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UNITED STATES GENERAL ACCOUNTING OFFICE

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8112 FEDERAL OFFICE BUILDING

FIFTH AND MAIN STREETS

CINCINNATI, OHIO 45202

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May 11, 1976

Lieutenant General James T. Stewart
Commander, Aeronautical Systems Division
Wright-Patterson Air Force Base, Ohio 45433

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Dear General Stewart:

2/ The General Accounting Office is currently reviewing the progress of the F-16 Weapon System. During this review, we noted that the cost to maintain idle capacity (MIC) at Air Force Plant Number 4 operated by the Fort Worth Division of the General Dynamics Corporation is paid directly through a nonprofit facilities contract. These same MIC costs are also included in the overhead rates applied to all contracts at the plant. To prevent MIC costs from being paid twice, the F-16 full-scale development contract was credited for the total fiscal year 1976 cost of MIC. C 1916

Crediting a single contract for the total MIC cost lowers the reported cost of the credited contract but does not eliminate MIC costs from other General Dynamics' contracts. Since only cost and not profit is credited, it also causes the Air Force to pay profit on MIC costs commensurate with the risk associated with development and production efforts. In the case of the F-16 development contract credit for fiscal year 1976, MIC procurement funds improperly subsidized about \$2.2 million in F-16 development costs.

In July 1975, Aeronautical Systems Division (ASD) Procurement and Production officials requested that action be taken which would eliminate the need to credit a single contract for MIC costs each year. Since then, however, no further action has been taken nor apparently, is any planned. We are recommending that you assign to the appropriate ASD organization the responsibility for eliminating MIC costs from General Dynamics' overhead rates.

BACKGROUND

Air Force Plant Number 4 is owned by the Government but operated by the Fort Worth Division of the General Dynamics Corporation under nonprofit facility contract number F33657-72-C-0811. General Dynamics

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also maintains certain Air Force-required idle production capability at the plant and these costs are included in the forward pricing overhead rates applied to all supply contracts at the Fort Worth plant. These costs, together with the profit rate associated with each contract, are paid as part of the price of the item being produced.

In 1973, ASD officials determined that the Government would benefit by making direct payments for MIC costs through the facilities contract. Government procured end items would be at more realistic prices because supply contracts would not be burdened with overhead costs associated with MIC and financing of MIC cost through a cost reimbursable facilities contract, without fee, would reduce costs on future fee-bearing supply contracts.

ASD began direct funding of MIC in April 1974 but neither reopened existing contracts nor instructed General Dynamics to exclude MIC from the forward pricing rates of future supply contracts. ASD increased the amount of the facilities contract by the amount of negotiated MIC costs but reduced only the F-111 contract (F33657-73-C-0369), the largest supply contract at General Dynamics, by the same amount. ASD officials said the administrative burden of reopening the several hundred existing supply contracts would have offset the benefits of direct funding.

The F-111 contract received the MIC credit in fiscal years 1974 and 1975 for \$1.15 million and \$5.2 million, respectively. Though General Dynamics' profit on existing contracts included profit on MIC costs, ASD decided that profit on the F-111 contract should not be reduced.

In fiscal year 1976, the F-16 contract received credit for MIC costs under the same procedure as was applied to the F-111 contract. ASD officials said the credit was applied to the F-16 because it is now the largest volume supply contract. The negotiated MIC credit for fiscal year 1976 is \$3.4 million even though only \$1.2 million of that amount was applied, through overhead, to the F-16 contract. By crediting the F-16 contract with the total MIC amount, \$2.2 million of F-16 development costs are being paid for with MIC procurement funds.

The profit rate for the F-16 full-scale development program is 11 percent. Since only cost and not profit is credited, about \$132,000 in profit is paid on the \$1.2 million MIC costs applied to the F-16 contract. The remaining \$2.2 million MIC costs receive profit depending on the profit rate of the contract to which the costs are distributed. Thus, General Dynamics is receiving profit on MIC costs at a rate commensurate with aircraft development and other effort.

On July 10, 1975, an ASD Production and Procurement official requested the Air Force Plant Representative Office at General Dynamics to exclude MIC costs from General Dynamics' overhead rates beginning in calendar year 1977. The request was coordinated with the F-111 System Program Office. A response was requested by August 15, 1975.

As of April 1976, we were unable to find any ASD personnel who had acted or followed up on the July 10, 1975 letter. The F-111 official who wrote the letter said that since the F-16 program received the 1976 MIC credit, he was no longer responsible for the problem. An official of ASD's Deputy for Procurement and Production, unable to find a response to the July letter, obtained a copy from General Dynamics. The response, dated November 14, 1975, suggested delaying the exclusion of MIC costs from overhead rates until questions on maintenance policy, funds availability, and cost accounting procedures are resolved. No action has been taken on the contractor's response and an ASD Procurement and Production official told us he was not responsible for determining who receives the MIC credit or why, but only to see that General Dynamics is paid for MIC costs.

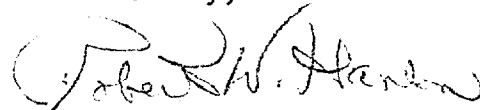
CONCLUSION AND RECOMMENDATION

The method used by ASD to pay General Dynamics' MIC costs has not achieved its purpose of removing costs associated with MIC from items bought from General Dynamics. Crediting a single contract for the cost of MIC distorts the reported price of that contract and causes the Air Force to pay a profit for plant maintenance-type work. Further, in the case of the fiscal year 1976 MIC credit to the F-16 development contract, MIC procurement money is improperly subsidizing about \$2.2 million of F-16 development effort.

Although ASD officials initiated action to eliminate MIC costs from General Dynamics' overhead rates in July 1975, no further action has been taken. We recommend that you assign to the appropriate ASD organization, the responsibility for removing MIC costs from General Dynamics' forward overhead rates so that the original purposes of direct funding MIC costs are realized.

We would appreciate being advised of any action you plan to take.
We would be pleased to discuss this matter with you or your
representatives.

Sincerely,

A handwritten signature in cursive script that reads "Robert W. Hanlon". The signature is written in dark ink and is positioned above the typed name.

Robert W. Hanlon
Regional Manager