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United States General Accounting Office

GAO

Report to the Commander, U.S. Air Force,
Oklahoma City Air Logistics Center

November 1987

CONTRACT PRICING

Overpriced B-52 Bomber Avionics Subcontract



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Seattle Regional Office**B-219741****Room 1992, Jackson Federal
Building
915 Second Avenue
Seattle, WA 98174**

November 30, 1987

**Major General William P. Bowden
Commander, Oklahoma City Air Logistics Center
Tinker Air Force Base, Oklahoma 73145-5320****Dear General Bowden:**

We have completed a subcontract pricing review at Sundstrand Data Control, Inc., (Sundstrand) Redmond, Washington. We examined material pricing on a Sundstrand subcontract awarded by the Boeing Military Airplane Company (Boeing) in Wichita, Kansas, for Lot VII of the Offensive Avionic System/Cruise Missile Integration program applicable to the B-52 aircraft, contract number F34601-85-C-0633. Our objective was to determine whether Sundstrand provided Boeing with accurate, complete, and current cost or pricing data as required by the Truth in Negotiations Act, Public Law 87-653.

We determined that Sundstrand did not provide Boeing with accurate, complete, and current cost or pricing data. Boeing, after analysis and negotiation, included the resulting Sundstrand subcontract price in its proposal to the government. As a result, the price of the prime contract was overstated by a net amount of \$644,601, including overhead and profit.

Sundstrand recognized that it may have a liability for any amounts where subcontract prices were increased because of nondisclosure. Further, Sundstrand stated it is prepared to work with Boeing and the Defense Contract Audit Agency to determine its liability, if any. Boeing stated that it appeared the pricing actions we identified were affected by the defective disclosure of data, however, it noted that an extensive factual review and analysis would be required before the matter could be resolved. Air Force negotiators stated they relied upon the subcontract Boeing negotiated with Sundstrand and accepted the cost as submitted.

We believe the information presented in this report provides a basis for you to initiate action to recover these 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 Mr. Neil Asaba, at (206) 442-5356.

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.

We are sending copies of this report to the Controller, Sundstrand Data Control, Inc., Redmond, Washington; Director of Aerospace Pricing, Sundstrand Corporation, Rockford, Illinois; Contracts Manager and Subcontract Manager, Boeing Military Airplane Company, Wichita, Kansas; the Secretary of the Air Force; Department of Defense, Office of Inspector General, Washington, D.C.; Regional Director, Defense Contract Audit Agency, San Francisco, California; Branch Manager, Defense Contract Audit Agency, Seattle, Washington; Commander, Defense Contract Administration Services Region, El Segundo, California; and Commander, Aeronautical Systems Division, Wright-Patterson Air Force Base, Ohio. Copies will be made available to others upon request.

Sincerely,

A handwritten signature in black ink, reading "John P. Carroll". The signature is fluid and cursive, with the first name "John" being the most prominent part.

John P. Carroll
Regional Manager

Noncompliance With Public Law 87-653 Resulted in Overstated Subcontract Prices for B-52 Avionics

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. When 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 Air Force negotiated and awarded a firm fixed-price contract, F34601-85-C-0633, to the Boeing Military Airplane Company (Boeing) in fiscal year 1986 for Lot VII of the Offensive Avionic System/Cruise Missile Integration program applicable to the B-52 aircraft. The negotiated price was \$74,115,000. Part of this contract called for Boeing to supply the Air Force with 973 magnetic tape transports, which are used to transfer data from ground-based systems to aircraft systems on the B-52. Boeing subcontracted the production of the transports in a firm-fixed price contract — Purchase Order 614706 — to Sundstrand in an agreement signed on February 23, 1985, for a price of \$10,465,852.

Sundstrand's Certificate of Current Cost or Pricing Data to Boeing was signed on March 4, 1985. Sundstrand certified that the data it supplied to Boeing were accurate, complete, and current as of February 22, 1985. Boeing's Certificate of Current Cost or Pricing Data to the government was signed about a year later on February 13, 1986. Boeing certified that the data it supplied to the government were accurate, complete, and current as of January 10, 1986.

Incomplete and Noncurrent Data Results in Overstated Prices

Sundstrand did not submit current or complete cost or pricing data to Boeing. As a result, the price of the prime contract, F34601-85-C-0633, was overstated by a net amount of \$644,601, including overhead and profit. We reviewed prices on 15 items which constituted about 85 percent of the proposed material costs in the Sundstrand proposal. We found prices on 11 of the 15 to be incorrect, with 9 resulting in overstatements.

The errors occurred because Sundstrand did not disclose to Boeing:

Appendix I
Noncompliance With Public Law 87-653
Resulted in Overstated Subcontract Prices for
B-52 Avionics

- plans to buy two items from a vendor at lower prices rather than making the items as it had originally proposed;
- an analysis showing purchase order prices were lower than the prices proposed for five parts; and
- current purchase order data for four parts.

Table I.1 shows the overpricing associated with each part. Additional details are provided after the table.

Table I.1 Overpricing/Underpricing of Individual Parts

Part Number	Sundstrand quantity	Proposed price	Available price	Amount of overpricing (underpricing)
Vendor Prices lower than cost to make				
700-1141-002	486	\$564.33	\$383.02	\$88,117
700-1142-001	486	506.10	289.14	105,443
Purchase order prices lower than proposed prices				
400-0120-001	1,946	5.07	1.71	6,539
400-0120-002	7,784	4.46	1.82	20,550
400-0120-006	3,892	4.86	1.89	11,559
400-0120-009	1,946	3.50	1.70	3,503
400-0120-010	1,946	5.31	2.04	6,363
Current purchase order data not disclosed				
340-0062-003	2,919	15.20	15.00	584
440-0517-001	973	40.18	30.54	9,380
340-0061-001	2,919	14.80	14.87	(204)
404-2051-002	1,946	145.52	151.91	(12,435)
Total cost of parts overstatement				\$239,399
Add-ons by Boeing and Sundstrand ^a				405,202
Total Overstatement to the government				\$644,601

^aThe term "add-ons" as used in this report refers to the combined amounts added by Sundstrand and Boeing to the basic cost of parts for such things as overhead, estimated economic inflation, allocations of interest expense associated with loans for new warehouse facilities, and profit

Sundstrand Proposed Making Two Parts but Planned to Buy Them at Lower Prices

Sundstrand submitted incomplete data when it did not disclose to Boeing its decision in January 1985 to buy 50 percent (486 units) of the required parts it previously said it would make. For example, as shown in table I.1, Sundstrand's proposed cost to make part No. 700-1141-002 was \$564.33 a unit while its vendor's price was \$383.02, or \$181.31 less for each unit. Since 486 units were needed, overpricing on this part totaled \$88,117. Sundstrand's proposed cost for another part on Table I.1 was \$506.10 per unit and the vendor's price was \$289.14 or \$216.96 less. Again 486 units were needed and, thus, the overpricing totaled

\$105,443. Sundstrand's previous practice had been to make all of these parts and it priced its proposal to Boeing on this basis. However, in August 1983, a year and a half before contract agreement in February 1985, Sundstrand had started the process necessary to qualify one of its vendors as a new source for these parts.

Sundstrand prepared a plan to qualify and test the vendor's parts and revised the plan based on comments from Boeing. In December 1983, Sundstrand issued a purchase order to the vendor for quantities of both parts. In November 1984, Sundstrand tested the vendor's parts and found them satisfactory. Sundstrand approved the vendor as a qualified source and in January 1985, changed its bill of material to show it planned to buy half of the parts required from the newly approved source. However, Sundstrand did not provide the new bill of materials to Boeing, and instead, priced its proposal as if it were going to make all of the parts. Boeing negotiators told us that if Sundstrand had given them the revised bill of material and the lower price quote, they would have adjusted their negotiation position.

Sundstrand agreed that it did not disclose the difference in cost between using the new source and making the two parts. Sundstrand noted, however, that it did not have access to Boeing or Defense Contract Audit Agency records or personnel and as a result was not prepared to admit liability for the overpricing. Sundstrand stated that when agreement on the facts and the amount of liability is reached, it will repay any monies due.

**Sundstrand Did Not
Disclose an Analysis
Showing Purchase Order
Prices Were Lower Than
Proposed Prices**

Sundstrand did not provide complete cost or pricing data because it did not disclose to Boeing a one-page analysis that showed purchase order prices for five parts were lower than the prices Sundstrand proposed. Sundstrand's proposed prices for the five parts were based on a quote from a vendor it had not used since February 1983, about 2 years before agreement on contract price with Boeing. We found that Sundstrand, in 1983, compared the prices offered by four vendors and identified a new vendor that offered significantly lower prices. As a result, Sundstrand changed vendors in September 1983, and has been purchasing parts from this lower-price vendor since that time.

For example, Sundstrand proposed a unit price of \$4.46 for 7,784 bearings (Part number 400-0120-002 on Table I.1) based on a September 1984 quote from its old vendor. Sundstrand had also issued a purchase order for \$1.82 a unit for 4,700 of the same bearings to its new vendor

in January 1985, about 6 weeks before agreement on the contract price with Boeing. Sundstrand did not disclose the lower price to Boeing. The overstatement for this part is \$20,500 as shown in Table I.1.

In December 1984, Sundstrand completed a one-page analysis, comparing purchase order prices to proposed prices. The five parts were included in this analysis. The analysis showed the purchase order prices for these five parts were significantly lower, ranging from 51 to 67 percent less than the proposed prices. However, Sundstrand did not disclose the analysis to Boeing nor did it reduce its proposal.

In February 1985, Sundstrand submitted copies of various purchase orders to Boeing. However, we found that Sundstrand's and Boeing's copies of the submission differed significantly. Sundstrand's copy included three purchase orders from the new, lower-price vendor dated September 1983, July 1984 and August 1984 for the five parts and a cover page which identified the purchase orders in the submission. In contrast, Boeing's copy was missing both of these items. Boeing's cost analyst stated that their copy of the submission is what they received from Sundstrand. Sundstrand officials said that they did not verify that the submission provided to Boeing was identical to their copy.

Despite these differences, it is clear that Sundstrand did not disclose the one-page analysis, which should have been disclosed under Public Law 87-653, to Boeing showing overpricing. Based on this record, there is a basis for a defective pricing recovery.

Boeing negotiators stated that if Sundstrand had provided the one-page analysis, they would have changed their negotiation position. Sundstrand disagrees, believing adequate disclosure was made.

Sundstrand Did Not Disclose Current Purchase Order Data

Sundstrand had current purchase order data on four parts which it did not disclose to Boeing. As a result, all four prices were inaccurate, two were overstated and two were understated. We found no evidence that Sundstrand compared the proposed prices to the purchase order prices on three of the four parts¹ as it had on the five parts discussed previously.

¹One of the four was on Sundstrand's one-page analysis; however, we did not discuss this part in the previous section because Sundstrand had a lower more current purchase order price than what was on the one-page analysis.

For example, Sundstrand proposed a unit price of \$145.52 for 1,946 units of Part Number 404-2051-002 based on a January 1984 purchase order. In October 1984, Sundstrand issued a purchase order to this same vendor for a unit price of \$151.91 for 2,328 units. The understatement on this part came to \$12,435 as shown in Table I.1.

On the other hand, Sundstrand proposed a unit price of \$40.18 for 973 units of Part Number 440-0517-001 based on a vendor quote provided in September 1984. About a month later, in October 1984, Sundstrand issued a purchase order to a different vendor for a unit price of \$30.54 for 1,150 units. The overstatement on this part totalled \$9,380 as shown in Table I.1.

Sundstrand generally agreed with our findings, but because it did not have access to Boeing or Defense Contract Audit Agency records or personnel, the company stated that it could not conclusively determine whether there was nondisclosure for these four parts.

Objective, Scope and Methodology

Our objective was to assess whether Sundstrand, a subcontractor, complied with Public Law 87-653 in disclosing accurate, complete, and current cost or pricing data to its prime contractor, Boeing. We conducted our review at Sundstrand, in Redmond, Washington; Boeing, in Wichita, Kansas; and Tinker Air Force Base, in Oklahoma City, Oklahoma.

We reviewed Sundstrand, Boeing, and Air Force documents, including negotiation records, purchase order files, the bill of material and related price proposals. We also interviewed subcontractor, prime contractor, and Air Force officials responsible for the pricing, negotiations, and award of the subcontract we reviewed. We limited our review to selected parts accounting for about 85 percent of proposed material costs.

Our review was conducted between December 1986 and June 1987 in accordance with generally accepted government auditing standards.

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