UNITED STATES GENERAL ACCOUNTING OFFICE

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STATEMENT OF

FRANK C. CONAHAN, ASSISTANT COMPTROLLER GENERAL

NATIONAL SECURITY AND INTERNATIONAL AFFAIRS PROGRAMS

BEFORE THE

SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY

OF THE

COMMITTEE ON GOVERNMENT OPERATIONS

UNITED STATES HOUSE OF REPRESENTATIVES

ON

GAO CONTRACT PRICING REVIEWS AT SELECTED DEFENSE CONTRACTOR LOCATIONS

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before the Subcommittee to discuss the results of GAO's contract pricing reviews at selected major defense contractors. Our work was performed pursuant to your August 1985 request and focused on contractors' compliance with the Truth in Negotiations Act (Public Law 87-653). We reviewed the pricing of selected elements of 19 contracts at 10 major defense contractors. The contracts were awarded between 1982 and 1986.

We found problems in all 19 contracts. We believe the prices may be overstated by as much as $14 million because contractors did not disclose pertinent pricing information to Department of Defense (DOD) contracting officers. Prices of several contracts were overstated by an additional $7 million because contracting officers did not use relevant pricing data disclosed by contractors or did not rely on pricing recommendations made by the Defense Contract Audit Agency (DCAA). The contractors we visited and the amount of potential overpricing associated with each contractor are shown in attachment I.

THE TRUTH IN NEGOTIATIONS ACT

In fiscal year 1985, noncompetitive contracts awarded by DOD totaled $96 billion. Because competitive marketplace forces are absent, contract prices are based largely on cost estimates

proposed by contractors. Contracts negotiated on price proposals that exceed a reasonable approximation of the ultimate cost of contract performance may result in unjustified gains or enrichments at the expense of the government.

Recognizing the government's vulnerability in negotiating noncompetitive contract prices, the Congress passed the Truth in Negotiations Act in 1962. The Act requires contractors and subcontractors to submit cost or pricing data to support certain noncompetitive price proposals and to certify that the data submitted are accurate, complete, and current. It also provides for price reductions if it is later found that any defective data in proposals significantly increased the contract price.

In passing the Act, Congress sought to place the government on an equal footing -- an informational parity -- with contractors. During negotiations, government contracting officers should have knowledge of all facts affecting the pricing of the contract to ensure reasonable prices are negotiated.

FURNISHING DATA IN COMPLIANCE WITH THE TRUTH IN NEGOTIATIONS ACT

Our work showed that DOD contracting officers were not always provided pertinent and timely cost or pricing data. In fact, we found many cases where contractors had more accurate, complete, and current data that indicated lower prices than those proposed

to the government. For example, we found that contractors did not disclose more current vendor price quotations, actual subcontract awards, or evaluations of subcontractor proposals. We believe the nondisclosure of such data caused contractor proposals to be potentially overstated by $14 million. If DOD contracting officers had the data, we believe they would have had a sound basis for negotiating lower contract prices.

For example, at Hughes Aircraft Company, we examined the pricing of 20 major parts and found that they were overstated by $1.7 million. The overpricing resulted primarily because Hughes did not disclose lower prices it had already negotiated with its subcontractors. Hughes also had price quotations from multiple suppliers in its purchasing files but, in many cases, only provided the highest prices to the government.

In addition to the overstated prices for the 20 parts, Hughes made a computational error in its proposed material prices. Hughes' proposal included price adjustments for additions and deletions to material requirements. Our check of the mathematical accuracy of the adjustments showed that the contract price was overstated by about $477,000.

Hughes does not agree with the results of our review. Regarding the $1.7 million overpricing, they stated that updated material pricing information was disclosed to the government during

negotiations. They also stated that there is information in government files to show that a computational error was not made. Hughes, however, has not been able to provide any documentation to support their position. The government procuring office agrees with us that updated pricing information was not disclosed and the computational error was not found during negotiations.

Hughes also claims it understated its proposal for material scrap, obsolescence, and rework by an amount which exceeds the overpricing we found. We did not review the propriety of the claimed offset. This is a matter for the contracting officer to decide.

In another example, we reviewed two contracts at Honeywell's Defense Systems Division for anti-personnel and anti-armor mines. Honeywell's proposals were overstated by $1.9 million because of an inflated overhead rate. The company did not disclose information about known future business that was pertinent to the development of the proposed overhead rate. Had this information been disclosed Honeywell's proposed overhead rate would have been substantially lower.

Honeywell agrees the proposed overhead rate was inflated but contends the government should have known this. Honeywell maintains that rates were discussed during negotiations and believes all pertinent information was disclosed. Honeywell's

negotiation records, however, state that while a rate was discussed, the data supporting the rate was not disclosed. That data supported a much lower rate.

In another case involving disclosure, Pratt and Whitney submitted data after price agreement had been reached and claims the submission was a timely disclosure under the Act.

The purpose of the Act was, as I have mentioned, to give the contractor and the government the same information in arriving at price agreement. It is difficult to understand how Pratt's view would allow the government to have the same information as the contractor.

Pratt asserts that its data submittal after price agreement meets the Act's disclosure requirements. The contracting officer, however, states that the contract price was based only on data provided prior to price agreement. In addition, the commander of the Navy procuring activity, in response to our inquiry, emphasized it is the contractor's responsibility to provide the Navy with the most current, complete, and accurate data available at the time of price agreement.

The position taken by Pratt raises issues that could ultimately be decided by the Armed Services Board of Contract Appeals or in court. If, Mr. Chairman, the issues are decided against the

government, we believe the Truth in Negotiations Act should be amended to prevent defenses of this type.

CONTRACTING OFFICERS' FAILURES TO USE COST OR PRICING DATA

While contractors have not always complied with the disclosure requirements of the Act, we found instances where DOD contracting officers did not always use available data to negotiate lower prices. We found contracts were overpriced by $7 million because contracting officers failed to use data made available by contractors or to rely on pricing recommendations by the DCAA.

For example, on a contract for M-60 tank gun sights awarded to Texas Instruments, we estimate the contract price was significantly increased because data submitted by the contractor was not used. In this case, DCAA advised the contract negotiator that the materials portion of the proposal was unacceptable as a basis for negotiation because more than 40 percent of the estimated material cost was questioned or unsupported. Later, Texas Instruments provided the government contract negotiator information during negotiations indicating lower material prices than originally proposed. However, the contract negotiator chose not to use the more current data believing the contract price would not have been significantly affected. A close examination of the data would have shown the contract price could have been reduced by about $4.7 million.

Under the Truth in Negotiations Act, the government can reduce contract prices if contractors do not provide accurate, complete, and current information. No such remedy is available when higher than warranted contract prices are caused by the contracting officer's misuse of data. In such cases, the government must live with the negotiation results.

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Mr. Chairman, we are issuing reports on each of the contracts we reviewed and recommending price reductions where contractors did not comply with the Act. This concludes my statement and I will be pleased to answer any questions you or the Subcommittee members may have.

ATTACHMENT I

RESULTS OF GAO PRIME CONTRACT PRICING AUDITS

CONTRACTOR	POTENTIAL OVERPRICING RESULTING FROM: CONTRACTORS' NONDISCLOSURE*	POTENTIAL OVERPRICING RESULTING FROM: GOVERNMENT CONTRACTING OFFICERS' ACTIONS OR INACTIONS
Boeing Aerospace	$ 346,123	
Boeing Vertol	1,007,757	$ 384,501
GM - Allison Gas Turbine	357,879	
GM - Detroit Diesel	341,871	
Honeywell Defense Systems Division	1,909,398	
Hughes Aircraft	2,339,601	1,777,396
Lockheed Missiles System Division	3,135,149	
Martin Marietta Orlando Aerospace	1,313,038	
Pratt and Whitney	3,572,906	
Texas Instruments Equipment Group		4,740,086
Total	$14,323,722	$6,901,983

* Amounts recovered will depend on contracting officers' decisions and, possibly, litigation results.