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REPORT TO THE CONGRESS

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Implementation Of Emergency Loan Guarantee Act B-169300

Lockheed Aircraft Corporation
Emergency Loan Guarantee Board

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

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DEC. 6, 1972



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

B-169300

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

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This is our first report on the implementation of the Emergency Loan Guarantee Act administered by the Emergency Loan Guarantee Board. 1177

This review was made pursuant to the Emergency Loan Guarantee Act, 1971 (15 U.S.C. 1841, supp. I, 1970); the Budget and Accounting Act, 1921 (31 U.S.C. 53); and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget, and to the Chairman, Emergency Loan Guarantee Board.

Comptroller General
of the United States

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D I G E S T

WHY THE REVIEW WAS MADE

The Emergency Loan Guarantee Act, approved August 9, 1971 (Public Law 92-70), created the Emergency Loan Guarantee Board. The Board was authorized to provide Government guarantees to lenders for the repayment of loans of up to \$250 million made to major business enterprises. Such a loan is to be authorized when the Board finds that (1) a loan is needed and that failure to meet this need would adversely and seriously affect the economy, (2) credit is not otherwise available to the applicant, and (3) the prospective earning power of the applicant and the value of security pledged gives reasonable protection to the United States. The authority of the Board to enter into any new commitments will terminate on December 31, 1973. Lockheed Aircraft Corporation, Burbank, California, has been the only business enterprise to apply for a loan guarantee under the act.

Section 7(b) of the act provides that the General Accounting Office (GAO) audit all accounts, books, records, and transactions of any borrower under the act. The act requires GAO to report the results of the audit to the Congress and to the Emergency Loan Guarantee Board.

The Chairmen of the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking and Currency were informed that GAO has interpreted this provision of the statute as requiring it to:

--Monitor the activities of the borrower, to provide assurance that the borrower and lenders comply with the terms of the statute and that the interests of the Government are adequately protected.

--Advise the Congress of any matters which may affect the ability of the borrower to repay the Government-guaranteed loan.

--Inform the Congress of any other information which may be relevant under the circumstances existing during the loan guarantee period. (See app. I.)

To the extent feasible, GAO has used the most current information available to reflect significant events that occurred before September 30, 1972.

GAO intends to report to the Congress and to the Emergency Loan Guarantee Board annually during the existence of the loan guarantee, unless conditions warrant more frequent reports.

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FINDINGS AND CONCLUSIONS

GAO's review indicated that:

- Lockheed and the lending banks have complied with the requirements of the Emergency Loan Guarantee Act. The Government has been placed in a preferred position with respect to collateral, and, on the basis of current book valuations and certain known market values of the pledged assets, the Government's interests appear to be adequately protected. (See pp. 13 and 14.)
- Barring unforeseen circumstances, Lockheed should generate sufficient cash during the next several years to permit repayment of the Government-guaranteed portion of the loan. (See p. 16.)
- Unless Lockheed obtains substantial additional orders for its L-1011 TriStar commercial airliner, losses on that program could impair its financial condition. Lockheed currently estimates that it will have to sell about 275 TriStars to recover all program costs. As of October 31, 1972, Lockheed had firm orders for 117 aircraft and customers had taken options for an additional 67. (See p. 15.)

As of September 30, 1972, Lockheed borrowed \$130 million under a credit agreement for which the Government guaranteed repayment. The company's cash flow projections indicate an additional \$90 million will be required to finance continued production of the L-1011. Lockheed's initial financial forecast (August 30, 1971) indicated that it would borrow about \$150 million of the available \$250 million.

L-1011 production costs have been higher and progress payments from the Department of Defense have been lower than anticipated. This resulted in increased cash requirements and borrowings now estimated to peak at \$220 million. (See p. 12.)

Lockheed is taking steps to resolve the production problems that have resulted in higher costs and in late deliveries of aircraft to the airline purchasers. GAO is currently determining whether Lockheed is succeeding in correcting these problems. (See pp. 15 and 16.)

Lockheed officials are considering developing a longer range version of the L-1011. Estimated development costs for that model would require additional financing of between \$70 million and \$100 million. This venture would require prior approval of the Emergency Loan Guarantee Board and the lenders. The longer range aircraft would require engines with greater thrust. On August 7, 1972, the British Government announced that it has agreed to provide financial support to Rolls-Royce to proceed with the development of such an engine. (See pp. 16 and 17.)

The Emergency Loan Guarantee Board has made available for GAO's review certain reports and financial analysis prepared by the Board's fiscal agent after it reviewed documents received from Lockheed. The Board has acted in accordance with its fiscal agent's recommendations in granting the guaranteed loan and increments. (See p. 11.)

RECOMMENDATIONS OR SUGGESTIONS

This report contains no recommendations or suggestions.

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Lockheed Aircraft Corporation and the staff of the Emergency Loan Guarantee Board agreed with the contents of this report. The Board continues to maintain that GAO does not have the statutory authority to examine the Board's internal records related to its decisionmaking process. (See p. 11 and app. II.) GAO believes the Board's position is

without merit. (See p. 11 and app. III.)

MATTERS FOR CONSIDERATION
BY THE CONGRESS

Because Lockheed is the largest defense contractor, the Congress should be aware that Lockheed Aircraft Corporation may face financial difficulties if additional L-1011 sales are not forthcoming.

CHAPTER 1

INTRODUCTION

The General Accounting Office (GAO) has made a selective examination of the activities of the Lockheed Aircraft Corporation, Burbank, California, in connection with borrowings under the Emergency Loan Guarantee Act, approved August 9, 1971 (Public Law 92-70).

Section 7(b) of the act provided that GAO audit all accounts, books, records, and transactions of any borrower under the act. We have interpreted this section of the statute as requiring us to continuously review any of Lockheed's decisions and actions which may affect its assets, income, or ability to repay the loan. (See app. I.)

We intend to issue annual reports to the Congress and to the Emergency Loan Guarantee Board until the guaranteed loans are repaid or the Government's obligations are otherwise terminated. We will issue interim reports if there are significant matters that require the attention of the Congress.

We reviewed corporate actions which had a material effect on the financial structure of Lockheed. We also examined into the bases for Lockheed's forecasts of cash flow and revenue and compared these forecasts to actual transactions. We relied on the examinations performed by Lockheed's independent external auditors, particularly as those examinations related to verification of assets pledged to protect the interests of the Government. We also made such tests of the accounting records and major cash transfers and expenditures as we deemed necessary.

We examined certain records of the Emergency Loan Guarantee Board in support of its actions in approving Lockheed's loan guarantee and the agreements prepared by the Board to protect the Government's interest as required by the act.

EMERGENCY LOAN GUARANTEE ACT

The act created the Emergency Loan Guarantee Board which was authorized to provide a Government guarantee for the repayment of loans of up to \$250 million to major business enterprises when it finds that (1) a loan is needed and that failure to meet this need would adversely and seriously affect the economy, (2) credit is not otherwise available to the applicant, and (3) prospective earning power of the applicant and the value of security pledged gives reasonable protection to the United States. The Board found that the Lockheed Aircraft Corporation, the only borrower under the act, met the above conditions.

The legislative history of the Emergency Loan Guarantee Act suggests that the prime objective was to avoid the adverse impacts from the impending financial collapse of Lockheed. Among these impacts were the effects on regional employment and the resultant loss of taxes; financial crises among Lockheed's suppliers (many of which were small business concerns); and potential significant losses of the investment in the TriStar, particularly the cash advances made by major air carriers.

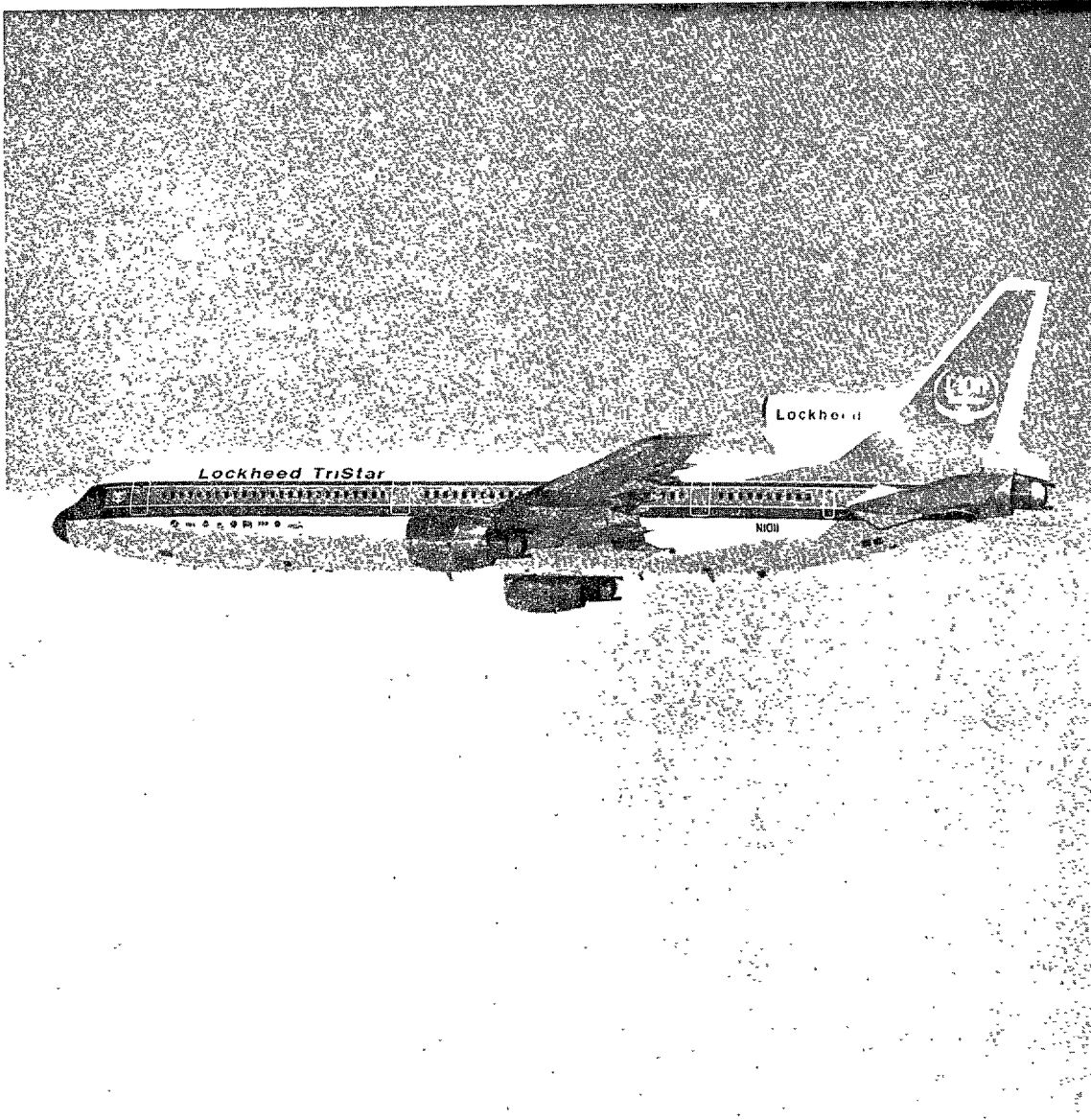
Lockheed Aircraft Corporation--the largest defense contractor--had contract awards from the military departments exceeding \$1.5 billion during each of the past 3 fiscal years. Lockheed's major defense programs include the C-5A Galaxy and C-130 Hercules transport aircraft; the P-3 Orion and S-3A Viking antisubmarine warfare aircraft; and the Poseidon, Polaris, and Trident fleet ballistic missiles.

Testimony during congressional hearings, preceding enactment of the loan legislation, indicated that Lockheed's survival would help retain a competitive commercial aircraft industry in the United States and would help maintain this country's preeminent position as the worldwide supplier of commercial aircraft. It was also felt that the U.S. balance-of-payments position could be improved if Lockheed's L-1011 TriStar jet airliner was marketed overseas. Most important, the additional financing was considered critical for Lockheed's future as a going concern and was particularly essential for it to fulfill its production commitments on the L-1011.

In August 1971 when the Emergency Loan Guarantee Act was approved, Lockheed's net investment in development and unfinished production costs (work-in-process inventory) for the L-1011 TriStar program amounted to \$652.4 million, or almost 70 percent of Lockheed's current assets. (Current assets are cash or other assets which are expected to be realized in cash or sold or consumed during the normal operating cycle of the business, usually 1 year.) Excluding the L-1011 assets (which would not be converted to cash in 1971), Lockheed's current liabilities in August 1971 exceeded its current assets by \$38.5 million, which indicated that Lockheed had an immediate need for cash to meet current commitments. (Current liabilities are obligations whose liquidation requires the use of current assets or the creation of other liabilities.) Additional funding therefore was considered necessary to insure that working capital would be available to Lockheed.

Lockheed had already borrowed \$400 million from a 24-bank underwriting group, and, earlier in 1971, it had been making arrangements to increase this loan. Before the completion of these financial arrangements, however, there was a delay in production and delivery of completed aircraft due to the financial failure of Rolls-Royce, Ltd., of England, the manufacturer of the RB. 211 engines for the TriStar. The Rolls-Royce failure and related increased costs made it necessary for Lockheed to renegotiate its contracts with customers and suppliers for the L-1011 aircraft. As a result of these events and the uncertainties involved in reaching agreements on restructuring of the contracts, agents for the banks stated that they would not proceed with the planned credit expansion without a Government guarantee of repayment. Representatives of the British Government had stated that development and production of the RB. 211 engine by Rolls-Royce would not receive government support without a guarantee from the United States Government of additional financial aid to Lockheed. Rolls-Royce was reorganized under British Government sponsorship and manufacturing operations were continued upon enactment of the Emergency Loan Guarantee Act.

On September 14, 1971, the U.S. Government agreed to guarantee up to \$250 million of additional borrowings by Lockheed. A separate agreement which Lockheed and the



24 lending banks signed formalized the expanded credit line. The new credit agreement was contingent upon a reaffirmation by the major air carrier customers to purchase the TriStar and upon adequate financial support by the British Government for complete development and production of the RB. 211 engine. The major TriStar customers also aided in the financing by agreeing to advance an additional \$100 million in prepayments.

The act provides for the establishment of an emergency loan guarantee fund to be used by the Emergency Loan Guarantee Board for payment of its expenses and to fulfill its obligations under the act. Guarantee fees prescribed and collected for each loan guaranteed under the act are to be deposited in this fund.

The guarantee agreement provides that Lockheed pay for the account of the guarantor a guarantee fee which has been fixed unless altered by the Board at 2.3 percent of the average daily amount of principal of each outstanding guaranteed note. The agreement also provides that the financing institutions pay to the guarantor 50 percent of the commitment fee paid by the borrower. The commitment fee is paid at the rate of one-half of 1 percent of the daily average unused amount of the banks' commitments. The above fees, which are to be paid quarterly, started on December 31, 1971.

As of September 30, 1972, the fund totaled \$2,632,693 and consisted of guarantee fees of \$2,175,131, commitment fees of \$419,820, and amortized discount of Treasury bills of \$37,742. Expenses incurred against the fund through September 30, 1972, totaled \$148,326 and comprised legal fees of \$56,396 for the preparation of the various agreements that had to be executed; service fees of \$68,797 to the Board's designated fiscal agent, the Federal Reserve Bank of New York; and administrative expenses of \$23,133.¹

As authorized by the act, the funds (\$1,719,366) not required for current operations were used to purchase Treasury bills through September 1972.

¹Emergency Loan Guarantee Board statements of income and financial condition as of September 30, 1972, prepared by the Bureau of Accounts, Division of Financial Management, Department of the Treasury.

CHAPTER 2

THE EMERGENCY LOAN GUARANTEE BOARD

The act established the Emergency Loan Guarantee Board which is:

*** composed of the Secretary of the Treasury as Chairman, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Securities and Exchange Commission."

The officials who have served on the Board since its inception are as follows.

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
Secretary of the Treasury and Chairman of the Board:		
John B. Connally	August 1971	June 1972
George P. Shultz	June 1972	Present
Chairman of the Board of Governors of the Federal Reserve System:		
Arthur F. Burns	August 1971	Present
Chairman of the Securities and Exchange Commission:		
William J. Casey	August 1971	Present

The Board has designated the Federal Reserve Bank of New York as its fiscal agent as provided in section 10 of the act.

The General Accounting Office (GAO) is responsible to the Congress for conducting examinations of executive agencies to determine whether they are carrying out only those activities or programs authorized by the Congress and whether they are conducting them in the manner contemplated and are accomplishing the objectives intended.

In this examination we are concerned with how the Board conducts its activities in accordance with the act and

whether it adequately protects the Government's interest. We were informed that the Board's fiscal agent is expected to perform financial and credit analyses, making use of various sources of available data--including all the data submitted by Lockheed--and to periodically make recommendations to the Board on the guaranteed loan or increments.

The Board has taken the position that GAO does not have statutory authority of access to internal records related to the Board's decisionmaking process. A summary of the Board's rationale for its opinion is contained in appendix II.

We believe that GAO has responsibility for reviewing the activities of the Board and has the right to examine any records that the Board used in reaching its decisions. A summary of the basis for GAO's position citing pertinent legislation is provided in appendix III.

In compliance with the views expressed by the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking and Currency, the Board made available for our examination certain correspondence and financial analyses prepared by its fiscal agent in connection with its review of documents and reports submitted by Lockheed, thus enabling us to examine the activities of the Board in connection with the Lockheed guarantee. However, the Board stated in its Annual Report dated September 5, 1972, that the legal difficulties between GAO and the Board were unaffected by its release of records to us. Thus, the Board has not conceded that GAO has any legal right to all records of the Board--a position we think is without merit.

On the basis of our examination of the records made available to us, we believe that the Board had complied with the provisions of the Emergency Loan Guarantee Act and, in granting the guaranteed loan and increments thereof to Lockheed, has acted in accordance with the recommendations of the fiscal agent.

CHAPTER 3

LOANS UNDER GOVERNMENT GUARANTEE

A credit agreement between Lockheed and its lenders, dated August 30, 1971, provided that Lockheed could borrow up to \$250 million under a Government guarantee. The \$250 million was to be available to Lockheed under the terms of the credit agreement through June 29, 1973. After that date, the guaranteed credit ceiling will decrease periodically until the end of 1974--at which time the amount available will be reduced to \$70 million. All guaranteed loans are to be repaid by the end of 1975 unless they are extended by joint action of the Emergency Loan Guarantee Board and the lending banks.

The credit agreement and/or the guarantee act precludes certain Lockheed actions without written consent of the Board and the banks. Among the restricted activities are the payment of cash dividends; payments of other indebtedness to banks making guaranteed loans; creation of additional financial debt; mergers, acquisitions, and entry into additional major non-Government ventures; and change in the nature of Lockheed's business. Our review revealed no violations of the statutory or credit agreement requirements.

The act states that, when a borrower seeks an advance under the loan agreement, it should provide the Emergency Loan Guarantee Board with a plan setting forth the expenditures for which the advance will be used and the period during which the expenditures will be made. Upon the expiration of such periods, the borrower is required to report to the Board any instances in which amounts advanced were not expended in accordance with the plan.

Lockheed's initial financial forecast (August 30, 1971) for loan guarantee purposes indicated that it would require a total of \$150 million. Lockheed borrowed \$130 million through September 30, 1972, in increments of \$50 million, \$25 million, \$25 million, and \$30 million. The loans were made on September 14 and November 18, 1971, and on January 26 and August 17, 1972. In its most recent estimate (August 1972), Lockheed projected its borrowings to a total of \$220 million of the \$250 million it could borrow under

the Emergency Loan Guarantee Act. The additional \$70 million in borrowing requirements is due to (1) current and possible future production costs of the L-1011 aircraft and (2) changes in Department of Defense policy resulting in slower progress payments.

In accordance with requirements of the act, Lockheed submitted expenditure plans to the Emergency Loan Guarantee Board for each of the four increments. The plans showed that the loans were needed to provide working capital to continue TriStar production. These plans and Lockheed's forecasts indicated that the program's 12-month expenditures through August 1972 would exceed receipts by \$238 million. The actual expenditures for the period exceeded receipts by about \$290 million.

ASSETS PLEDGED AS COLLATERAL

The guarantee act requires that the prospective earning power of the applicant and the value of the security pledged, furnish reasonable assurance that the borrower will be able to repay the loan and that the Government will have priority over the lenders with respect to the collateral securing the loans. A security and pledge agreement dated August 30, 1971, was executed by Lockheed and the agents for the 24-bank underwriting group. In the agreement Lockheed pledged certain assets as security for the guaranteed loans. The banks agreed to subordinate their interests in all collateral to the interests of the Government.

Assets consisting of the outstanding shares of stock of five wholly owned subsidiaries and certain machinery and equipment located in Los Angeles County, California, were pledged as security. The book value of the assets pledged amounted to \$250.5 million at the end of June 1972, as follows:

	<u>Amount</u> <u>(millions)</u>
Stock of subsidiaries:	
Lockheed Missiles & Space Company, Inc.	\$ 54.4
Lockheed Shipbuilding and Construction Company	33.1
Lockheed Electronics Company, Inc.	29.0
Lockheed Air Terminal, Inc.	11.2
Lockheed Properties, Inc. (note a)	85.6
Machinery and equipment (Los Angeles County)	<u>37.2</u>
 Total	 <u>\$250.5</u>

^a Lockheed Properties, Inc., was established specifically to retain title to various pledged properties in California, Texas, and New Jersey.

Data on current market values of the pledged properties was, for the most part, unavailable either from Lockheed or from the Bank of America, the collateral pledgee representing the lending banks. Property tax bills for fiscal year 1972 showed that real properties having a total book value of \$61.7 million were listed at a total market value of \$258.3 million. Market valuations were not readily available for the other pledged properties.

We recognize that the book value or the current market value of assets are not necessarily reliable indicators of the amounts that could be realized in the event of forced liquidation. On the basis of real property tax assessments and generally favorable earnings of subsidiaries (3-year average of \$28.3 million after taxes and after an extraordinary loss of about \$30 million), we believe that the Government's interests are being adequately safeguarded.

CHAPTER 4

FINANCIAL STATUS OF LOCKHEED AIRCRAFT CORPORATION

The current financial position of Lockheed is such that it will face financial difficulties unless substantial additional orders for the L-1011 aircraft are obtained. The following observations illustrate the relative importance of the L-1011 program to the financial structure of Lockheed at the end of June 1972.

--The net investment in L-1011 inventories was \$914.1 million;¹ the total net worth of Lockheed was \$261 million.

--Current assets (excluding L-1011 inventories) were \$351.6 million; current liabilities were \$559.4 million.

L-1011 PROGRAM

Lockheed currently estimates that it will have to sell about 275 TriStars to recover all program costs. As of October 31, 1972, Lockheed received firm orders for 117 TriStars and purchase options for an additional 67. Deliveries to the airlines began in April 1972.

Until recently Lockheed had been estimating a break-even point of from 255 to 265 L-1011 sales. Current production costs, however, have been higher than projected because of increased material usage, higher labor costs, and delays in current deliveries. Some of the increased costs resulted from a stretchout in production because of changed customer requirements. This has resulted in the currently estimated break-even point of 275 aircraft and increased borrowing requirements. (See p. 12.) Lockheed is taking steps to bring

¹ Lockheed's recorded work-in-process inventory, in addition to including partially completed aircraft, parts, related material, and tooling, also includes precertification development and planning costs applicable to the L-1011 TriStar airliner.

the production costs down and to get deliveries to purchasers back on schedule. We are currently determining whether Lockheed is succeeding in resolving these problems.

Even if total sales of the L-1011 TriStar aircraft are limited to the number of firm orders (110 aircraft) as of September 30, 1972, on a companywide basis, Lockheed will probably generate about \$393 million in cash through 1975--an amount sufficient to repay the Government-guaranteed loan. If the options (60 aircraft) are exercised by customers, cash generated by all operating divisions should approximate \$685 million by the end of that year.

Regardless of the seemingly positive cash outlook, Lockheed could suffer substantial losses if it does not receive additional TriStar orders. For example, Lockheed's overall operating loss through 1975 could approach \$60 million if TriStar sales are limited to current firm orders and options. In the unlikely event that only 110 of these aircraft for which Lockheed is holding firm orders are sold, Lockheed's overall operating loss could be close to \$435 million.

The estimate of possible losses on the sales of 110 or 170 TriStars has excluded several factors which are not susceptible to measurement in advance. A further production stretchout, for instance, could increase costs significantly. Also, commitments to subcontractors for aircraft components in excess of those needed for aircraft sold may have to be fulfilled, regardless of production cutbacks. Although Lockheed's current net worth may be sufficient to absorb a loss of up to \$260 million, Lockheed's working capital position may be impaired in these circumstances and Lockheed would undoubtedly need additional outside financing.

Lockheed officials believe that the overall prospects for the L-1011 are highly favorable and that additional orders will materialize once the aircraft has proven its capabilities in scheduled commercial operations. Some airlines have also expressed an interest in a longer range version of the L-1011 which will allow the aircraft to function in extended transoceanic flights with a normal payload.

Lockheed believes that additional outside financing estimated at between \$70 million and \$100 million will be needed to launch the longer range aircraft program. This venture will require prior approval of the Emergency Loan Guarantee Board and the lender banks. Further discussions are also scheduled with various airlines as potential customers for the longer range aircraft.

The longer range aircraft would require engines with greater thrust. On August 7, 1972, the British Government announced that it has agreed to provide financial support to Rolls-Royce to proceed with the development of such engines.

MARKET FORECASTS FOR
WIDE-BODIED TRIJET AIRCRAFT

We have reviewed the available market forecasts by interested aircraft companies, Federal agencies, and independent associations for commercial trijet airliners. These forecasts, all of which are at least a year old, indicate a worldwide market for basic and long-range wide-bodied trijet (of the L-1011 and DC-10 type) of between 1,300 and 1,400 planes through the year 1980. Of the total forecast demand for these aircraft, approximately 775 planes are of the basic or intermediate range configuration DC-10-10 and L-1011.

As of September 30, 1972, reported orders for the Lockheed L-1011 and McDonnell Douglas DC-10 series, the only available wide-bodied trijets, were as follows:

	Domestic			Foreign		
	Orders	Options	Total	Orders	Options	Total
Intermediate range:						
DC-10-10	83	9	92	5	-	5
L-1011	<u>92</u>	<u>36</u>	<u>128</u>	<u>18</u>	<u>24</u>	<u>42</u>
Total	<u>175</u>	<u>45</u>	<u>220</u>	<u>23</u>	<u>24</u>	<u>47</u>
Long range:						
DC-10-20	22	6	28	-	-	-
DC-10-30	<u>2</u>	<u>-</u>	<u>2</u>	<u>46</u>	<u>36</u>	<u>82</u>
Total	<u>24</u>	<u>6</u>	<u>30</u>	<u>46</u>	<u>36</u>	<u>82</u>
Convertible (passenger-cargo):						
DC-10	<u>14</u>	<u>4</u>	<u>18</u>	<u>3</u>	<u>-</u>	<u>3</u>
Total--all models	<u>213</u>	<u>55</u>	<u>268</u>	<u>72</u>	<u>60</u>	<u>132</u>
Composite forecast demand through 1980			<u>755 to 914</u>			<u>394 to 620</u>

If the demand forecast by various interested organizations is reasonably accurate, then the bulk of the orders for wide-bodied trijet airliners have not as yet been placed with either of the two producers. We understand that, in addition to new market sources, customers who have already placed orders may be expected to order additional aircraft during the second half of the decade.

LOCKHEED FINANCIAL MANAGEMENT

Lockheed management has recognized that the future of Lockheed depends, to a great extent, on the timely liquidation of TriStar inventories and on Lockheed's ability to control costs and conserve its cash. Lockheed has initiated actions to limit the expenditures for fixed assets.

Corporate sales for the 18-month period ended June 1972 were about \$397 million less than the amount projected by Lockheed in August 1971. The decrease was attributed primarily to lower than anticipated cost reimbursements for the C-5 Galaxy Air Force jet transport. Net earnings for the period, however, were more than Lockheed expected. The actual operating results for the 18 months are compared to the August 1971 forecast below.

	<u>Operating results for</u> <u>18-month period ended June 1972</u>		
	<u>Forecast</u>	<u>Actual</u>	<u>Actual over</u> <u>or under(-)</u> <u>forecast</u>
	(millions)		
Sales	\$4,415.8	\$4,018.8	\$-397.0
Interest and other income	<u>13.8</u>	<u>9.4</u>	<u>-4.4</u>
	4,429.6	4,028.2	-401.4
Cost and expenses	4,325.9	3,932.6	-393.3
Interest expense	<u>63.1</u>	<u>55.3</u>	<u>-7.8</u>
	4,389.0	3,987.9	-401.1
Earnings before Federal income tax and extraor- dinary gain	40.6	40.3	-.3
Provision for deferred Federal income tax	<u>21.7</u>	<u>21.1</u>	<u>-.6</u>
Earnings before extraor- dinary gain	18.9	19.2	.3
Gain on sale of fixed assets	<u>3.8</u>	<u>7.0</u>	<u>3.2</u>
Net earnings for the period	<u>\$ 22.7</u>	<u>\$ 26.2</u>	<u>\$ 3.5</u>

As a result of the Rolls-Royce financial failure, production and deliveries under the L-1011 program were delayed about 6 months; this resulted in a significant increase in the costs of the program. Estimated delay and disruption costs of \$40 million have been charged to income in 1971. Even though Lockheed's forecast did not anticipate these increased costs, the net earnings still closely approximated the amount forecast.

In August 1972 Lockheed forecast deliveries of 178 L-1011 aircraft for the 5-year period 1972-76 and corporate net earnings that recognized a stretchout in deliveries of about 18 months.

As in past years the bulk of Lockheed's business (excluding the L-1011 program) was with the Department of Defense. We tested the validity of Lockheed's 5-year financial forecast dated August 1972 by comparing its forecast of gross sales to the Government for each of the 5 years (1972-76) with the Government's forecast of purchases of six major weapons systems. Our tests included about 31 percent of the total forecast gross sales.

Department of Defense officials were unable to confirm certain of the estimated new business for two of the weapons systems because other firms were competing with Lockheed for these systems. However, gross sales estimated by Lockheed for the systems covered in our test were about 6 percent higher than the military departments' planned purchases in the 5-year period and, thus, do not vary significantly from the military plans for purchase.

COPY

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

B-169300

JAN 12 1972

Dear Mr. Chairman:

The General Accounting Office has finalized its audit objectives for the Emergency Loan Guarantee Board and Lockheed Aircraft Corporation and has initiated an audit of Lockheed pursuant to the Emergency Loan Guarantee Act, Public Law 92-70. This letter is to explain to you and your committee how we plan to discharge our responsibilities, both with respect to the activities of the Board and of Lockheed. A similar letter is being sent to the Chairman of the Senate Committee on Banking, Housing, and Urban Affairs.

The Emergency Loan Guarantee Act prescribes certain actions that are to be taken by the Board.

Board Actions Required Prior to Approving the Loan Guarantee

The Board must find that (a) a loan to the applicant is needed and that failure to meet this need would adversely and seriously affect the economy, (b) credit to the applicant is not otherwise available, and (c) prospective earning power of the applicant and value of security pledged gives reasonable protection to the United States.

In this connection the Board must receive (a) a certification from the lender that it would not make a loan without such a guarantee, (b) audited financial statements from the applicant, and (c) full and unrestricted access to the applicant's books and other documents.

GAO's review of the activities of the Board would include an examination into (a) the basis or rationale for its various determinations, (b) the documents it should have received from the borrower and the lender, and (c) whether the Board's actions comply with the spirit and intent of the Act.

Board Actions Related to the Loan Guarantee Agreement

The Board must satisfy itself that the underlying loan agreement on which the guarantee is sought contains all appropriate affirmative and negative covenants and provides for the Board's approval of any amendment. In addition, the Board shall establish the interest rate, establish and collect a guarantee fee, have the guaranteed loan fully

APPENDIX I

collateralized, and obtain priority over the lender and any other person with respect to the collateral.

Subject to Board waiver, the debtor enterprise is prohibited from declaring dividends on its common stock or making any payments on its other indebtedness to a lender whose loan is guaranteed under the Act.

GAO's examination of the loan guarantee agreement should consider whether (a) all mandatory provisions have been included in the loan agreement and the reasons for any omissions, (b) all parties whose rights and responsibilities are affected have acquiesced, and (c) the interest rates and guarantee fee established by the Board are consistent with the intent of the Act. GAO also should examine into the receipt and accountability of the guarantee fee. With respect to those provisions that are subject to Board waivers, and were waived, the review should examine into the basis for the Board's decision that the waiver was not inconsistent with reasonable protection of the interests of the United States under the guarantee.

On each occasion that the borrower seeks an advance under the agreement several actions are required: (a) the lender must give the Board 10 days notice of intent to provide funds, (b) the lender must state whether or not the borrower is in default, and (c) the borrower must provide the Board with a plan on how and when funds advanced are to be used, and subsequently report any deviations from the plan.

Concerning the borrower's plan for applying advances under the guaranteed loan, GAO should consider whether the funds advanced were applied solely for the purposes stated by the borrower in its application for each advance.

We believe a review of the activities of the Board is a vital part of the overall examination, since all of the authority contained in the Act is vested in the Board. While the Emergency Loan Guarantee Act does not provide for GAO review of the activities of the Board, in our opinion, such a review is authorized under the general authority granted the General Accounting Office by the Congress to review the records of agencies of the executive branch of the Government.

The Chairman of the Board, however, informed us that the Board does not believe the Congress intended that the General Accounting Office review its decisions. Unless the Board can be prevailed upon to change its position, we will be unable to carry out our responsibilities as we view them.

GAO's Audit of Lockheed

Section 7 (b) of the Act requires GAO to make a detailed audit of all accounts, books, records, and transactions of any borrower with respect to which an application for a loan guarantee is made. After studying the legislative history of the Act and discussing the intent of this Section of the Act with its sponsor, we have concluded that the audit should consist primarily of a continuous review of corporate decisions and actions that may diminish the borrower's assets or income or otherwise adversely affect the corporation's ability to pay back the Government guaranteed loan within the maximum time period prescribed in the Act. For example, the impact of any new agreements with suppliers, customers or employees will have to be considered.

GAO will review the bases for the borrower's forecasts of cash flow, profit and volume of business and examine into whether any new forecasts properly reflect all known facts. Further, GAO will keep alert to any changes in the business climate that could affect the borrower's continued viability as a going concern. The audit will consider possible ways of placing a valuation on the collateral supporting the guaranteed loan and whether the valuation equals or exceeds the amount of the loan outstanding.

GAO plans to make maximum use of the work performed by the borrower's internal audit staff, independent external audit by its public accounting firm, the legal counsel of the borrower, the fiscal agent of the Loan Guarantee Board, the work of other Government audit groups, and the data presented by the borrower in support of its application for the loan guarantee. The audit will be detailed to the extent of selectively examining into the major transfers and expenditures of funds. But it will not entail the minutia of checking payrolls, purchase invoices, receiving records, and the like. At the present time it is not expected that we will be privy to the deliberations of Lockheed's Board of Directors. Therefore, should there be a merger, a corporate acquisition or disposition, or the like, we would become aware of it only after the transaction is reflected in the records or public disclosure is made.

GAO plans to make annual reports to the Congress and the Loan Guarantee Board that will include information on the amounts withdrawn under the guarantee and status of repayments, and on the financial condition of the borrower. Interim reports will be considered if significant matters are found that could substantially alter the continued existence of the borrower as a going concern or its ability to repay the Government guaranteed loan.

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As you know, the legislative history leading to the inclusion of the GAO audit provision is not at all a complete one. For this and other reasons, I think it is important that we have an understanding as to the scope of the audit work necessary to protect the interest of the Government under the Emergency Loan Guarantee program.

There is also the question as to the appropriate response to letter of December 9, 1971, from the Secretary of the Treasury, as Chairman of the Emergency Loan Guarantee Board, in which he declines to furnish GAO any information with respect to the work of the Board in carrying out its responsibilities under the Act. I sent you a copy of that letter with my letter to you of December 17, 1971. We believe strongly that the Budget and Accounting Act of 1921 gives us access to the Board's records. I have not yet made a response to the Secretary with the thought that a discussion with you would be appropriate prior to replying.

I will call your office with the hope of setting up a meeting shortly after the Congress returns on January 18.

Sincerely yours,

(SIGNED) ELMER B. STAATS

Comptroller General
of the United States

The Honorable Wright Patman
Chairman, Committee on Banking
and Currency
House of Representatives



THE GENERAL COUNSEL OF THE TREASURY
WASHINGTON, D.C. 20220

November 14, 1972

Dear Mr. Keller:

Enclosed is the material you requested for inclusion in the GAO Report and a memorandum setting forth the Guarantee Board's position re: GAO access to certain internal records.

Very sincerely yours,

(Signed) Samuel R. Pierce, Jr.

SAMUEL R. PIERCE, JR.

Mr. Robert F. Keller
Deputy Comptroller General
441 G Street, N.W.
Washington, D.C.

Enc.

APPENDIX II

SUMMARY OF GUARANTEE BOARD POSITION FOR GAO REPORT

The crux of the controversy between the GAO and the Board is whether the GAO enjoys a statutory right of access to internal records of executive agencies relating to the decision-making process. Section 312 of the Budget and Accounting Act of 1921 grants the Comptroller General authority to investigate all matters relating to the receipt, disbursement and application of public funds. The underscored language indicates that something less than unlimited authority to investigate all executive matters was contemplated.

The Attorneys General who have considered the proper role of the GAO have consistently maintained that the GAO lacks authority to go behind determinations made by executive agencies and form independent judgments as to their validity. See, for example, 37 O.A.G. 95 (1933); 34 O.A.G. 311 (1924). This position of the Attorneys General is consistent with the Supreme Court's statement as to the limited changes effected by the 1921 Act: "The chief change effected by the Budget and Accounting Act was that it transferred powers lodged with officials of the Treasury Department to the Comptroller General and made his office independent of the Executive Branch of government. Globe Indemnity Co. v. United States, 291 U.S. 476, 480 (1934).

It is submitted that the GAO possesses no statutory authority to examine internal records of executive agencies relating to the decision-making process. To hold otherwise would make it difficult for responsible government officials to obtain complete and candid staff advice. Moreover, while the Board does not rely on the doctrine of executive privilege, if the GAO's claim to the right of unlimited review of executive records were adopted, it would necessarily raise serious constitutional questions involving separation of powers.

SUMMARY OF GAO'S POSITION ON ACCESS TO
THE BOARD'S RECORDS

With regard to the Board's position, GAO unquestionably has the right and duty to inquire into the legality, the efficiency, and the economy of the use of public funds in Government departments and establishments and to make reports thereon to the Congress and its committees. Such authority is spelled out in section 312 of the Budget and Accounting Act, 1921 (31 U.S.C. 53); section 206 of the Legislative Reorganization Act of 1946 (31 U.S.C. 60); sections 117(a) and (b) of the Accounting and Auditing Act of 1950 (31 U.S.C. 67(a)); and section 204 of the Legislative Reorganization Act of 1970 (Pub. L. 91-510, 84 Stat. 1140).

Supportive of the basic authority of section 312 of the Budget and Accounting Act, 1921, which is cited above and which is discussed in the Board's statement, is section 313 of that act which grants the Comptroller General authority for access to records of departments and agencies.

The only exception to the section 313 authority relates to certain foreign affair expenditures made under section 291 of the Revised Statutes, 31 U.S.C. 107. Since that is the only exception stated and following the legal maxim that the specific setting forth of one type of exception precludes others from arising, it seems clear that the Comptroller General may require, and the departments are required to furnish, documents and all other materials relating to any other transaction or activity. Also, the language of section 313 itself (except as to the expenditures under 291 R.S.) in requiring the departments to furnish such information as the Comptroller General "may require of them" and its requirement that he be given access to any documents of the departments clearly gives him access to all such documentation.

The legislative background of the Budget and Accounting Act, 1921, makes no qualification as to what records can be required; the provision itself apparently being considered sufficiently specific. The legislative reports do bring out that one of the principal functions of the Comptroller General is to enable the Congress to be kept advised as to

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expenditures of the Government and that the Comptroller General is expected to criticize extravagance, duplication, and inefficiency in executive departments. There is no doubt that, in passing the act, the Congress did not intend that the executive agencies could, or would, withhold any books, documents, papers, or records needed by the Comptroller General. Otherwise, the very purpose of the act would be nullified. Moreover, and of particular significance in this consideration, without access to the types of records sought, it would be impossible for GAO to perform the reviews envisioned by the Accounting and Auditing Act of 1950; by section 312 of the Budget and Accounting Act of 1921 which speaks of the receipt, disbursement, and application of public funds; and by section 204 of the Legislative Reorganization Act of 1970.