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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

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PROCUREMENT AND SYSTEMS  
ACQUISITION DIVISION



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AUG 01 1973

The Honorable  
The Secretary of Defense

Attention: Assistant Secretary of Defense  
(Comptroller)

Dear Mr. Secretary:

We examined selected types of material costs charged by Bell Helicopter Company, Fort Worth, Texas, to Government contracts. Bell, a division of Textron, Inc., manufactures military and commercial helicopters and vertical-lift aircraft. At the time of our review, Bell held open Government contracts totaling \$1.8 billion. Of this amount, about \$1.5 billion, or about 87 percent, were fixed-price incentive contracts negotiated on a noncompetitive base. About 70 percent of this amount, or \$1 billion, was for fully delivered contracts administered as open contracts because final price negotiations had not been conducted.

The Army's Aviation Systems Command (AVSCOM), St. Louis, Missouri, administers these contracts through its resident personnel at the Bell plant. A resident staff of the Defense Contract Audit Agency (DCAA) is also located at the Bell plant.

The allowability of millions of dollars of costs charged to Government contracts could not be determined, because Bell's material accounting and control system does not provide adequate accountability for parts used in producing helicopters. Under this system the Government is not assured that its contracts are correctly charged. Further, the lack of accountability has delayed final price negotiation of incentive contracts.

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DEFICIENCIES IN BELL'S MATERIAL  
ACCOUNTING AND CONTROL SYSTEM

Under the Armed Services Procurement Regulation, fixed-price incentive contracts are not to be used unless the contractor's accounting system can produce accurate contract costs so that the final price negotiation provision of the contract can be satisfactorily applied. Under this provision the final price is negotiated on the basis of actual costs and the Government and contractor's sharing cost underruns or overruns. Because these cost provisions are applicable to most Government contracts with Bell, the allowability of costs is most important.

Bell's material cost accounting and control system does not provide adequate accountability over selected finished parts after they have been initially charged to a Government contract. Costs of these parts, if purchased, are charged upon receipt or, if manufactured, upon completion, to the contract for which ordered. Upon receipt or completion, the parts may be routed to the production line or stored if they are not immediately required. In either event no records of accountability are maintained after the initial charge to a contract. Once the parts are routed to the production line or storage area, they may be used on any contract, either Government or commercial. Although the helicopters produced for the Government are not identical to those produced for commercial sale, many of the parts are interchangeable.

Government does not have assurance  
that contract charges are proper

Before 1971 the costs of parts purchased or manufactured to replace missing or damaged parts were charged to the contract for which the shortage occurred, even though that particular contract had been previously charged for the entire quantity of parts needed under the contract. This, of course, generated identifiable excess material charges against the contract requirements. Bell, in an attempt to keep charges to each contract in line with requirements, transferred costs numerous times from one contract to another. During 1971, however, Bell accumulated these costs in an account which was subsequently allocated to all contracts. By commingling these costs, Bell cannot identify them to specific contracts--commercial or Government.

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In 1969 and 1970 Bell incurred costs for the replacement of lost parts of about \$5.1 million which were charged directly to Government and commercial contracts. In 1971 Bell incurred similar costs of \$1.6 million which were charged to an accumulation account and allocated to Government and commercial contracts. The total cost for this 3-year period, about \$6.7 million, represented charges for parts which had been previously purchased or manufactured and charged directly to contracts but which could not be located when needed. During this same period about \$4.1 million to replace scrapped parts and about \$4.5 million to rework parts were allocated to all contracts, regardless of actual benefit to specific contracts.

Failure to close out contracts promptly

Fixed-price incentive contracts provide that final contract prices be negotiated shortly after a 90-day period beginning after the last item is delivered. We found, however, that, as of June 1972, Bell contracts for helicopters which had been completely delivered from January 1967 to May 1970 had not been closed out. Target dates for closing these contracts ranged from 24 months to over 5 years after final deliveries.

The Army's records and Bell's cost records showed that costs were being transferred into and out of contracts long after the last item or helicopter was delivered. We believe that the deficiencies in Bell's material accounting and control system, as discussed above, have significantly contributed to the Army's inability to close out these contracts promptly.

DCAA reported deficiencies in the material accounting and control system

Most of the undesirable features in Bell's material accounting and control system were previously reported to the Army. For example, in a May 1970 report to the Commanding General, AVSCOM, DCAA described some of the more important findings and observations from its reviews and audits as follows:

"The commingled material accounting system \* \* \* does not provide the proper 'audit trails' or controls necessary to assure reliable interim

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costing of material and parts to the various Government production contracts. Also, the system is not adequate to assure timely finalization of fixed-price-incentive type contracts or to assure that final contract costs claimed are accurate and are, in fact, appropriately claimed under the contract for which they were incurred. The inadequacies in the material accounting and control systems are not the result of any singular or isolated departmental weakness, but result from a chain of inadequate control from the time materials and parts are received in the Receiving Department to the final pricing of incentive contracts."

As a result of this DCAA report and the findings of a July 1970 Army "should cost" team report, the Army negotiated certain agreements with Bell to correct some of the deficiencies. The Army signed the agreements, however, before it received DCAA's comments on the adequacy of the proposed corrective actions. DCAA has since stated that the agreements, for the most part, ignore the questionable features of the contractor's system.

In an effort to solve some of these problems, the Director, Procurement and Production, AVSCOM, in December 1971, assigned the Chief, Contract Cost and Price Analysis Office, to a task force to make an in-depth analysis to identify the causes of the problems at Bell. The task force has not yet completed its assignment, some 18 months after it was organized.

#### CONTRACTOR'S COMMENTS

Although Bell did not disagree with the factual information presented, it insisted that its material accounting and control system assured proper charges of material costs to Government contracts. We believe, however, that, because Bell does not account for material used for specific Government contracts and commingles material costs to replace missing and damaged parts and allocates such costs to all contracts, the Government is not assured that charges to Government contracts are reasonably accurate.

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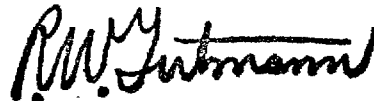
RECOMMENDATION

We recommend that the Department take the necessary action to require Bell to establish, before awarding other fixed-priced incentive contracts, a material accounting and control system which will properly account for materials charged to Government contracts.

We shall appreciate receiving your comments on this matter. If you desire, we shall be pleased to furnish any additional information we may have on this review.

We are sending copies of this letter to the Director, Office of Management and Budget; the Secretary of the Army; and the Chairmen of the House and Senate Committees on Government Operations, Appropriations, and Armed Services.

Sincerely yours,



Director