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

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DETC-00-10-3010
June 17, 1991

MEMORANDUM FOR COMMANDING OFFICER, SAN ANTONIO AIR LOGISTICS CENTER


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

## TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>TRANSMITTAL MEMORANDUM/EXECUTIVE SUMMARY</td>
<td>1</td>
</tr>
<tr>
<td>PART I - INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>Background</td>
<td>1</td>
</tr>
<tr>
<td>Objectives and Scope</td>
<td>1</td>
</tr>
<tr>
<td>Prior Audit Coverage</td>
<td>2</td>
</tr>
<tr>
<td>PART II - FINDING AND RECOMMENDATION</td>
<td>3</td>
</tr>
<tr>
<td>Pricing of Contract F41608-85-D-A011, Delivery Order 0099</td>
<td>3</td>
</tr>
<tr>
<td>APPENDIX A - Chronology of Significant Events</td>
<td>7</td>
</tr>
<tr>
<td>APPENDIX B - Report of Potential Monetary and Other Benefits Resulting from Audit</td>
<td>9</td>
</tr>
<tr>
<td>APPENDIX C - Computation of Defective Pricing of Contract F41608-85-D-A011, Delivery Order 0099</td>
<td>11</td>
</tr>
<tr>
<td>APPENDIX D - List of Audit Team Members</td>
<td>13</td>
</tr>
<tr>
<td>APPENDIX E - Final Report Distribution</td>
<td>15</td>
</tr>
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</table>

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.
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# Report of Potential Monetary and Other Benefits Resulting from Audit

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<td>Monetary benefit to be derived by contractor's compliance with Public Law 87-653, &quot;Truth in Negotiations Act.&quot;</td>
<td>One time collection of $145,044 to be initiated by the San Antonio Air Logistics Center. Monetary benefit is classified as &quot;funds put to better use.&quot;</td>
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### COMPUTATION OF DEFECTIVE PRICING OF CONTRACT F41608-85-D-A011

**DELIVERY ORDER 0099**

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<th>Part Number</th>
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<td></td>
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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.*
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LIST OF AUDIT TEAM MEMBERS

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