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 NOT TO BE RELEASED OUTSIDE THE GENERAL ACCOUNTING OFFICE EXCEPT ON THE BASIS OF SPECIFIC APPROVAL BY THE OFFICE OF CONGRESSIONAL RELATIONS. A RECORD OF WHICH IS KEPT BY THE DISTRIBUTION SECTION, PUBLIC AFFAIRS BRANCH, OAS
 COMPTROLLER GENERAL OF THE UNITED STATES
 WASHINGTON, D.C. 20548

RELEASED

B-140389

JUL 9 1972

Dear Mr. O'Konski:

In your letter dated October 20, 1971, you expressed concern about the possible competitive advantage conferred on the 1 Wyman-Gordon Company and the Aluminum Company of America 1-2082
 2 (ALCOA), by reason of their leases with the Department of the 0-2083
 3 Air Force, through the use of Government-furnished heavy forg- 35
 ing presses. The rents paid under these leases, as you pointed out, are based on sales rather than on acquisition costs of the equipment as is generally provided for under the provisions of the Armed Services Procurement Regulation. The contractors are required by the leases to pay rentals of 4 percent on Government sales and 7 percent on commercial sales. You are concerned whether the Government collects the appropriate rental fee on the contractors' commercial work.

In addition, you have requested that we determine whether

- the rent paid fairly equates with the cost of ownership (taxes, insurance, depreciation, and the use of capital),
- the rent charged is a reasonable return on the Government's capital investment,
- the exception from the standard policy of the Office of Emergency Preparedness and the Armed Services Procurement Regulation is adequately documented, and
- it is appropriate for the Government to finance deferred billings to the extent of the rent applicable thereto.

CURRENT STATUS OF THE AIR FORCE
HEAVY PRESS PROGRAM

There are presently seven contractors participating in the Air Force Heavy Press Program with Government-owned facilities costing about \$212 million. Four of the contractors, including ALCOA and Wyman-Gordon, operate Government plants.

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ALCOA and Wyman-Gordon operate the four largest presses furnished by the Air Force. Each company has a 35,000-ton and a 50,000-ton hydraulic press. ALCOA, a participant in the heavy press program since 1952, operates Air Force Plant 47 located at its Cleveland Works in Ohio. The 35,000-ton and 50,000-ton presses were acquired in 1957 and 1959, respectively.

Wyman-Gordon operates Air Force Plant 63 at North Grafton, Mass. The operation of the plant began in April 1946 with an 18,000-ton forging press, and the 35,000-ton and 50,000-ton presses were furnished in 1955 to produce aluminum and magnesium forgings.

The Air Force is considering selling its heavy press facilities on the basis of their real value as "going business operations." ALCOA and Wyman-Gordon have indicated an interest in entering into negotiations on this basis. The General Services Administration has engaged an appraisal firm to evaluate the heavy press facility leased to Wyman-Gordon; the Air Force is in the process of preparing the necessary papers for filing the preliminary report of excess on the ALCOA facilities.

The Wyman-Gordon facility is being evaluated in terms of its overall production capability, a reasonable projection of the market for its products, and the financial return that can be anticipated from the sale of its products. The Air Force intends to use the going-business or earnings value as a true reflection of the fair market value of the property. In the event a sale is not consummated, the fair market value, rather than the percentage of sales, will provide a basis for determining future rentals.

Both companies' leases, which expire on June 30, 1972, will be informally extended on a month-by-month basis under the present terms until officials from each company and the Air Force have had an opportunity to discuss the results of the current appraisal and to determine whether there is a basis for negotiating the sale of the plant.

We believe that the current effort by the Air Force to obtain realistic estimates from private appraisal firms as to the value of its heavy hammer and press facilities represents a reasonable approach to developing cost figures for either negotiating the sale of the facilities or setting new rental formulas.

COMPETITIVE ADVANTAGE

The 35,000-ton and 50,000-ton hydraulic presses operated by both companies can fabricate large integrated forgings not otherwise obtainable from existing sources in the industry for use on aircraft, aircraft engines, and missiles and other systems. To the extent that there is a demand for forgings of this size, the two companies appear to have a competitive advantage.

We have not determined whether items being produced on the heavy presses could be made by other equipment. ALCOA officials claim that the items produced by ALCOA on the Air Force presses cannot be produced by a company which does not have a large press. The advantage is inherent in the equipment, according to these officials. They advised us that Wyman-Gordon was ALCOA's only competitor for the items produced on the heavy presses.

The 35,000-ton presses have not been used as extensively as the 50,000-ton presses. We noted, for the 3-year period ended December 1971, that the 35,000-ton presses were used only 21 and 55 percent of the time available at ALCOA and Wyman-Gordon, respectively. On the other hand, the 50,000-ton presses were used 70 percent of the time available at ALCOA and 86 percent at Wyman-Gordon for the same 3-year period.

In the latter part of 1971, the 50,000-ton press at ALCOA was damaged, and it has not been used since that time. DOD officials estimated that it might require as long as 2 years before it could be put into operation.

Ownership costs

Another advantage both companies have is the use of the Air Force heavy presses to solicit forging business without having to concern themselves with the attendant ownership costs. Had Wyman-Gordon, for example, elected to acquire all the assets provided by the Air Force since 1946, its ownership costs through 1971, including depreciation, taxes, insurance, etc., would have been about \$80 million. In contrast, the company paid the Government \$18 million in rent.

At ALCOA, the data we were able to obtain show that as original owner its cost of ownership, based on an average annual cost of ownership from 1966 through 1970, would have been about \$17.5 million, compared with its rent payments to the Government of about \$3 million. We could not determine what percentage of the aerospace forging business the two companies had acquired through the use of Government presses, because comprehensive sales statistics were not available for the forging industry or for individual companies.

RELATIONSHIP OF RENTALS TO
A REASONABLE RETURN ON THE
GOVERNMENT'S INVESTMENT

If the rentals received from both companies were the only criterion for measuring return on the Government's investment, the return was low. At ALCOA we computed an annual return of 1.4 percent on the Air Force investment in facilities over the 5-year period ended December 31, 1970. Likewise, at Wyman-Gordon the rental return on the Government's investment averaged about 1.09 percent over the same period.

At the time the facilities were provided, however, a return on the Government's investment for the use of the facilities was not a primary concern. The Government sponsored the heavy press program to stabilize and maintain an industrial capability for forgings of greater dimensions, of improved weight-strength ratios, and of increased reliability not previously available in the industry.

In 1967 the 35,000-ton and 50,000-ton presses at ALCOA were used for Government work about 46 and 79 percent of the available time, respectively. ALCOA has produced airframe parts, landing-gear components, wheels, engine fan rotors, and other items for a number of military aircraft. The company has produced also missile parts for the Poseidon and Titan Programs. By 1970 the use of the 35,000-ton and 50,000-ton presses at ALCOA for Government work had decreased to 16 and 39 percent, respectively. Since 1969 the percentage of sales for Government work has averaged about 53.5 percent.

A significant percentage of the sales made by Wyman-Gordon in the past have been for Government programs, about 68 percent in 1967 and in 1968. Since then, however, only 56 percent of its sales have been for Government work. The rental rates under nonstandard leases were based on the premises that the presses would be used primarily for Government work and that there would be idle capacity due to the lack of a commercial market. Since the ratio of non-Government work by both companies has increased, the premises may no longer be valid and it may be advisable to reexamine the need to use nonstandard leases in the Air Force heavy press and hammer programs.

Officials of the Department of Defense and Wyman-Gordon have indicated to us that the Government has received a substantial return on its investment, in the form of lower costs of the end products assembled with parts forged on the heavy presses. For example, the "wet wing" for the B-52 aircraft is, in effect, a large fuel tank that provides the maximum range for this intercontinental strategic bomber. Through the heavy press process, wing panels of the required strength and reduced weight were produced at considerably less fabrication and machining cost than would have been possible by other forging methods. In the opinion of these officials, the savings realized on this program and a variety of other aircraft and missile programs have more than paid for the heavy press program.

EXCEPTION FROM STANDARD ARMED SERVICES
PROCUREMENT REGULATION RENTAL POLICY

Air Force heavy press and hammer facilities are leased to the contractors under the provisions of section 2667, Title 10, U.S. Code, which permits deviation from the standard rental rates contained in the Armed Services Procurement Regulation.

As we mentioned previously the Air Force is now considering selling or leasing these facilities, on the basis of their real value, as going-business operations. The Air Force objective is to achieve private ownership with the contingency that the equipment will be available to use for current and emergency defense needs.

The Air Force Systems Command is reexamining the methods of leasing for the entire Air Force heavy press and hammer programs and is consulting with commercial leasing firms, as well as with such Government agencies as the Army Corps of Engineers and the General Services Administration. Its findings are to be used as a basis for renegotiating equitable leasing arrangements if sales are not consummated, to minimize or eliminate competitive advantages and to provide an acceptable rate of return on the Government's investment in its facilities.

PROPER REIMBURSEMENTS AND DEFERRED BILLINGS

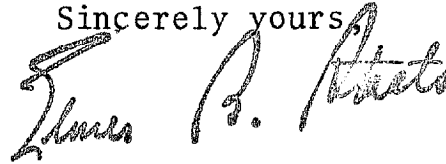
The two companies had adequate procedures and practices for insuring that the work performed on the presses was being done on commercial or Government contracts. Both were reimbursing the Government at the appropriate rental rates (4 or 7 percent).

With regard to deferred billings, we do not consider it appropriate for any contractor to exclude from its computation of Government rentals any portion of sales that are billed to customers on a delayed or deferred basis. Neither company has employed deferred-billing procedures which would avoid payment of the rentals due the Government.

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We trust that the information contained herein is sufficiently responsive to your request. We shall not distribute this report further unless copies are requested and we obtain your agreement or unless you publicly announce its contents.

Sincerely yours

A handwritten signature in cursive script, appearing to read "James B. Stewart".

Comptroller General
of the United States

CI The Honorable Alvin E. O'Konski
✓ House of Representatives