

GAO

Report to the Commander, U.S. Army
Tank Automotive Command, Department
of the Army

January 1987

CONTRACT PRICING

Overpricing of X-1100 Transmission Contracts



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United States
General Accounting Office
Washington, D.C. 20548

Cincinnati Regional Office

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January 9, 1987

Major General Arthur Holmes, Jr.
Commander, U.S. Army Tank Automotive Command
East Eleven Mile Road
Warren, Michigan 48397-5000

Dear General Holmes:

We recently completed a review at the General Motors Corporation, Detroit Diesel Allison Division, in Indianapolis, Indiana, to determine whether the prices in three contracts for X-1100 transmissions used on the M-1 tank were fair and reasonable. Specifically, we assessed whether the contractor complied with the Truth in Negotiations Act (Public Law 87-653) by providing accurate, complete, and current cost or pricing data. The act requires that before the government awards any negotiated contract expected to exceed specified dollar amounts, the contractor, unless exempted, must submit cost or pricing data to support the proposed price, and must certify that the data submitted are accurate, complete, and current. One such exemption exists where the prices of materials are based on established market prices for commercial items sold in substantial quantities to the general public.

Detroit Diesel Failed to Obtain Cost Data on Some Parts

Some of the parts Detroit Diesel purchased from New Departure Hyatt—another division of the General Motors Corporation—were improperly considered to be commercial items sold in substantial quantities to the general public, improperly exempted from the requirements of the Truth in Negotiations Act, and sold to Detroit Diesel for more than cost. As a result, Detroit Diesel's 1981 through 1983 proposals were overstated by \$341,871, including overhead and profit. The overstatement, in turn, led to overpriced contracts during the same period. Detailed information concerning the overpriced parts is in appendix I.

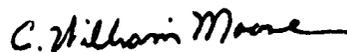
Recommendation

We believe the results of this review provides a basis to initiate action to recover these funds from Detroit Diesel and we recommend you take such action.

The scope of our work is detailed in appendix I. If you or your staff need additional information or would like to discuss these matters, please call me or Mr. Arthur D. Gross on (513) 684-2105. We would appreciate being informed of any actions taken on this matter.

We are sending copies of this report to the General Manager of the Detroit Diesel Allison Division; the Department of Defense, Office of the Inspector General, Washington, D.C.; the Regional Director, Defense Contract Audit Agency, Chicago, Illinois; and the Commander, Defense Contract Administration Services Region, Chicago, Illinois. Copies will also be available to others upon request.

Sincerely yours,



C. William Moore
Regional Manager

Overpricing on X-1100 Transmissions Calendar Years 1981 Through 1983

Background

The Truth in Negotiations Act (Public Law 87-653), as amended, requires that contractors, unless exempted, submit cost or pricing data in support of proposed prices for noncompetitive contracts. Contractors are also required to certify that the data submitted are accurate, complete, and current. In cases where Public Law 87-653 is applicable, a clause is included in the contract which gives the government a right to a price reduction if it is determined that the price was overstated because the data submitted were not in accordance with the statute and the certification.

The Truth in Negotiations Act allows an exemption to its data submission and certification requirements when an item's price is based on market prices of commercial items sold in substantial quantities to the general public. The Defense Acquisition Regulation (DAR) in effect at the time of the contracts involved here (DAR 3-807.7 (b)) defined a sale to the general public as a sale:

"(i) to other than the Government (including FMS); (ii) to other than affiliates of the seller; or (iii) for end use by other than the Government (including FMS)." [FMS refers to foreign military sales.]

According to DAR 3.807-7, sales in "substantial quantities" are determined by separating a contractor's total sales into sales to the "general public" and sales to the "U.S. Government or contractors for U.S. Government use." Unless sales to the general public are 55 percent or more of all sales, the substantial quantities test is not met and no exemption will be granted. Unless exempted, sales between affiliates are to be priced at manufacturing cost, with no profit added by the seller.

From September 1979 through August 1981, the Detroit Diesel Allison Division, a division of the General Motors Corporation, furnished the X-1100 transmission for the M-1 tank directly to the tank's manufacturer. Beginning in September 1981, Detroit Diesel sold the X-1100 transmission to the U.S. Army Tank Automotive Command which then provided the transmissions to the manufacturer as government-furnished equipment. Details of the three X-1100 firm-fixed-price contracts awarded between 1981 and 1983 are shown in table I.1.

Appendix I
Overpricing on X-1100 Transmissions
Calendar Years 1981 Through 1983

Table I.1: Contracts Reviewed

Contract number	Number of transmissions	Contract amount	Contract award date^a	Delivery period
DAAF07-80-C-0164, P00016	145	\$23,524,698	2/25/82	Sept - Dec 1981
DAAE07-80-C-0164, P00023	718	118,983,400	10/13/82	1982
DAAE07-80-C-0164, P00029	735	123,897,564	6/20/83	1983

^aAdministrative delays caused the contract to be awarded after the delivery period started.

Detroit Diesel's Failure to Obtain Cost or Pricing Data Resulted in Overstated Prices

Some of the parts Detroit Diesel used in the X-1100 transmission were purchased from New Departure Hyatt, another division of the General Motors Corporation. Based on New Departure Hyatt's assurances that the parts were commercial items sold in substantial quantities to the general public and, therefore, exempt from data submission requirements, Detroit Diesel did not request cost or pricing data. Detroit Diesel used the commercial prices (which included profit) it paid to New Departure Hyatt in its proposal and told the Army's contracting officer that the parts were commercial and exempt from the requirement to submit cost or pricing data. Based apparently on Detroit Diesel's representations, the contracting officer did not question the basis for the exemption.

Using the criteria in the DAR, we found that 12 different parts¹ included in Detroit Diesel's calendar years 1981 through 1983 contract proposals were improperly exempted from the requirement to submit cost or pricing data. Not all of the 12 improperly exempted parts sold to Detroit Diesel were overpriced, however. New Departure Hyatt sold some of the parts at or below cost. However, others were overpriced by \$341,871, including overhead and profit.

According to the DAR, the sales might not have to be supported by cost or pricing data, if the parts were otherwise sold in substantial quantities to the general public to ensure that the government ultimately did not pay an inflated price. However, sales between divisions of the same company, as sales between affiliates, are presumed by regulation not to be arms-length transactions and, consequently, not sales to the general public. Therefore, these sales cannot be used by New Departure Hyatt to meet the substantial quantities test for obtaining an exemption from the submission of cost or pricing data.

¹The number of noncommercial parts ranged from 7 in 1981 to 12 in 1983.

Detroit Diesel did not request New Departure Hyatt to document the basis for the claimed exemption until December 7, 1982. Had Detroit Diesel requested the documentation sooner, it would have been aware as early as 1981 that cost or pricing data were required for these parts. For example, New Departure Hyatt's sales of part number 12267707 and similar parts to the general public were only 27 percent of its total sales of these parts in model year 1980, ending August 31, 1980, and less in model years 1981 through 1983.

New Departure Hyatt forwarded the requested documentation on January 19, 1983, and Detroit Diesel later gave it to the government plant representative. The data, representing New Departure Hyatt sales for a 3-month period, indicated that some parts were not sold to the general public in substantial quantities. To ensure that the sales were of that type, the government plant representative requested verification from the government's administrative contracting office² for New Departure Hyatt on February 11, 1983. The administrative contracting office, in turn, requested assistance from the Defense Contract Audit Agency on February 23, 1983. On April 21, 1983, the Defense Contract Audit Agency confirmed that some part sales were not made in substantial quantities to the general public. By that time, however, the calendar year 1983 negotiations between Detroit Diesel and the Tank Automotive Command for X-1100 transmissions had been completed and the information was not used to adjust prices for that year. Although the Army took action to assure the availability of cost data for later years, the overpricing before 1984 was not adjusted.

During calendar years 1981 through 1983, the Army contract negotiation teams were unaware of the inaccurate data and accepted the proposed prices for all New Departure Hyatt parts. As a result, the contracts were overpriced by \$341,871, including overhead and profit, as shown in table I.2.

²The administrative contracting office serves as a focal point for all inquiries relative to the contract and is responsible for assuring compliance with its terms.

**Appendix I
Overpricing on X-1100 Transmissions
Calendar Years 1981 Through 1983**

Table I.2: Comparison of Prices Accepted and Actual Part Costs for Calendar Years 1981-83

Detroit Diesel Allison part number	Price accepted by government	New Departure Hyatt standard cost plus contract profit ^a	Excess per part	Total parts	Total over-statement of material
1981					
11669559	\$63.26	\$52.57	\$10.69	290	\$3,100
12267707	122.34	102.41	19.93	145	2,890
Total					5,990
Overhead					997
Total					6,987
1982					
11669514	233.05	223.09	9.96	718	7,151
11669559	79.10	58.15	20.95	1,436	30,084
12267707	153.65	121.98	31.67	718	22,739
907685	248.27	150.54	97.73	718	70,170
Total					130,144
Overhead					25,694
Total					155,838
1983					
11669514	244.10	218.24	25.86	735	19,007
11669559	82.60	54.70	27.90	1,470	41,013
12267674	33.64	33.21	.43	2,940	1,264
12267707	152.36	131.98	20.38	684	13,940
12267707	152.36	121.87	30.49	51 ^b	1,555
907685	254.82	164.70	90.12	735	66,238
Total					143,017
Overhead					36,029
Total					179,046
Total (all years)					\$341,871

^aContract profit added to New Departure Hyatt's cost to be consistent with Detroit Diesel's method for establishing profit in the prime contracts.

^bParts taken from existing inventory to complete the 1983 contract. Detroit Diesel purchased these parts from New Departure Hyatt in 1982 and the cost in column 2 is New Departure Hyatt's standard cost for 1982 plus the contract profit negotiated for 1983.

**Detroit Diesel
Comments**

Detroit Diesel officials told us that sufficient sales to the general public occurred to allow an exemption for some of the parts. In arriving at their conclusion, they considered sales by New Departure Hyatt to

Detroit Diesel as sales to the general public. As mentioned previously, sales between divisions of the same company do not qualify as sales to the general public. Since New Departure Hyatt cannot meet the substantial quantities sales to the general public test without these sales, we believe there is no basis for an exemption. Without the exemption, New Departure Hyatt should have charged Detroit Diesel no more than its cost to manufacture.

Detroit Diesel officials also said that even if the questioned sales did not provide an exemption and the government was entitled to a contract price reduction, General Motors was entitled to offset the price reduction because New Departure Hyatt sold other parts to Detroit Diesel for less than the manufacturing cost. The information we collected indicates that the underpricing resulted when New Departure Hyatt made an intentional management decision to reduce prices on certain parts. An intentional management decision to reduce prices below what disclosed data would have supported has been the basis for an offset against a claim for defective pricing only when the government was fully aware of the management decision during negotiations. (United States v. Rogerson, 785 F.2D 296 (CAFC. 1986.)) We have no evidence that either Detroit Diesel or the government knew of New Departure Hyatt's decisions to sell below cost.

Objective, Scope, and Methodology

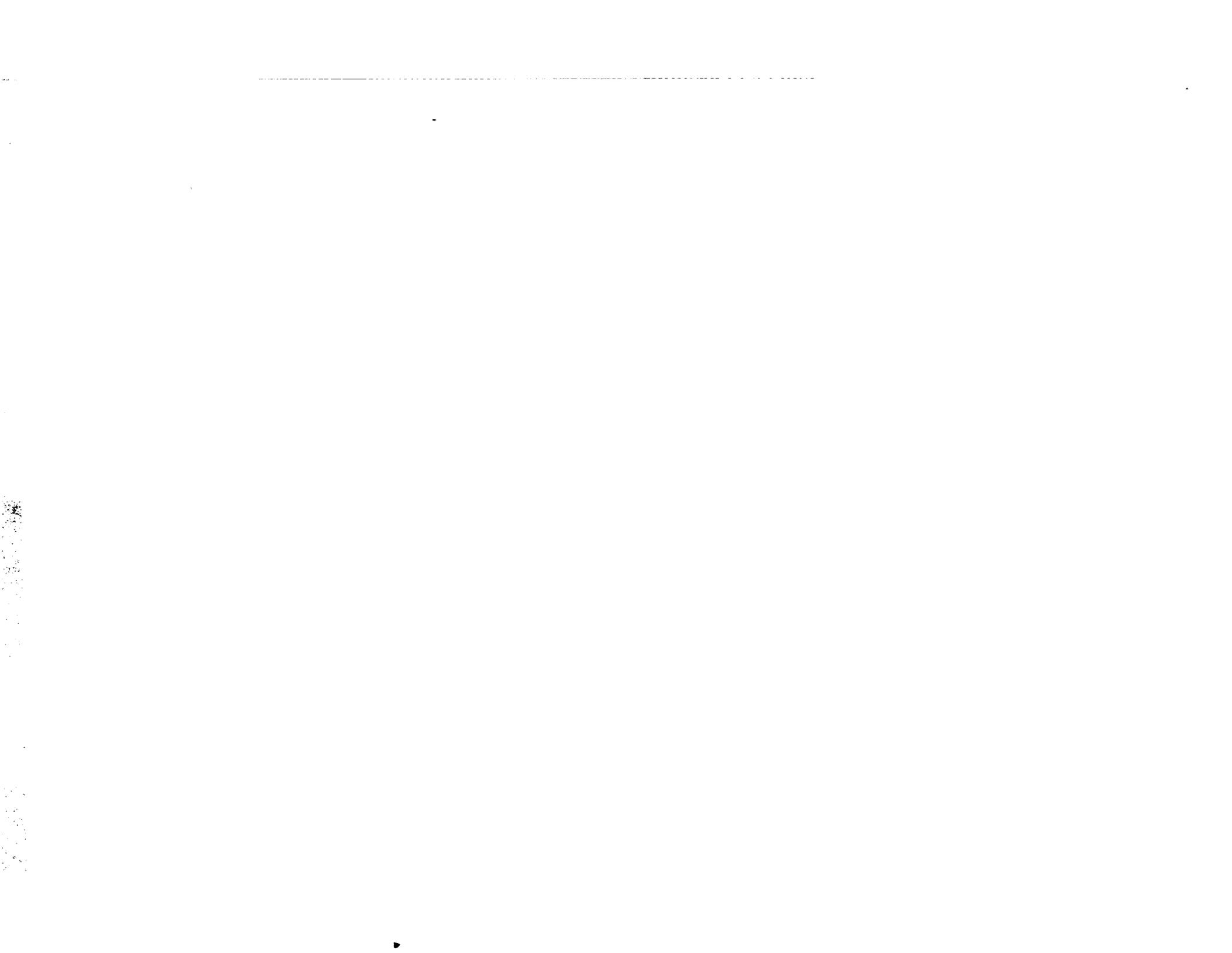
We conducted our review at General Motors Corporation's Detroit Diesel Allison Division, Indianapolis, Indiana, and New Departure Hyatt Division, Sandusky, Ohio; U.S. Army Tank Automotive Command, Warren, Michigan; the Defense Contract Administration Services and the Defense Contract Audit Agency resident offices at Detroit Diesel. Our overall objective was to determine if Detroit Diesel complied with Public Law 87-653 by providing accurate, complete, and current cost or pricing data.

We made a detailed review of the contract for XT-1410 transmissions delivered during calendar year 1983, including a review of the price proposals and negotiation records. This data showed that the local government plant representative had questioned the exemption for not submitting cost or pricing data for some of the XT-1410 parts. Based on this information, we also reviewed the X-1100 transmission contracts for calendar years 1981-83 to determine whether a similar condition existed. Our effort on the X-1100 transmission contracts was limited specifically to a review of the contractor's classification of noncommercial parts as commercial. We reviewed the sales and cost records for the

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23 parts New Departure Hyatt sold to Detroit Diesel for the X-1100 transmission contracts.

Our review was performed in accordance with generally accepted government auditing standards.



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