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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

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The Honorable William Proxmire  
Chairman, Subcommittee on Priorities  
and Economy in Government  
Joint Economic Committee  
Congress of the United States

Dear Mr. Chairman:

In your letter of April 28, 1975, you requested that we undertake a study of [depreciation charged to Government work by selected major defense contractors]. You were particularly concerned with the possibility that disproportionately heavy costs of depreciation had been allocated to defense contracts with the subsequent use of the related assets on commercial work at either no cost for depreciation or a disproportionately low cost.

Our study was performed at five company locations that we understood you particularly wanted covered: Lockheed-California Company, Burbank, California, a division of Lockheed Aircraft Corporation; Convair Division, General Dynamics Corporation, San Diego, California; Pratt & Whitney Aircraft Division, United Technologies Corporation, East Hartford, Connecticut; Sikorsky Aircraft Division, United Technologies Corporation, Stratford, Connecticut; and Aircraft Engine Group, General Electric Company, Evendale, Ohio.

Based on our review of available data, depreciation charges appeared reasonably allocated between Government and commercial work at Lockheed-California, Convair, and Pratt & Whitney over the 10-year period from 1965 through 1974. An analysis similar to that made at these three plants could not be made at General Electric because of the contractor's cost accounting system design. An analysis at Sikorsky would have been possible; however, it would have required an unreasonable expenditure of time for an exhaustive review of detail records.

At Lockheed-California, Convair, and Pratt & Whitney our methodology was to accumulate actual contractor depreciation charges over a 10-year period for Government and commercial work. We then treated the 10-year period as a single accounting period and redistributed the total depreciation charges. By using a 10-year period we felt it would be

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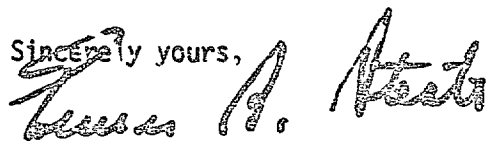
possible to see whether, on balance, total depreciation was distributed equitably. This would tend to eliminate the effect of any disproportionate depreciation allocations during any year or years during the period.

The best basis for distributing depreciation is on the basis of actual asset utilization. This type of information was not available at any of the contractors, and it has been our experience that it is not generally maintained due to the difficulty of accumulating and summarizing it for the great number of assets involved. In the absence of actual asset utilization data, we used the best basis available in each case to allocate the depreciation charges to Government work and to commercial work for the 10-year period. Generally, we used direct labor costs or hours as a basis for our allocations. These bases are frequently used by contractors to allocate indirect expenses, including depreciation. There are limitations on their accuracy, however, for allocation of any single item in an expense pool. Although acceptable and reasonably accurate for allocating a pool of indirect expenses, there is a possibility of distortion when used in attempting to break out and apportion an individual cost element such as depreciation. For example, actual costs of depreciation could vary between contracts in the same department due to differences in the operations and equipment required to produce the items involved. Different production processes may be machine intensive or labor intensive. In addition, the distortions attributable to such factors could be further aggravated by use of accelerated methods of depreciation.

With these reservations, as stated above, the actual depreciation charged to Government work by Lockheed-California, Convair, and Pratt & Whitney appeared reasonable for the 10-year period from 1965 through 1974.

In accordance with your request, draft copies of this report have not been provided to the Department of Defense or to the contractors involved for their comments. However, we have informally discussed with each contractor our findings regarding it. We trust this information is responsive to your request.

Sincerely yours,



Comptroller General  
of the United States