DEPARTMENT OF DEFENSE

AUDIT REPORT

PRICING OF CONTRACT F41608-85-D-A011,
DELIVERY ORDER 0099,
AT GENERAL ELECTRIC COMPANY-
AIRCRAFT ENGINE BUSINESS GROUP

Report Number 91-096 June 17, 1991

Office of the
Inspector General

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

June 17, 1991

MEMORANDUM FOR COMMANDING OFFICER, SAN ANTONIO AIR LOGISTICS CENTER

SUBJECT: Report on the Audit of Pricing of Contract F41608-85-D-A011, Delivery Order 0099, at General Electric Company-Aircraft Engine Business Group (Report No. 91-096)

We are providing this final report for your information and use. This report resulted from the audit of contract pricing performed at the General Electric Company, Lynn Massachusetts, from June to August 1988. The objectives were to determine whether contract F41608-85-D-A011, Delivery Order 0099, awarded to General Electric by the San Antonio Air Logistics Center in the amount of $7,022,925 was overpriced and to determine the reasons for 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 General Electric Company did not disclose to the Government negotiator current cost data, which were available to the contractor at the time that Delivery Order 0099 was repriced in accordance with contract clauses. Such disclosure is required by Public Law 87-653, "Truth in Negotiations Act." Disclosure of current cost data would have shown that costs were less than the amounts proposed and certified for price lists included in contract F41608-85-D-A011. We recommended that the procurement contracting officer initiate action to obtain a downward price adjustment of $145,044 (page 3).

A draft of this report was sent to the Commanding Officer, San Antonio Air Logistics Center, on February 8, 1991. We did not receive management comments on the draft report finding and recommendation. Accordingly, we request that the Commanding Officer respond to this final report by August 17, 1991. As required by DoD Directive 7650.3, the comments must indicate concurrence or nonconcurrence in the finding and recommendation addressed to you. If you concur, describe the corrective actions taken, or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, you must state your specific reasons for your nonconcurrence. If appropriate, you may propose alternative methods for accomplishing desired improvements.

In order for your comments to be considered responsive, you must state concurrence or nonconcurrence with the estimated monetary benefits of $145,044 identified in Appendix B of this report. If you nonconcur with the estimated amount to be recovered 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 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. If you have any questions on this audit, please contact Mr. Salvatore D. Guli, Program Director, at (703) 614-6285 (DSN 224-6285). This office will be available to assist the contracting officer in the collection of the recommended contract price adjustments. A list of audit team members is in Appendix D. Appendix E lists the distribution of this report.

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosure

cc: Secretary of the Air Force

REPORT ON THE AUDIT OF PRICING OF CONTRACT F41608-85-D-A011, DELIVERY ORDER 0099, AT GENERAL ELECTRIC COMPANY-AIRCRAFT ENGINE BUSINESS GROUP

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Prepared by:
Contract Management Directorate
Project 8CE-5001.03

REPORT ON THE AUDIT OF PRICING OF CONTRACT F41608-85-D-A011, DELIVERY ORDER 0099, AT GENERAL ELECTRIC COMPANY-AIRCRAFT ENGINE BUSINESS GROUP

PART I - INTRODUCTION

Background

During our evaluation of contractor performance on the "Audit of Spare Parts Pricing Agreements," Project 8CE-5001, we found that the General Electric Company was not providing certified cost or pricing data on orders issued against prepriced Basic Ordering Agreements and on orders issued under requirements contracts containing provisions for resetting prices. As a result, we made an audit of the pricing of contract F41608-85-D-A011, Delivery Order 0099, a requirements contract with provisions to annually reset prices to determine whether the contractor had submitted accurate, complete, and current pricing data at the time the order was repriced.

In 1989, General Electric Company sales exceeded $42 billion. The Aircraft Engine Business Group, the largest operating element of the company, serves a broad range of customers, but primarily manufactures aircraft engines, spare parts, and performs 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

The audit objectives were to determine whether contract F41608-85-D-A011, Delivery Order 0099, awarded to the General Electric Company, was overpriced and the reasons for overpricing. Criteria used to determine overpricing were Public Law 87-653, "Truth in Negotiations Act"; Public Law 91-379, "Cost Accounting Standards"; the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement. We reviewed the contractor's proposal to the Air Force, the Government's contract documents, the Defense Contract Audit Agency's preaward audit reports, the Naval Plant Representative Office's cost and pricing analysis reports, the Government's price negotiation memorandum, and the contractor's accounting records. Documents and records that we reviewed related to events that occurred through April 22, 1986, the date Delivery Order 0099 was issued and, October 9, 1986, February 10, 1987, and June 30, 1988, the respective dates of annual repricing.

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. During the audit, we did not evaluate the internal controls applicable to the pricing of delivery orders. Activities visited during the audit were the

*Contractor proprietary data deleted.

contractor's plant in Lynn, Massachusetts, and the Naval Plant Representative's Office and the Defense Contract Audit Agency located at the contractor's plant.

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 positive findings of * in defective pricing.

*Contractor proprietary data deleted.

PART II - FINDING AND RECOMMENDATION

Pricing of Contract F41608-85-D-A011, Delivery Order 0099

FINDING

The audit disclosed information supporting the conclusion that the General Electric Company violated the provisions of Public Law 87-653, "Truth in Negotiations Act," by not submitting current, accurate, and complete cost or pricing data in support of contract F41608-85-D-A011, Delivery Order 0099. Although unit prices were reset annually, the reset unit prices only incorporated revised forward pricing burden rates. Material and labor prices were not reset even though costs had changed significantly. Additionally, an accounting change made the new burden rates incompatible with the previously negotiated material and labor costs. The reset prices were not recertified at the time of the annual price change with General Electric submitting current material and labor costs. As a result, Delivery Order 0099 was overpriced by $145,044.

DISCUSSION OF DETAILS

Background. The Truth in Negotiations Act is intended to avoid contract overpricing by ensuring that the Government and the contractor have equal knowledge of facts affecting contract pricing. Informational parity is achieved when data are accurate, complete, and current at the time of contract price. The Truth in Negotiations Act also requires a downward price adjustment if a negotiated price is overstated because a contractor furnished inaccurate, incomplete, or noncurrent pricing data to the Government. In a defective pricing case, the Government must prove that:

- the data causing defective pricing fulfill the definition of cost or pricing data,

- the data were reasonably available to the contractor before agreement on contract price,

- the Government relied on the defective cost or pricing data in negotiating a contract price, and

- reliance on the defective data caused an increased contract price.

On April 22, 1986, the San Antonio Air Logistics Center (SAALC) awarded contract F41608-85-D-A011, Delivery Order 0099, to the General Electric Company-Aircraft Engine Business Group for various spare parts in the amount of $7,022,925 for deliveries in 1986 through 1988. The contract contained provisions to annually reset prices for spare parts. A complete chronology of significant events is in Appendix A.

Details of the Audit. The contractor's accounting records disclosed that the contractor violated the provisions of the Truth in Negotiations Act by not providing current cost data available at the time contract unit prices were reset. Based on the results of negotiation, unit prices were reestablished on October 9, 1986, and February 10, 1987, for 1986 and 1987 deliveries, respectively. Unit prices for 1988 were being reestablished at the time of our audit (June 1988), but the modification had not been issued for revised 1988 prices. Delivery Order 0099 provided for the delivery of spare parts from 1986 through 1988.

Accounting Change. At the time that General Electric Company and the SAALC negotiated the unit prices, the General Electric Company was also changing its accounting system. The accounting change, which became effective January 1, 1986, (less than 2 months after completion of the negotiation) reclassified some labor related costs from indirect expense to direct expense. The revised accounting system was incompatible with the way costs were classified in pricing this contract. Under the accounting change, the burden rates were lower because certain costs, previously treated as indirect costs, were now treated as direct costs. However, when resetting the prices on this contract, only the indirect expenses were reset. Therefore, a revised lower burden rate would be applied to the preset direct cost. The direct costs for the price list were not reset to capture the costs shifted to direct cost under the revised system. Consequently, in order to compensate for this difference, the contractor and the buying command had to add a factor to the indirect rate to account for all costs. This completely deviated from the revised accounting system. The pricing agreement should have been terminated and reset to agree with the revised accounting system.

Basis of Defective Pricing. We computed defective pricing based on the cost data in effect at the time of the price change for each year. Our computations of data at the time of repricing included current direct costs as well as the current negotiated sell price factors (Appendix C). Current direct costs represent average finished goods inventory amounts for material and labor costs for spare parts produced from September 1986 through June 1988. The current negotiated sell price factors represent the factors negotiated on September 26, 1986, January 29, 1987, and August 19, 1987, which formed the basis for prices applicable to 1986, 1987, and 1988 deliveries, respectively. The contractor's repricing failed to update the prices for the most current direct material costs and only included updated burden (sell price) costs. The following schedule provides an example of the computation for defective pricing on one spare part, part number 5018T16P01.

Pricing on Price List				
Unit Labor Cost	$ *			
Multiplied by New Labor Rate Factor	$ *			
Burdened Labor	$ *			
Multiplied by Added Factor	$ *			
Total Burdened Labor Plus Added Factor	$ *	*	$ *	
Preset Unit Material Cost	$ *			
Multiplied by Material Rate Factor	*			
Burdened Unit Material Cost	$ *	*	$ *	
Price List Price			$3,984.29	$3,984.29
Pricing with Current Cost Data				
Current Labor Cost	$ *			
Multiplied by New Labor Rate Factor	*			
Burdened Labor	$ *		$ *	
Current Material Cost	$ *			
Multiplied by Material Burden Rate	*			
Burdened Unit Material Cost	$ *		$ *	
Price Based on Current Data			$ *	*
Amount of Unit Defective Pricing on Part Number 5018T16P01				$ *

Numbers have been rounded up or down to compute the price list price.

RECOMMENDATION FOR CORRECTIVE ACTION

We recommend that the Commanding Officer, San Antonio Air Logistics Center, request the cognizant procurement contracting officer to initiate action to obtain a downward contract price adjustment of $145,044 from the General Electric Company, on Contract F41608-85-D-A011, Delivery Order 0099, pursuant to the Truth in Negotiations Act.

MANAGEMENT COMMENTS AND AUDIT RESPONSE

We did not receive management comments on the draft of this report issued on February 8, 1991. Accordingly, we request that the Commanding Officer, San Antonio Air Logistics Center, respond to the finding, recommendation, and monetary benefits by August 19, 1991.

*Contractor proprietary data deleted.

CHRONOLOGY OF SIGNIFICANT EVENTS

EVENT	DATE
Original Proposal	October 11, 1984
Revised Proposal	June 18, 1985
Certification	
Prime Cost	November 22, 1985
Profit	December 6, 1985
Confirmation of Negotiation - Addendum	March 12, 1986
Delivery Order 0099 Issued	April 22, 1986

REPORT OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.	Monetary benefit to be derived by contractor's compliance with Public Law 87-653, "Truth in Negotiations Act."	One time collection of $145,044 to be initiated by the San Antonio Air Logistics Center. Monetary benefit is classified as "funds put to better use."

COMPUTATION OF DEFECTIVE PRICING OF CONTRACT F41608-85-D-A011, DELIVERY ORDER 0099

		Price List		Current Data at Order Date							
Order Date 1/	Part Number	Year	Unit Price 2/	Material	Material Burdened (a)	Labor	Labor Burdened (b)	Total (a) + (b)	Unit Overpricing	Quantity	Total Overpricing
April 22, 1986	5040T48P01	1987	$ 11.79	$ *	$ *	$ *	$ *	$ *	$ *	34,089	$
		1988	12.20	*	*	*	*	*	*	51,918	
	6029T00G01	1986	664.69	*	*	*	*	*	*	176	
		1987	739.44	*	*	*	*	*	*	2,192	
		1988	768.08	*	*	*	*	*	*	34	
	5014T74G05	1986	72.70	*	*	*	*	*	*	1,548	
		1987	82.81	*	*	*	*	*	*	820	
		1988	85.88	*	*	*	*	*	*	588	
	5013T83P01	1987	2,295.45	*	*	*	*	*	*	210	
		1988	2,382.65	*	*	*	*	*	*	141	
	500T80P01	1988	168.47	*	*	*	*	*	*	1,086	
	500T81P01	1987	5.90	*	*	*	*	*	*	117	
		1988	119.68	*	*	*	*	*	*	810	
	5015T78G03	1987	86.01	*	*	*	*	*	*	5,545	
		1988	89.22	*	*	*	*	*	*	199	
	5018T16P01	1986	3,448.91	*	*	*	*	*	*	8	
		1987	3,836.55	*	*	*	*	*	*	177	
		1988	3,984.29	*	*	*	*	*	*	144	
	646C574P4	1986	41.97	*	*	*	*	*	*	528	
		1987	47.93	*	*	*	*	*	*	614	
		1988	49.74	*	*	*	*	*	*	4	
									Total Overpricing on Delivery Order 0099		$ 145,044

1/ While the delivery order was issued April 22, 1986, the contractor had certified more accurate data on November 22, 1985, for future deliveries. This was consistent with Contract F41608-85-D-A011 provisions allowing for annual resetting of prices.

2/ Unit prices from outdated price list.

*Contractor proprietary data deleted.

LIST OF AUDIT TEAM MEMBERS

David K. Steensma, Director, Contract Management Directorate
Salvatore D. Guli, Program Director
Bruce Burton, Project Manager
Garry Hopper, Auditor
Larry Zaletel, Auditor
Mable Randolph, Editor
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Commanding Officer, San Antonio Air Logistics Center
Auditor General, U.S. Air Force Audit Agency

Defense Activities

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

Non-DoD Activities

Office of Management and Budget
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Congressional Committees:

Senate Subcommittee of Defense, Committee on Appropriations
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