

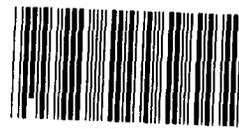
GAO

Report to the Commander, Aeronautical
Systems Division
Department of the Air Force

August 1986

CONTRACT PRICING

Material Prices Overstated on T-56 Engine Contracts



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United States
General Accounting Office

Cincinnati Regional Office

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B-219741

August 26, 1986

Lieutenant General William E. Thurman
Commander, Aeronautical Systems Division
Wright-Patterson Air Force Base, Ohio 45433

Dear General Thurman:

We recently completed a review at General Motors Corporation's Allison Gas Turbine Division (Allison) in Indianapolis, Indiana, where we examined six T-56 aircraft engine contracts to determine if the contract prices were fair and reasonable. We assessed whether the contractor complied with the Truth in Negotiations Act (Public Law 87-653), in providing accurate, complete, and current cost or pricing data. The law requires that before awarding any negotiated contract that is expected to exceed specified dollar amounts, the contractor must submit cost or pricing data to support the proposed price, and must certify that the data submitted are accurate, complete, and current. The Truth In Negotiations Act applies to all Allison contracts discussed in this report.

The cost and pricing data submitted by Allison were not accurate or current because erroneous foreign exchange rates were used to support the costs of two foreign made engine parts. The two parts were priced in Allison's proposals to the Air Force using a standard exchange rate of \$2.40 per pound sterling. Allison, however, should have used the exchange rates that had been negotiated with the government for the periods these contracts were negotiated. As a result, the 1983 through 1986 proposals were overstated by \$357,879, including overhead and profit. This overstatement, in turn, led to overpriced contracts during the same period. Allison officials have agreed with our findings and are prepared to make appropriate adjustments. Detailed information concerning the overstated prices is in appendix I.

We believe this information provides a basis for you to initiate action to recover these funds from Allison and recommend that you take such action. We would appreciate being informed of the actions taken. If you or your staff need additional information, please call me or Mr. Arthur D. Gross on (513) 684-2105.

We are sending copies of this report to the General Manager, Allison Gas Turbine Division, the Department of Defense, Office of the Inspector

General, Washington, D.C.; the Regional Director, Defense Contract Audit Agency, Chicago, Illinois, and the Commander, Defense Contract Administration Services Region, Chicago, Illinois. Copies will also be available to others upon request.

Sincerely yours,

C. William Moore

C. William Moore
Regional Manager

Overpricing on T-56 Engines For Calendar Years 1983 Through 1986

Background

Public Law 87-653, as amended, requires that, with certain exceptions, contractors submit cost or pricing data in support of proposed prices for noncompetitive contracts. Contractors are also required to certify at the time of price agreement that the data submitted are accurate, complete, and current. In cases where Public Law 87-653 is applicable, a clause is included in the contract which gives the government a right to a price reduction if it is determined that the price was overstated because the data submitted were not in accordance with the statute and the certification.

Allison has furnished T-56 aircraft engines to the Air Force and Navy for over 30 years. The engines are used primarily on C-130 transport aircraft. We reviewed the pricing of two foreign made parts (engine vanes) included in six T-56 engine contracts. The contracts, awarded between 1982 and 1986, were at firm fixed-prices. Contract details are in table I 1.

Some of the parts Allison uses in the engines are purchased from British sources and Allison has adopted procedures to deal with fluctuating currency exchange rates. Rather than deal with changing rates, Allison and the local administrative contract officer annually negotiate an exchange rate to be used in all of Allison's proposals during the year that contain prices for British made parts. However, when the parts are actually purchased, they are entered into inventory, in accordance with Allison's internal policy, at \$2.40 per pound sterling, regardless of the actual exchange rate or the rate negotiated with the administrative contract officer. Then, when preparing proposals for government contracts, Allison normally adjusts the inventory price (\$2.40 per pound sterling) to match the current negotiated exchange rate for proposals.

For the parts discussed below, Allison did not follow the above procedure.

**Appendix I
Overpricing on T-56 Engines For
Calendar Years 1983 Through 1986**

Table I.1: Contracts Reviewed

Contract number	Number of engines	Contract amount	Contract award date	Delivery year
F33657-79-C-0814-P00022	92	\$ 38,194,046	November 30, 1982	1983
F33657-78-C-0229-P00026	58	23,537,302	November 30, 1982	1983
F33657-79-C-0814-P00041	105	48,307,911	March 12, 1984	1984
F33657-78-C-0229-P00029	44	19,218,052	January 31, 1984	1984
F33657-84-C-2243	222	109,912,194	May 15, 1985	1985
F33657-84-C-2243-P0004	187	97,229,276	April 21, 1986	1986

**Allison's
Noncompliance With
Public Law 87-653
Resulted in Overstated
Prices**

Allison did not submit accurate data for two parts which were purchased from a foreign supplier. The dollar costs of the two parts—Vane 0265685 and Vane 0265686—were included in proposals using the standard rate of \$2.40 per pound sterling, but we found that the negotiated rate was actually \$1.20 to \$1.71 at the time price agreements for the contracts were reached. For example, in July 1983, Allison purchased its calendar year 1984 requirements from a foreign supplier. The purchase order price was 40.6 pounds sterling for each part. Allison converted the pounds sterling to dollars by using the standard \$2.40 rate and recorded the parts in the inventory at \$97.44 per part.

When preparing proposals, Allison's cost estimating system required adjustments in the price of these parts to the then current negotiated exchange rate. Allison overlooked the adjustments for the two parts purchased from a foreign supplier under the contracts listed in table I.1. The error caused the contract proposals to be overstated by \$357,879, including overhead and profit, as shown in table I.2.

Air Force contract negotiation teams relied on Allison's bills of materials and accepted the data substantially as submitted. Allison officials agree that the contract proposals were overstated because erroneous exchange rates were used. The officials advised us that they are prepared to make appropriate adjustments in the negotiated contract prices.

**Objective, Scope, and
Methodology**

We conducted our review at General Motors Corporation's Allison Gas Turbine Division, Indianapolis, Indiana; Aeronautical Systems Division, Wright-Patterson Air Force Base, Ohio; and the Defense Contract

Administration Services and the Defense Contract Audit Agency resident offices at Allison. Our overall objective was to determine if Allison complied with Public Law 87-653 by providing accurate, complete, and current cost or pricing data.

We made a detailed review of the contract for delivery of T-56 engines during calendar year 1985 (contract F33657-84-C-2243), including a review of the price proposals and negotiation records. Our review of the propriety of proposed material costs included a judgmental sample of purchased parts which we traced to inventory records in order to assure material costs were properly supported. We also examined adjustments to material costs made in the contract ledger at the end of calendar year 1985 and identified two parts that had been recorded based on erroneous exchange rates. Based on this information, we expanded our review to determine whether a similar condition existed in other contracts. This effort was limited specifically to a review of the contractor's procurement records needed to quantify the extent of overpricing due to the use of erroneous exchange rates

Our review was performed in accordance with generally accepted government auditing standards.

**Appendix I
Overpricing on T-56 Engines For
Calendar Years 1983 Through 1986**

Table I.2: Comparison of Proposed and Actual Part Costs

Contract	Vane 0265685	Vane 0265686	Total
F33657-79-C-0014-P00022			
Proposed \$2 40/pound sterling	\$214,750	\$55,117	\$269,867
Actual \$1 7107/pound sterling	206,514	52,456	258,970
Difference	8,236	2,661	10,897
Overhead ^a	2,963	958	3,921
Profit ^b	1,534	496	2,030
Total	\$12,733	\$4,115	\$16,848
F33657-78-C-0229-P00026			
Proposed \$2 40/pound sterling	\$135,385	\$34,747	\$170,132
Actual \$1 7107/pound sterling	130,193	33,070	163,263
Difference	5,192	1,677	6,869
Overhead ^a	1,868	603	2,471
Profit ^b	968	312	1,280
Total	\$8,028	\$2,592	\$10,620
F33657-79-C-0814-P00041			
Proposed \$2.40/pound sterling	\$259,434	\$66,055	\$325,489
Actual \$1 4769/pound sterling	221,306	57,065	278,371
Difference	38,128	8,990	47,118
Overhead ^a	9,705	2,288	11,993
Profit ^b	6,907	1,629	8,536
Total	\$54,740	\$12,907	\$67,647
F33657-78-C-0229-P00029			
Proposed \$2 40/pound sterling	\$108,715	\$27,680	\$136,395
Actual \$1 4769/pound sterling	92,738	23,913	116,651
Difference	15,977	3,767	19,744
Overhead ^a	4,066	959	5,025
Profit ^b	2,894	682	3,576
Total	\$22,937	\$5,408	\$28,345
F33657-84-C-2243			
Proposed \$2 40/pound sterling	\$544,735	\$142,031	\$686,766
Actual \$1 2079/pound sterling	460,339	118,761	579,100
Difference	84,396	23,270	107,666
Overhead ^a	22,442	6,188	28,630
Profit ^b	16,283	4,489	20,772
Total	\$123,121	\$33,947	\$157,068

**Appendix I
Overpricing on T-56 Engines For
Calendar Years 1983 Through 1986**

Contract	Vane 0265685	Vane 0265686	Total
F33657-84-C-2243-P0004			
Proposed \$2 40/pound sterling	\$479,318	\$122,713	\$602,031
Actual \$1 4389/pound sterling	437,759	112,536	550,295
Difference	41,559	10,177	51,736
Overhead ^a	12,075	2,957	15,032
Profit ^b	8,501	2,082	10,583
Total	\$62,135	\$15,216	\$77,351
Total amount by which proposals overstated	\$283,694	\$74,185	\$357,879

^aOverhead rates were calculated using the rates established in Allison's forward pricing rate agreements

^bProfit was calculated using the profit rate established during each contract negotiation

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