DEPARTMENT OF DEFENSE

AUDIT REPORT

PRICING OF BASIC ORDERING AGREEMENT DAAJ09-88-G-0001,
DELIVERY ORDER 0053, AT GENERAL ELECTRIC COMPANY-
AIRCRAFT ENGINE BUSINESS GROUP

No. 91-076

May 9, 1991

Office of the
Inspector General

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

May 9, 1991

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY
(FINANCIAL MANAGEMENT)

SUBJECT: Final Report on the Audit of Pricing of Basic Ordering Agreement DAAJ09-88-G-0001, Delivery Order 0053, at General Electric Company-Aircraft Engine Business Group (Report No. 91-076)

This is our report on the Audit of Pricing of Basic Ordering Agreement DAAJ09-88-G-0001, Delivery Order 0053, at General Electric Company-Aircraft Engine Business Group for your review and comments. The audit was performed from June to August 1988. The audit objectives were to determine whether Basic Ordering Agreement DAAJ09-88-G-0001, Delivery Order 0053, awarded to General Electric Company by the U.S. Army Aviation Systems Command in the amount of $3,636,080, was overpriced and the reasons for any overpricing. We did not evaluate internal controls in this audit. This audit was made as a result of conditions identified during the "Audit of Spare Parts Pricing Agreements," Project No. 8CE-5001.

The audit verified that Delivery Order 0053 was overpriced by $509,581 because the U.S. Army Aviation Systems Command (AVSCOM) purchased spare parts from General Electric Company at a price higher than the price based on current material cost escalation. The results of the audit are summarized in the following paragraph, and the details and audit recommendation are contained in Part II of this report.

Delivery Order 0053, issued to the General Electric Company in March 1988, did not include the current price for the part purchased. The price used in Delivery Order 0053 was based on the price established in November 1985 for Basic Ordering Agreement DAAJ09-88-G-0001. The price used in the delivery order was not adjusted to account for the decrease in the contractor's material escalation rate. As a result, Delivery Order 0053 was overpriced by $509,581 or about 14 percent of the delivery order's total price. We recommended that the procurement contracting officer request a voluntary refund from the General Electric Company (page 3).

A draft of this report was provided to the Assistant Secretary of the Army (Financial Management) on January 10, 1991. On March 15, 1991, the Deputy Director, U.S. Army Contracting Support Agency, concurred in the finding but nonconcurred with the recommendation. The Deputy Director stated

that the conditions for soliciting a refund were not met. We still believe a refund should be requested for the reasons discussed in Part II of the report. Accordingly, we request that you provide additional comments on the recommendation and the estimated monetary benefits of $509,581, identified in Appendix B.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. In order for your comments to be considered responsive, you must state concurrence or nonconcurrence with the estimated monetary benefits. If you nonconcur with the estimated monetary benefits, or any part thereof, you must state the amount you nonconcur with and the basis of your nonconcurrence. Potential monetary benefits are subject to mediation in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment. This report is not subject to the provisions of DoD Directive 7640.2, "Policy for Followup on Contract Audit Reports."

We appreciate the courtesies extended to the staff during the audit. A list of audit team members is shown in Appendix D. Please contact Mr. Salvatore D. Guli, Program Director, at (703) 614-6285 (DSN 224-6285), or Mr. OrLando Yarborough at (703) 614-6272 (DSN 224-6272) if you have any questions on this audit. Copies of the report will be distributed to the activities listed in Appendix E. This office will be available to assist the contracting officer in the collection of the recommended contract price adjustment.

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosure

cc:
Secretary of the Army

REPORT ON THE AUDIT OF PRICING OF BASIC ORDERING AGREEMENT DAAJ09-88-G-0001, DELIVERY ORDER 0053, AT GENERAL ELECTRIC COMPANY-AIRCRAFT ENGINE BUSINESS GROUP

TABLE OF CONTENTS

	Page
TRANSMITTAL MEMORANDUM/EXECUTIVE SUMMARY	i
PART I- INTRODUCTION	1
Background	1
Objectives and Scope	1
Prior Audit Coverage	2
Part II - FINDING AND RECOMMENDATION	3
Pricing of Basic Ordering Agreement DAAJ09-88-G-0001, Delivery Order 0053	3
APPENDIX A - Chronology of Significant Events	7
APPENDIX B - Report of Potential Monetary and Other Benefits Resulting From Audit	9
APPENDIX C - Department of the Army Comments	11
APPENDIX D - List of Audit Team Members	15
APPENDIX E - Final Report Distribution	17

Prepared by:
Contract Management Directorate
Project No. 8CE-5001.01

REPORT ON THE AUDIT OF PRICING OF BASIC ORDERING AGREEMENT DAAJ09-88-G-0001, DELIVERY ORDER 0053, AT GENERAL ELECTRIC COMPANY-AIRCRAFT ENGINE BUSINESS GROUP

PART I - INTRODUCTION

Background

During our "Audit of Spare Parts Pricing Agreements," Project No. 8CE-5001, we found that the General Electric Company had not provided certified cost or pricing data to the Government, when orders exceeding the threshold for such data were issued against Basic Ordering Agreements. The Basic Ordering Agreements contained previously certified unit price lists. We also found potential overpricing on delivery orders which were priced with outdated prices or were not repriced with current cost data. As a result, we audited the pricing of Basic Ordering Agreement DAAJ09-88-G-0001, Delivery Order 0053, to determine whether the Delivery Order was overpriced and the reason for any overpricing.

The General Electric Company had sales surpassing $42 billion in FY 1989. The Aircraft Engine Business Group, the largest operating element of the company, serves a broad range of customers, but is primarily involved in the manufacture of aircraft engines and spare parts and in research and development for the U.S. Government. General Electric Company sales to the U.S. Government were approximately $ * and $ * billion for 1988 and 1989, respectively.

Objectives and Scope

Our objectives were to determine whether Basic Ordering Agreement DAAJ09-88-G-0001, Delivery Order 0053, awarded to the General Electric Company, by the U.S. Army Aviation Systems Command, was overpriced and the reasons for any overpricing. Criteria used to determine overpricing were Public Law 87-653, Truth in Negotiations Act, as amended; Public Law 91-379, Cost Accounting Standards; the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement. While performing the audit, we reviewed the contractor's proposal to the Army, the Government's contract documents, preaward audit reports issued by the Defense Contract Audit Agency, cost and pricing analysis reports issued by the Naval Plant Representative Office, the Government's price negotiation memorandum, and the contractor's accounting records. Documents and records that we reviewed related to events that occurred through March 4, 1988, the date that Delivery Order 0053 was issued. Appendix A lists the complete chronology of significant events.

*Contractor proprietary data deleted.

This financial related audit was made from June to August 1988, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, Department of Defense. We did not evaluate the internal controls applicable to the pricing of delivery orders during this audit. Activities visited during the audit were the contractor's plant in Lynn, Massachusetts; the Naval Plant Representative Office and the Defense Contract Audit Agency located at the contractor's plant; and the Aviation Systems Command in St. Louis, Missouri.

Prior Audit Coverage

From June 1983 through June 1987, the Defense Contract Audit Agency performed 79 defective pricing reviews at the Aircraft Engine Business Group Plant in Lynn, Massachusetts. Forty reviews resulted in findings of * in defective pricing.

*Contractor proprietary data deleted.

PART II- FINDING AND RECOMMENDATION

Pricing of Basic Ordering Agreement DAAJ09-88-G-0001, Delivery Order 0053

FINDING

Delivery Order 0053, issued to the General Electric Company - Aircraft Engine Business Group under Basic Ordering Agreement DAAJ09-88-G-0001, contained unit pricing based on an outdated price list. The unit price used in the delivery order was not updated to account for significantly lower material cost escalation. As a result, Delivery Order 0053 was overpriced by $509,581.

DISCUSSION OF DETAILS

Background.

The U.S. Army Aviation Systems Command (AVSCOM) awarded Basic Ordering Agreement DAAJ09-88-G-0001, Delivery Order 0053, to the General Electric Company-Aircraft Engine Business Group on March 4, 1988, for the procurement of 650 particle blowers, part number 6034T62P13, at a unit price of $5,593.97. The contract, which totaled $3,636,080, required deliveries from April through July 1988. AVSCOM negotiated, and the contractor certified, the unit pricing of 422 line items for the T-700 aircraft engine on November 2, 1985. The unit price for the particle blower was included in this negotiation.

Details of the Audit. AVSCOM used prices negotiated in the Basic Ordering Agreement in November 1985 to price Delivery Order 0053 without obtaining updated data to reflect current material cost escalation. Unit prices were incorporated into the Basic Ordering Agreement, but were not updated at the time orders were issued.

Basis of Overpricing. We computed overpricing based on the contractor's accounting data that were available before March 4, 1988, the date of the Delivery Order, since this was the date on which the contractor should have been required to certify that the cost or pricing data were accurate, complete, and current. Our computations of overpricing are discussed below.

Material Costs. AVSCOM negotiated bottom line unit prices in November 1985 for part number 6034T62P13, particle blower. The negotiated unit prices were $4,855, $5,174, and $5,594 for 1986, 1987, and 1988, respectively. The prices included material cost escalation for each year. The 1988 unit price was approximately 15.2 percent higher than the price negotiated for 1986. The unit price of $5,594 was used to price Delivery Order 0053, which was issued for a quantity of 650 units in March 1988. The General Electric Company did not inform the Government, at

the time Delivery Order 0053 was issued, that the actual escalation was much lower than the escalation used as the basis of the negotiated unit prices.

The contractor's actual material cost for this part in January 1988 was $ * . The actual material cost for this part in September 1985, before the unit price negotiations, was $ * . The resulting escalation was only percent. If updated material cost data were furnished to the Government, the Government would have been in a position to establish a lower price before issuing Delivery Order 0053. The failure to update the prices to reflect current material cost escalation resulted in overpricing of $509,581. The contract did not require that the contractor submit updated cost or pricing data annually nor did the contract contain a provision for resetting or adjusting material cost escalation factors. There is no apparent contractual remedy for recovering the overpricing of Delivery Order 0053. However, the Defense Federal Acquisition Regulation Supplement Subpart 242.71, "Voluntary Refunds," provides guidelines for requesting voluntary refunds from a contractor when it is considered that the Government was overcharged under a contract. Overpricing on Basic Ordering Agreement DAAJ09-88-G-0001, Delivery Order 0053, was computed as follows.

Element		Amount of Over-Pricing
Negotiated Unit Price		$ *
Material Cost - January 1988	$ *	
Negotiated Sell Price Factor	X *	
Cost or Pricing Data - January 1988		*
Unit Overpricing Due to Noncurrent Data		$ *
Quantity From Delivery Order 0053		X *
Total overpricing For Delivery Order 0053		$ 509,581

Negotiated in November 1985

The current sell price factors were negotiated in August 1987 between the Naval Plant Representative Office and the contractor. These factors were the most current factors in use at the time of the issuance of Delivery Order 0053.

RECOMMENDATION FOR CORRECTIVE ACTION

We recommend that the Commander, U.S. Army Aviation Systems Command, request the cognizant procurement contracting officer to initiate action for a voluntary refund of $509,581 from the General Electric Company on Basic Ordering

* Contractor proprietary data deleted.

Agreement DAAJ09-88-G-0001, Delivery Order 0053 in accordance with the Defense Federal Acquisition Regulation Supplement Subpart 242.71, "Voluntary Refunds.""

MANAGEMENT COMMENTS

The Deputy Director, U.S. Army Contracting Support Agency concurred in the finding but nonconcurred in the recommendation. The nonconcurrence was based on the rationale that the condition set forth in DoD Federal Acquisition Regulation Supplement 242.7101 for soliciting a refund, that is, "retention by the contractor of the amount in question would be contrary to good conscience and equity," was not met. As a result, the Army concluded that a voluntary refund should not be solicited. The response also stated that the Government and the contractor both entered into the agreement in good faith. It was recognized that some items may have been priced too high and others too low. These were business risks. The Deputy Director also stated that action was taken to preclude recurrence of similar overpricing problems and that the price list for the ensuing Basic Ordering Agreement was negotiated with General Electric on a discrete basis. The complete text of the comments is shown in Appendix C.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

We recognize that the Deputy Director's decision not to seek a voluntary refund from General Electric is within the authority granted by procurement regulation. While we share the same interest in fairness and equity, we believe that the prepriced a Basic Ordering Agreement provided an inequitable pricing arrangement in which Delivery Order 0053 was overpriced. We ask that the Deputy Director reconsider his position on the recommendation in view of the $509,581 in overpricing. Additionally, we request that the Assistant Secretary describe the specific actions AVSCOM has taken to preclude a recurrence of the problem and clarify the meaning of the phrase, "negotiated . . . on a discrete basis," used in reference to the current price list negotiated with General Electric.

CHRONOLOGY OF SIGNIFICANT EVENTS

EVENT	DATE
Initial Proposal for T-700 Spare Parts Submitted by General Electric Company	January 23, 1985
Update of Initial Proposal	April 1985
Update of Initial Proposal for Supplemental Parts	June 1985
Spare Parts Negotiations Conducted	October 30 through November 2, 1985
Negotiations Completed and Certificate Of Current Cost Or Pricing Data Signed	November 2, 1985
Basic Ordering Agreement DAAJ09-88-G-0001 Issued	November 24, 1987
Delivery Order 0053 Awarded	March 4, 1988

REPORT OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.	Potential one-year monetary benefit to be derived from voluntary refund in accordance with FAR.	Request for voluntary refund of $509,581 initiated by the U.S. Army Aviation Systems Command. The benefit is classified as "funds put to better use."

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
U.S. ARMY CONTRACTING SUPPORT AGENCY
5109 LEESBURG PIKE
FALLS CHURCH, VIRGINIA 22041-3201

REPLY TO
ATTENTION OF

SFRD-KP

15 MAR 1991

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
(AUDITING), 400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

SUBJECT: Draft Report on the Audit of Basic Ordering Agreement DAAJ09-88-G-0001, Delivery Order 0053, at General Electric Company-Aircraft Engine Business Group (Project No. 8CE-5001.01)

1. We reviewed subject report and concur with the finding. We do not concur with the recommendation. Our rationale for this position follows.

2. Basic Ordering Agreement (BOA) DAAJ09-88-G-0001 was negotiated in 1985 as part of the larger T-700 Engine multi-year procurement. The BOA was priced on a bottom line basis and that pricing considered in the overall multi-year settlement. Item prices were then allocated based on the bottom line settlement.

3. Delivery Order 0053 was initiated as a competitive procurement in January 1988. The two approved sources for the particle blower (PN 6034T62P13), General Electric and Sundstran, were solicited. Neither contractor submitted a proposal. Since there were no responses to the competitive solicitation, the order was placed under the BOA using the price list prices. An April 1986 delivery order for the same item also followed a competitive procurement in which offers were received from two contractors. Both offers were higher than the BOA price list.

4. It is our position that the Government erred both in its methodology for allocating prices on the BOA price list and in placing subsequent orders. The BOA pricing should have been done on a discrete basis.

5. Notwithstanding the foregoing, both Government and contractor entered into the agreement in good faith. It was recognized that some items may have been priced too high and others too low. These were business risks. Had the contractor refused to honor an order because the prices were too low, we would consider him in breach of contract and take appropriate action. Had he determined, after the fact, that prices were too low and asked for a subsequent price

increase, the Government would not consider his request favorably. In fact, he would not make such a request because under pricing was recognized as a business risk.

6. In this case, the price may have been too high, though we cannot verify it. The risk of such occurrence, however, was acknowledged at the time the BOA was negotiated. We do not believe that the Government should now disavow such risk and ask for a refund. The condition set forth in DFARS 242.7101 for soliciting a refund, i.e., "retention by the contractor of the amount in question would be contrary to good conscience and equity," is not met. Consequently, a voluntary refund should not be solicited.

7. The BOA cited above has expired. It has been the subject of numerous inquiries each requiring the expenditure of considerable resources. Consequently, the Commander, U.S. Army Aviation Systems Command, took action on 16 July 1990 to resolve these inquiries and preclude recurrence of similar problems (enclosed). For your information, the subsequent price lists negotiated with General Electric were done on a discrete basis.

8. The point of contact for this action is Thomas W. Colangelo, SFRD-KP, who may be reached at (703) 756-7564.

FOR THE DIRECTOR, U.S. ARMY CONTRACTING SUPPORT AGENCY:

Kenneth J. Loehr

Enclosure

KENNETH J. LOEHR
Acting Deputy Director
U.S. Army Contracting
Support Agency

CF:
SAIG-PA (Ms. Flanagan)
SARD-DER (Ms. Willey)
AMCIR (Mr. Kurzer)

DEPARTMENT OF THE ARMY
HEADQUARTERS, US ARMY AVIATION SYSTEMS COMMAND
4300 GOODFELLOW BOULEVARD, ST. LOUIS, MO 63120-1798

REPLY TO ATTENTION OF

AMSAV-G

DON W. SCHMITZ
Director of Procurement
and Production

16 JUL 1990

13 JUL 1990

MEMORANDUM FOR DIRECTOR PROCUREMENT AND PRODUCTION

SUBJECT: Inspector General Action Request/General Electric (GE) Company Price Challenge

1. The Inspector General (IG) has just completed an inquiry into an allegation that GE overcharged the Army for a special tool: a T700 Engine Blade Extension. This case was originally referred to IG channels on 17 Oct 89 because the Corpus Christi Army Depot was charged $5000 for a $148 item. The root cause of this problem raises my concerns and requires your immediate attention.

2. The contracting officer negotiated a bottom line settlement for "administrative convenience" on an ILS package for the T700-GE-401C program. Because of this, several hardware items and various services were combined into a single line item. The contracting officer exercised questionable judgement in doing this and violated the provisions of FAR 52.215-26 by not insuring the integrity of unit prices. The result of this "convenience" was a 9-month inquiry that tied up the resources of my IG, your staff, and the contractor's personnel; not to mention the excessive amount of stock fund dollars lost to a user in the field.

3. I want you to ensure that your contracting officers thoroughly understand the significance of this issue. I am sure you are aware that similar overcharging incidents have recently found their way into the news media and congressional inquiries. That kind of publicity is never welcome. Overall we do an outstanding job of supporting our Army Aviation customers, but we cannot afford to be careless in the procurement business. This problem was avoidable, and because we didn't do it right the first time, we all lost time and money. No value added here!

4. In order to resolve this matter, some follow-up action is still required. Therefore, I want you to coordinate with the AVSCOM IG and provide him with copies of all documentation required to close this case.

Donald R. Williamson

DONALD R. WILLIAMSON
Major General, USA
Commanding

LIST OF AUDIT TEAM MEMBERS

David K. Steensma, Director, Contract Management Directorate
Salvatore D. Guli, Program Director
Bruce Burton, Project Manager
OrLando Yarborough, Auditor
Larry Zaletel, Auditor

FINAL REPORT DISTRIBUTION

Office of the Secretary

Assistant Secretary of Defense (Production and Logistics)
Comptroller of the Department of Defense
Deputy Assistant Secretary of Defense (Procurement)

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Financial Management)
Assistant Secretary of the Army (Research, Development and Acquisition)
Commander, U.S. Army Aviation Systems Command
Auditor General, Army Audit Agency

Other Defense Activities

Director, Defense Contract Audit Agency
Commanding Officer, Defense Plant Representative Office, General Electric

Non-DoD Activities

Office of Management and Budget
General Accounting Office,
NSIAD Technical Information Center

Congressional Committees:

Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Ranking Minority Member, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations