follow.

Determination of adequate price
competition questionable

1. A prime contractor's proposal included a subcontract estimate of \$3,719,933. Although some cost or pricing data was submitted by the prime contractor in support of this estimate, we concluded that it was inadequate. For example, cost or pricing data supporting labor hours and material costs was not submitted or identified.

We asked the contracting officer why complete cost or pricing data had not been obtained. He told us that a determination had been made that adequate price competition existed, that no reliance was placed on the subcontractor cost or pricing data submitted, and that the subcontractor's proposal was accepted as reasonable. We found no indication that the prime contractor had requested an exemption from submitting the subcontractor data or that the contracting officer had documented the basis for his decision.

In reviewing the available records, we found that initially the prime contractor requested and received quotes from two sources for the work to be subcontracted; the lowest source quoted a price of \$5,495,350. The prime contractor included this amount in his original proposal. Before negotiation of the prime contract, however, the scope of the work for the subcontract was decreased substantially. In revising its proposal for the change in scope, the prime contractor negotiated only with the subcontractor quoting the lowest initial price. Because of the change, the subcontractor revised its quote from \$5,495,350 to \$3,719,933. We concluded that the change in work scope was so substantial as to nullify any reliance on previous competition and that cost or pricing data in support of the \$3,719,933 estimate should have been obtained and evaluated.

2. In another case the contracting officer accepted the prime contractor's statement that prices of three subcontracts were based on adequate competition even though the contracting officer knew that the required quantities were split between two offerors. The prime contractor contended that the subcontractors were well-known capable suppliers of the components involved; that, in the initial phases of proposal preparation, they were both contacted for quotations; that this field is highly competitive which tends to equalize costs in the production of the components; and that its purchasing department had engaged the subcontractors in discussions and negotiations which reduced initial bids. The prime contractor concluded that these factors had the effect of competition on all procurements of the subject components. We believe, however, that competition was less than adequate because the suppliers knew that the prime contractor had previously purchased these components by splitting requirements between the suppliers.

After we discussed this case with the head of the procurement office, he agreed that the subcontract awards should not have been considered competitive and that subcontractor cost or pricing data should have been obtained.

Evidence not obtained for
sales based on catalog price

At one procurement office we found two cases in which prime contractors were exempted from furnishing subcontractor cost or pricing data because the subcontract prices were based on catalog prices for items sold in substantial quantities to the general public. In neither instance, however, did the contracting officer, as required by ASPR, obtain documentation that there had been substantial sales to the general public at the catalog prices.

GREATER EMPHASIS NEEDED ON USE OF
PRIME CONTRACTOR EVALUATIONS OF
SUBCONTRACTOR PROPOSALS TO DETERMINE
THE REASONABLENESS OF SUBCONTRACT ESTIMATES

ASPR states that, although the prime contractor is responsible for the selection of subcontractors and for subcontract prices, the contracting officers must have adequate knowledge of these elements and their effects on contract prices and when appropriate, they should elicit from the prime contractor information concerning the cost or price analysis accomplished. We found only one case in which the prime contractor submitted a cost or price analysis of the subcontractor's proposal. Even in this case, the prime contractor's evaluation was primarily a compilation of DCAA and Defense Contract Administration Service reports and a history of negotiations between the subcontractor and the prime contractor.

ASPR was revised April 28, 1972, to make it mandatory for prime contractors and high-tier subcontractors to review and evaluate subcontractor proposals and accompanying cost or pricing data and furnish the results to the Government as part of their cost or pricing data submissions. ASPR also provides that when, in the contracting officer's opinion, the prime contractor or high-tier subcontractor's analysis of the subcontract proposal is inadequate, the

contracting officer will return the analysis package to the prime contractor for reaccomplishment.

Our review of three prime contracts resulting from solicitations issued after the effective date of the new requirement showed little improvement in the amount of information the prime contractor made available to the Government concerning its analysis of subcontractor proposals and supporting cost or pricing data. Further, 12 buyers at 3 procurement offices told us that they were not aware of the April 28, 1972, revision to ASPR.

Procurement officials at another procurement office said that compliance with the requirement for prime contractors to submit their analyses of subcontractor cost or pricing data will be left to technical and administrative personnel at the contractor's plant, DCAA, and other members of the pricing team.

SUBCONTRACTOR COST OR PRICING DATA
NOT RETAINED AS REQUIRED

ASPR provides that purchasing office contract files shall include all cost or pricing data submitted or used. However, in a number of prime contract awards by three of the five procurement offices visited, we found that, although Government personnel obtained and evaluated subcontractor cost or pricing data, this data had either been destroyed or returned to the contractor or its present location was unknown. Some contracting officers and price analysts said that subcontractor data is generally not retained in the contract files because the Government does not have privity of contract with subcontractors. They felt that prime contractors are responsible for maintaining the subcontract data.

When the cost or pricing data relied on in establishing the prime contract price is not retained and when postaward audits indicate that pertinent subcontractor data had not been disclosed, contracting officers might not be able to determine what data had been submitted and relied on. In that event, the Government's rights to a price adjustment under the defective pricing clause of the contract might be impaired.

One procurement office has already acted to emphasize the need to retain subcontractor cost or pricing data. After our review, the Commander, Space and Missile Systems Organization, issued instructions to its procurement personnel stating that the contracting officer should retain subcontract pricing proposals and supporting cost or pricing data.

RECOMMENDATIONS

We recommend that the Secretary of Defense insure that contracting officials:

- Enforce the requirement that prime contractors support their major subcontract cost estimates with subcontractor cost or pricing data as prescribed by ASPR.
- Carefully review and adequately document the basis for their determinations that the prime contractor is exempt from submitting subcontractor cost or pricing data.
- Require contractors to evaluate subcontractor proposals and to submit the results of these analyses with the proposals.
- Retain subcontractor cost or pricing data relied on in negotiating prime contract prices as part of the purchasing office contract files.

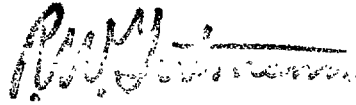
We shall appreciate receiving your comments on these matters. If you desire, we shall be pleased to furnish any additional information we may have on this review.

We are sending copies of this letter to the Director, Office of Management and Budget; the Secretaries of the Army, the Air Force, and the Navy; the Director, Defense Supply Agency; and the Director, Defense Contract Audit Agency. We

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are also sending copies to the Chairmen of the Senate and House Committees on Government Operations, Appropriations, and Armed Services.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "R. W. Gutmann". The signature is written in a cursive style with a horizontal line extending to the right.

R. W. Gutmann
Director

Enclosure

PROCUREMENT OFFICES VISITED
AND
PRIME CONTRACTS REVIEWED

ARMY:

Aviation Systems Command (AVSCOM)	DAAJ01-72-C-0102
	DAAJ01-72-C-0123
	DAAJ01-72-C-0501
	DAAJ01-71-C-0840
	DAAJ01-72-C-0381
	DAAJ01-72-C-0012
	DAAJ01-72-C-0502

NAVY:

Naval Air Systems Command (NAVAIR)	N00019-71-C-0444
	N00019-71-C-0450
	N00019-71-C-0398
	N00019-72-C-0114

Naval Ship Systems Command (NAVSHIPS)	N00024-72-C-5096
	N00024-72-C-5032
	N00024-72-C-0236
	N00024-72-C-0319
	N00024-70-C-0252

AIR FORCE:

Aeronautical Systems Division (ASD)	F33657-72-C-0072
	F33657-71-C-0631
	F33657-71-C-0786
	F33657-72-C-0766
	F33657-72-C-0430
	F33657-69-C-0396

ENCLOSURE

**Space and Missile Systems
Organization (SAMSO)**

F04701-71-C-0130
F04701-70-C-0202
F04701-71-C-0175
F04701-71-C-0038
F04701-69-C-0194
F04701-68-C-0178
F04701-71-C-0031
F04701-71-C-0064