

B-140689-O.M., Oct. 29, 1959

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON 25, D. C.

DEFENSE ACCOUNTING AND
AUDITING DIVISION

SEP 2 1959

The Comptroller General

Reference is made to Mr. Surginer's discussion with Mr. Goldstein on August 12, 1959, and discussion between Messrs. Rumizen and Socolar of the General Counsel's Office and Messrs. Stacy and Wilson of the Navy Audit Group on August 13, 1959, on the sale of surplus Government plant equipment. During the latter discussion it was agreed to submit the case for consideration and advice.

The enclosed file of working papers concerns the sale of Government plant property equipment installed in the Naval Industrial Reserve Aircraft Plant, Kansas City, Missouri. The net proceeds from the sale of the Government equipment was credited against amounts due under a production contract with Westinghouse Electric Corporation who is leasing the property and the equipment. We believe that the proceeds should have been covered into the Treasury as miscellaneous receipts.

The plant and property is leased by the Bureau of Aeronautics (BuAer) to Westinghouse Electric Corporation under contract NOa 5880 dated January 1, 1956, which superseded contract NOy(r)60108 dated December 31, 1948. The Government plant equipment is used by Westinghouse on a rent-free basis under BuAer facilities agreement NOa 5826 dated March 24, 1958 (page 1). This agreement superseded contract NOa 1074 dated January 19, 1949, which covered the purchase and installation of the equipment as well as the use of the equipment.

Westinghouse has been producing jet engines at this plant under various contracts with the Navy for several years. The production contract in effect at the time the surplus Government plant equipment was sold, was NOas 56-1046-i dated September 28, 1956.

By memorandum dated June 23, 1958, (page 2) the Bureau of Aeronautics Representative (BAR), Kansas City, Missouri, advised BuAer that the contractor was rearranging his jet engine production lines and would report a considerable number of surplus machine tools. In this memorandum, the BAR proposed that the proceeds realized from the sale of surplus machine tools be credited to monies due the contractor under contract NOa 58-053c which was issued to cover the cost of packing and crating surplus equipment that might be requested by departments and agencies during the screening process. Reply from BuAer dated July 29, 1958, (page 3) advised that the proceeds must be credited to miscellaneous receipts.

After the equipment was screened by departments and agencies, Westinghouse was authorized to sell the surplus equipment. The surplus equipment which consisted of office machines, machine tools and production equipment was sold at public auctions conducted by Westinghouse on November 25, 1958, and February 18, 1959. (pages 4 and 5)

Notwithstanding the instructions issued by BuAer on July 29, 1958, that the proceeds from the sale must be credited to miscellaneous receipts, the Inspector of Naval Material (INSMAT) Chicago, on February 4, 1959, (page 6) informed the Office of Naval Material (ONM) that Westinghouse had advised that instructions on the application of proceeds from the first auction sale had not been received. By letter dated March 24, 1959, (page 7) to the BAR, the contracting officer of BuAer directed that the net proceeds from the sale of surplus Government-owned equipment be credited to contract NOas 56-1046-i, the then current contract for the production of jet engines.

The BAR then advised BuAer on March 26, 1959, (page 8) that the second auction sale had been conducted on February 18, 1959, and requested advice as to the application of all proceeds that would accrue as a result of disposal of Government plant equipment used under facilities agreement NOa 5826. In reply dated May 14, 1959, (page 9) BuAer advised "* * * Proceeds of sales of contractor inventory are to be credited to amounts due the contractor under the applicable supply or service contract. All other proceeds must be deposited in the Miscellaneous Receipts account of the U. S. Treasury. As soon as a determination is made as to the proper classification of the property sold on 18 February 1959, instructions for disposition of the proceeds will be issued." On May 19, 1959, (page 10) the contracting officer of BuAer again directed that the net proceeds be credited against amounts due Westinghouse under production contract NOas 56-1046-i, and stated "* * * This direction is issued pursuant to the provisions of Section 41, paragraph (b) of the subject contract." The net proceeds from the first sale amounting to \$502,335.80 was deducted from billings under contract NOas 56-1046-i, payable from appropriation 17x1504.81. The net proceeds from the second sale amounting to \$200,656.00 are being held for deduction from future billings under the same contract.

Section 41(b) of the contract referred to above (page 11) permits the contracting officer to decrease the property furnished or to be furnished under the contract and make equitable adjustment of the contract price. We believe, however, that the term "property" refers to Government material furnished under a production contract to produce an item rather than to Government plant equipment. Our belief appears to be confirmed by the provisions of paragraph h. of section 41 of the contract which provides that "Upon completion of this contract * * * the contractor shall submit * * * inventory schedules covering all items of Government-furnished property not consumed in the performance

of this contract * * *." Underscoring supplied. Paragraph 035600-3 of the Navy Comptroller Manual defines Government-furnished equipment and states in subparagraph 2., "it is neither consumed during production nor incorporated in the product."

Informal discussions with Navy representatives disclosed that their determination to credit the net proceeds of the sale of Government equipment to the current production contract was that the equipment was considered "contractor inventory" according to the definition in Chapter 1, Section 101, paragraph 10 of the Navy Property Redistribution and Disposal Regulation No. 1, Revised July 1, 1958. This regulation clearly states that contractor inventory is "Any 'Government' property acquired by and in possession of a contractor or subcontractor (including Government-furnished property) under a contract pursuant to the terms of which title is vested in the Government, and in excess of the amounts needed to complete full performance under the entire contract * * *." The basis for BuAer's determination that the plant equipment was "contractor inventory" is evidenced by comments made by the contracting officer, the Counsel for BuAer, and the Industrial Planning Division, on a route sheet (page 12) attached to the BAR's letter of March 26, 1959.

We are aware of the ruling in B-139655-OM dated July 20, 1959, which defined contractor inventory as "* * *" any property acquired by * * * a contractor * * *" with title to the property vested in the Government * * *," and upheld the action taken by the Air Force in crediting the proceeds from the sale of surplus equipment furnished for use in operating a Government storage site to future billings for operating the storage site. However, we believe that a clear distinction should be made for Government plant equipment that is leased to a contractor for production of specific items under successive production contracts. As of June 30, 1958, the Navy had 49 industrial reserve plants under lease with private contractors with plant equipment inventories valued at more than \$555 million. Considering the rapid changes being made in our weapons, we can visualize much of the present plant equipment being declared obsolete and sold as surplus with the result that current appropriations will be augmented by considerable amounts if the present practice is followed.

Hassell B. Bell

Hassell B. Bell
Assistant Director

Enclosure

Working papers containing
exhibits 1 through 12

October 29, 1959

Indorsement

Director, Defense Accounting and Auditing Division

Returned. Section 204(d) of the Federal Property and Administrative Services Act of 1949, 63 Stat. 389, redesignated section 204(e) by the act of August 31, 1954, 68 Stat. 1051, 40 U.S.C. 485(e), provides that:

"Where any contract entered into by an executive agency or any subcontract under such contract authorizes the proceeds of any sale of property in the custody of the contractor or subcontractor to be credited to the price or cost of the work covered by such contract or subcontract, the proceeds of any such sale shall be credited in accordance with the contract or subcontract."

The reports of the Legislative Committees of both Houses of Congress in connection with the Federal Property and Administrative Services Act of 1949 contain, with reference to section 204(e), the following explanation:

"This subsection recognizes that the contractual provisions authorizing the proceeds of sale of property to be credited to price or cost of the work covered by the contract, are controlling and are not subject to the requirements of the act relating to covering proceeds into the Treasury as miscellaneous receipts."

Therefore, and since section 41(h) of the contract requires the contractor to make such disposal of Government furnished property as may be directed or authorized by the contracting officer and provides that the net proceeds of any such disposal be credited to the contract price or paid in such other manner as the contracting officer may direct, it may be stated that the proceeds involved need not be deposited into the Treasury as miscellaneous receipts, provided the property furnished the contractor was a necessary incident to performance of his contract.

Section 203(f) of the act, 40 U.S.C. 484(f), provides that executive agencies may authorize contractors or subcontractors to retain or dispose of any contractor inventory, and section 3(k) of the act, 40 U.S.C. 472(k), states that:

"The term 'contractor inventory' means (1) any property acquired by and in the possession of a contractor or subcontractor under a contract pursuant to the terms of which title is vested in the Government, and in excess of the amounts needed to complete full performance under the entire contract; and (2) any property which the Government is obligated or has the option to take over under any type of contract as a result either of any changes in the specifications or

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plans thereunder or of the termination of such contract (or subcontract thereunder), prior to completion of the work, for the convenience or at the option of the Government."

The property involved ordinarily would fall squarely within this definition notwithstanding that it might have been used under successive production contracts; however, implicit in the definition and in the provision of section 204(e), above, is that the property must have been acquired in connection with the requirements of the contract. Accordingly, only if the proceeds from sales of the surplus machine tools referred to include an amount for items that were never used or contemplated for use by the contractor, even though a part of the facility furnished, that amount may not be considered contractor inventory and must be covered into the Treasury as miscellaneous receipts.

JOSEPH CAMPBELL

Comptroller General
of the United States

Attachments