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REPORT TO THE CONGRESS

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Audit Of Payments From
Special Fund To
Lockheed Aircraft Corporation
For C-5A Aircraft Program
During Period Ended June 30,
1971 G-162578

Department of Defense

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REPORT OF THE COMPTROLLER GENERAL
OF THE UNITED STATES

AUG. 9, 1971

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-162578

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To the President of the Senate and the
Speaker of the House of Representatives

This is our initial report on the audit of payments from the special fund to Lockheed Aircraft Corporation for the C-5A aircraft program during the period ended June 30, 1971. This audit was made pursuant to section 504, Public Law 91-441, which authorizes \$200 million of interim funding for the C-5A aircraft program to be paid through a special bank account. The law provides that Lockheed not be reimbursed for intercompany profits, bid and proposal costs, independent research and development costs, and other unsponsored technical costs, and depreciation and amortization expenses. The law provides also that the General Accounting Office audit payments from the special bank account on a quarterly basis and submit a report to the Congress not more than 30 days after the close of each quarter. C420

Payments to Lockheed from the special bank account started on June 16, 1971, and totaled \$20.4 million by June 30, 1971. Our review revealed no payments to Lockheed that were contrary to the provisions of Public Law 91-441. Since payments to Lockheed were made during the last 2 weeks of June 1971, we had only a limited time to make our audit. Therefore we are continuing our examination and will include further comments on the results of our audit in subsequent reports.

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretary of Defense; and the Secretary of the Air Force. 95

Comptroller General
of the United States

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ABBREVIATIONS

DCAA Defense Contract Audit Agency

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CHAPTER 1

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INTRODUCTION

In March 1970 the chairman of Lockheed's board of directors notified the Deputy Secretary of Defense that the company would require additional funding, over and above the Air Force estimate of the contract ceiling price, in order to complete development and production of 81 C-5A aircraft. He also advised the Deputy Secretary of Defense that it would be financially impossible for Lockheed to complete performance on the C-5A aircraft program, as well as other major defense programs, without further financing from the Department of Defense.

The Deputy Secretary of Defense informed the Congress of the Lockheed position and requested that it provide additional funding of \$200 million, over the amount requested in the regular appropriation, as an interim measure to permit Lockheed to continue development and production of the C-5A aircraft.

The Congress authorized the \$200 million by Public Law 91-441, section 504, approved October 7, 1970, to continue the C-5A aircraft program. (See app. I.) Section 504 specified that:

1. All payments from the \$200 million fund be made through a special bank account for reasonable and allocable direct and indirect costs incurred on the C-5A aircraft program.
2. The contractor not be reimbursed for intercompany profits; bid and proposal costs; independent research and development costs; and other similar unsponsored technical effort costs; and depreciation and amortization costs on plant, property, or equipment.
3. These excluded costs not be recoverable under any other contract.

4. All payments from the special bank account be audited by the Defense Contract Audit Agency (DCAA) and the General Accounting Office.
5. The Comptroller General report to the Congress not more than 30 days after the close of each quarter on the results of the General Accounting Office audit.

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PAYMENTS FROM THE SPECIAL BANK ACCOUNT

Payments from the \$200 million fund and from the special bank account were initiated on June 16, 1971, and the amounts deposited and withdrawn through June 30, 1971, were as follows:

		<u>Special Bank account</u>	<u>\$200 million fund</u>
Beginning balance		None	\$200,000,000
Deposits		\$21,405,511	
Withdrawals:			
Material and other charges	\$13,103,466		
Intercompany transactions:			
Charges	\$3,094,031		
Credits	-7,505,352	-4,411,321	
Labor		4,793,896	
Overhead		<u>6,916,967</u>	
		<u>20,403,008</u>	<u>\$ 21,405,511</u>
Balance at June 30, 1971		<u>\$ 1,002,505</u>	<u>\$178,594,489</u>

Procedures established by the Air Force to control withdrawals from the special bank account require that reimbursement vouchers be submitted by Lockheed to the Air Force contracting officer for approval. The Air Force contracting officer approves these payments subject to audit by DCAA. These vouchers are supported by detailed listings of material, labor, and overhead costs incurred on the C-5A aircraft program. The following comments describe the methods used by Lockheed to support withdrawals from the bank account.

MATERIAL AND OTHER CHARGES

Material costs and other miscellaneous charges paid from the special bank account through June 30, 1971, totaled \$13,103,466. Payments were supported by purchase orders, vendors' invoices, and receiving reports.

To ensure prompt payment to vendors, Lockheed has developed a weekly report that shows all vendor accounts which have not been paid within 30 days. The total amount of

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accounts payable outstanding more than 30 days and applicable to the C-5A aircraft program is to be deducted from the amount of reimbursement vouchers to Lockheed. Lockheed deducted from the first voucher \$1 million to cover the estimated amount of all accounts payable related to the C-5A aircraft program that may remain unpaid for 30 days or longer during the first month.

The accounts payable report for July 2, 1971, showed a total of \$483,889, which represented vendor accounts payable applicable to the program over 30 days old and which indicated that the amount withheld was more than adequate.

Intercompany transactions

Most development and production work on the C-5A aircraft program is being done by the Lockheed-Georgia Company, Marietta, Georgia, and by outside vendors and subcontractors. Some costs, however, are being incurred at the following Lockheed locations.

Lockheed Aircraft Corporation, Burbank, California
Lockheed-California Company, Burbank, California
Lockheed Aircraft Service Company, Ontario, California
Lockheed Electronics Company, Plainfield, New Jersey

These other locations periodically charge costs associated with their work on the C-5A aircraft to the Lockheed-Georgia Company according to established billing procedures. Although there were charges totaling \$3,094,031 from other locations of Lockheed for work on the C-5A aircraft program, they were more than offset by intercompany credits of \$7,505,352. These credits represent the excess of the amount paid for delivered items plus progress payments for undelivered items, compared with the amount reimbursable under the terms of the current contract. Effective May 31, 1971, the contract between Lockheed and the Air Force for C-5A aircraft was converted from a fixed-price incentive contract to a fixed loss, cost reimbursement contract.

LABOR COSTS

Labor costs totaling \$4,793,896, for 964,001 direct labor hours, were paid to Lockheed from the special bank account through June 30, 1971. These costs and hours were

charged to specific C-5A aircraft work orders. Costs for indirect labor were charged to the C-5A aircraft program through overhead allocations.

OVERHEAD EXPENSES

Overhead expenses totaling \$6,916,967 were paid from the special bank account during June 1971 on the basis of provisional overhead rates previously negotiated. Actual overhead rates are to be negotiated as of December 26, 1971, the end of the company's fiscal year.

Lockheed and the Air Force negotiate provisional overhead rates for use in cost reimbursement contract billings. During negotiations of 1971 rates, concluded in March 1971, costs which were unallowable under provisions of section XV of the Armed Services Procurement Regulation were excluded in establishing the provisional overhead rates.

The provisional overhead rate also was reduced to exclude those costs which are unallowable under Public Law 91-441. Such costs amounted to about \$801,000 for the period ended June 30, 1971.

DEFENSE CONTRACT AUDIT AGENCY

The audit by DCAA at the Lockheed-Georgia Company in the past generally has been directed toward reviewing accounts payable, payroll accounting systems, inventory accounting systems, etc., on a cyclical basis. Through these audits DCAA's objective is to gain insight into Lockheed's accounting processes and to determine the adequacy of the company's system of management controls.

DCAA has developed special audit procedures for reviewing Lockheed's vouchers requesting withdrawals from the fund for deposit in the special bank account and for auditing payments from the bank account.

CHAPTER 3GENERAL ACCOUNTING OFFICE AUDIT
OF PAYMENTS FROM SPECIAL BANK ACCOUNT

Our review was made at the Lockheed-Georgia Company, Marietta, Georgia; Lockheed Aircraft Corporation and Lockheed-California Company, Burbank, California; and Lockheed Aircraft Service Company, Ontario, California.

We reviewed the DCAA audit of payments from the special bank account for material costs and other charges and tested the work performed. In addition, we selected transactions shown on withdrawal vouchers and traced the amounts to such documents as purchase orders, receiving reports, vendors' invoices, and work orders, to determine the accuracy and propriety of the amounts paid. We also examined into the reasonableness and correctness of the procedures used in allocating the cost of common usage materials.

We examined costs incurred on the C-5A aircraft program by Lockheed companies in California and charged to the Georgia Company. Our review was directed at testing the accuracy and allowability of labor, material, and overhead costs incurred in intercompany billings.

Our audit of labor costs incurred by Lockheed included: (1) a review of internal procedures and controls established to ensure that labor costs were accurately distributed to contracts and other programs, (2) a review of labor audits by DCAA and Lockheed's internal auditors, and (3) tests to determine whether labor costs appeared reasonable and applicable to the C-5A aircraft program.

In our review of overhead, we examined Air Force and Lockheed procedures used in estimating and negotiating provisional overhead rates. We also examined into the reasonableness of provisional overhead rates and the costs eliminated to comply with Public Law 91-441.

Our review revealed no payments to Lockheed for the period ended June 30, 1971, that were contrary to the provisions of Public Law 91-441. Since payments to Lockheed

were made during the last 2 weeks of June 1971, we had only a limited time to make our audit. Therefore we are continuing our examination and will include further comments on the results of our audit in subsequent reports.

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APPENDIX

SECTION 504

PUBLIC LAW 91-441

OCTOBER 7, 1970

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Sec. 504. (a) Of the total amount authorized to be appropriated by this Act for the procurement of the C-5A aircraft, \$200,000,000 of such amount may not be obligated or expended until after the expiration of 30 days from the date upon which the Secretary of Defense submits to the Committees on Armed Services of the Senate and the House of Representatives a plan for the expenditure of such \$200,000,000. In no event may all or any part of such \$200,000,000 be obligated or expended except in accordance with such plan.

(b) The \$200,000,000 referred to in subsection (a) of this section, following the submission of a plan pursuant to such subsection, may be expended only for the reasonable and allocable direct and indirect costs incurred by the prime contractor under a contract entered into with the United States to carry out the C-5A aircraft program. No part of such amount may be used for—

(1) direct cost of any other contract or activity of the prime contractor;

(2) profit on any materials, supplies, or services which are sold or transferred between any division, subsidiary, or affiliate of the prime contractor under the common control of the prime contractor and such division, subsidiary, or affiliate;

(3) bid and proposal costs, independent research and development costs, and the cost of other similar un-sponsored technical effort; or

(4) depreciation and amortization costs on property, plant, or equipment.

Any of the costs referred to in the preceding sentence which would otherwise be allocable to any work funded by such \$200,000,000 may not be allocated to other portions of the C-5A aircraft contract or to any other contract with the United States, but payments to C-5A aircraft subcontractors shall not be subject to the restrictions referred to in such sentence.

(c) Any payment from such \$200,000,000 shall be made to the prime contractor through a special bank account from which such contractor may withdraw funds only after a request containing a detailed justification of the amount requested has been submitted to and approved by the contracting officer for the United States. All payments made from such special bank account shall be audited by the Defense Contract Audit Agency of the Department of Defense and, on a quarterly basis, by the General Accounting Office. The Comptroller General shall submit to the Congress not more than thirty days after the close of each quarter a report on the audit for such quarter performed by the General Accounting Office pursuant to this subsection.

(d) The restrictions and controls provided for in this section with respect to the \$200,000,000 referred to in subsections (a) and (b) of this section shall be in addition to such other restrictions and controls as may be prescribed by the Secretary of Defense or the Secretary of the Air Force.