DEPARTMENT OF DEFENSE

AUDIT REPORT

CONTRACTOR RENTAL OF DOD PLANT EQUIPMENT
AT TEXTRON LYCOMING, STRATFORD DIVISION,
A SUBSIDIARY OF TEXTRON INCORPORATED

No. 91-035 January 28, 1991

Office of the
Inspector General

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

January 28, 1991

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (PRODUCTION AND LOGISTICS)
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)

SUBJECT: Report on the Audit of Contractor Rental of DoD Plant Equipment at Textron Lycoming, Stratford Division, a Subsidiary of Textron Incorporated (Report No. 91-035)

This is our final report on the audit of Contractor Rental of DoD Plant Equipment at Textron Lycoming, Stratford Division, a subsidiary of Textron Incorporated (Textron), for your information and use. Comments on a draft of this report were considered in preparing the final report. This is the third and last report addressing rental issues as part of our Audit of the Administration of Contractor Rental of DoD Plant Equipment and Collection of Nonrecurring Costs. Nonrecurring cost issues were addressed in a separate report. The objective of the audit addressed in this report was to determine whether contracting officers adequately administered Textron's rental of DoD plant equipment. As part of this objective, we reviewed DoD's policy for rental of its plant equipment. Additionally, we reviewed the effectiveness of internal controls over the rental of plant equipment. We made the audit from February 1989 through March 1990. As of September 1988, DoD had provided $6.3 billion of plant equipment to contractors. Of this total, Textron had received $83.0 million in plant equipment.

As a result of our previous Report No. 89-087, "Audit of Contractor Rental of Government Real Property and Payment of Nonrecurring Costs," an Ad Hoc Group to the Defense Government Property Council was established. The Ad Hoc Group, chaired by the Deputy for Property Policy and Programs, Office of the Deputy Assistant Secretary of Defense (Logistics), was established to formulate DoD policy for real property rental issues. The Ad Hoc Group has recently started to address the rental of plant equipment issues identified in this report. The Ad Hoc Group has made progress towards revising the Federal Acquisition Regulation (FAR), "Use and Charges" clause. These efforts should result in improvements to Federal policies for contractor rental of the Government's real property and plant equipment. The group is to be commended for its efforts.

The audit showed that DoD did not receive appropriate rental amounts for Textron's non-Government use of plant equipment and that the rents paid by contractors for commercial use of DoD plant equipment were inconsistent with commercial rental rates. In addition, we found that contractor personnel and the Divisional Administrative Contracting Officer at Textron had made a significant effort to develop a new rental agreement. This agreement will provide a method equitable to both the contractor and the Government for calculating plant equipment rent. The results of the audit are summarized in the following paragraphs, and the details and audit recommendations are in Part II of this report.

DoD did not collect $1.2 million in rent from Textron for non-Government use of DoD property in 1988. DoD will lose an additional $6.1 million of rent from calendar years 1990 through 1995 if an improper rental credit is not rescinded. We recommended that the U.S. Army Aviation Systems Command rescind the rental credit on Textron's future sales of ALF-502 engines and that recalculations of the 1988 rental payment be finalized (page 5).

DoD's method of calculating rent for contractors' non-Government use of plant equipment was not consistent with sound commercial practices. As a result, contractors were not paying proper rentals for non-Government use of DoD plant equipment. For example, we estimated that with revised FAR rental rates, Textron would have paid an additional $571,069 for rent in 1988. We recommended changes to the FAR that will bring rental rates more in line with private-sector rates (page 11).

The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Internal controls were not adequate to ensure that Textron adequately identified rent-pay use of plant equipment. However, a revised method of calculating rent has been implemented and should correct the internal control weakness identified. The monetary benefits to be realized by implementing the revised method were not readily identifiable because Textron's future use of DoD plant equipment cannot be predicted.

A draft of this report was provided to the Assistant Secretary of Defense (Production and Logistics) and the Assistant Secretary of the Army (Financial Management) on October 12, 1990. The Principal Deputy, Office of the Assistant Secretary of Defense (Production and Logistics), concurred with all recommendations and monetary benefits in the report. The Principal Deputy's comments conformed to the provisions of DoD Directive 7650.3, and additional comments are not required. The

complete texts of the comments are in Appendix J. As of January 3, 1991, the Army had not commented on the draft report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. In order to comply with this Directive, we request that the Assistant Secretary of the Army (Financial Management) provide us comments on Finding A, Recommendations A.1., and A.2.; potential monetary benefits of $6.0 million; and internal control weaknesses identified in the report within 60 days of the date of this report. If you concur, describe the corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, please state your specific reasons. If appropriate, you may propose alternative methods for accomplishing desired improvements.

In order for your comments to be considered responsive, you must state concurrence or nonconcurrence with the estimated monetary benefits of $6.0 million, identified in Appendix I, that will result from rescinding Textron's ALF-502 rental credit. If you nonconcur with the estimated monetary benefits or any part thereof, you must state the amount you nonconcur with and the basis for your nonconcurrence. Potential monetary benefits are subject to resolution in the event of nonconcurrence or failure to comment.

The courtesies extended to the audit staff are appreciated. We would like to thank the contractor staff at Textron and the personnel of the Defense Contract Administration Services Plant Representative Office, Textron for their cooperation and assistance to the audit staff. If you have any questions about this audit, please contact Mr. Michael Joseph at (703) 693-0138 (AUTOVON 223-0138) or Mr. David Steensma at (703) 614-6283 (AUTOVON 224-6283). A list of the audit team members is provided in Appendix L. Copies of this report are being provided to the activities listed in Appendix M.

Robert J. Lieberman
Assistant Inspector General
for Auditing

cc:
Secretary of the Army
Director, Defense Acquisition Regulatory Council

REPORT ON THE AUDIT OF CONTRACTOR RENTAL OF DOD PLANT EQUIPMENT AT TEXTRON LYCOMING, STRATFORD DIVISION, A SUBSIDIARY OF TEXTRON INCORPORATED

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Prepared by:
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REPORT ON THE AUDIT OF CONTRACTOR RENTAL OF DOD PLANT EQUIPMENT AT TEXTRON LYCOMING, STRATFORD DIVISION, A SUBSIDIARY OF TEXTRON INCORPORATED

PART I - INTRODUCTION

Background

Contractors are ordinarily required to furnish all property necessary to perform Government contracts. In some circumstances, however, it is in the best interest of the Government to furnish certain items of property to the contractors. When contractors have Government property in their custody, Government contracting officers must ensure that the property is used to the maximum extent possible in performing Government contracts, give written approval before permitting contractors to use the property for non-Government work, and charge appropriate rental fees when the property is authorized for use on other than a rent-free basis.

The Federal Acquisition Regulation (FAR), subpart 45.1, defines plant equipment as personal property of a capital nature for use in manufacturing supplies or performing services, or for any administrative or general plant purpose. Plant equipment includes equipment, machine tools, test equipment, furniture, vehicles, and accessory and auxiliary items, but does not include special tooling or special test equipment. Industrial plant equipment (IPE) is plant equipment with an acquisition cost of $5,000 or more, used for the purpose of cutting, grinding, shaping, forming, or otherwise altering properties of items entailed in manufacturing, maintenance, supply, processing, assembly, or research and development operations. Other plant equipment (OPE) is plant equipment, regardless of dollar value, which is used in, or in conjunction with, the manufacture of components or end items relative to maintenance, supply, processing, assembly, or research and development operations.

The contractor determines the non-Government (rent-pay) usage of plant equipment and computes the rent due the Government for each rental period. Within 90 days after the close of each rental period, the contractor must submit to the contracting officer a written statement on the use of the property and the rent due, along with payment.

Rent for plant equipment is calculated using the rates in FAR 52.245-9, "Use and Charges" clause, Table I. The monthly rental rates specified in the FAR are applied to the acquisition cost of the equipment according to the Federal Supply Class and age of the equipment. When calculating rentals, DoD does not add its costs to rehabilitate the plant equipment to the acquisition costs.

The full rental value of plant equipment is calculated as though 100 percent of the applicable property were in a rent-pay status. The FAR requires that a credit amount for rent-free usage be deducted from the full rental value. The rent-free usage credit is based on a unit of measure that will result in an equitable division of the rental charge between rent-pay and rent-free usage. The FAR identifies direct labor hours, sales, or hours of use as possible units of measure for this purpose. The rent-free use is divided by the total use, and the resulting quotient is multiplied by the full rental value to determine the rent-free usage credit. The rent-free usage credit is then subtracted from the full rental value to calculate the total rent due.

Plant equipment rental receipts are deposited in the U.S. Treasury. These offsetting receipts are deducted from budget authority and outlays. Outlays are the amounts of checks issued or other payments made, net of refund or reimbursement. With current Gramm-Rudman-Hollings Act restrictions on DoD budget authority, an increase in offsetting receipts would help DoD reach its outlay targets.

Objectives and Scope

The objective of this audit was to determine whether contracting officers adequately administered the rental of DoD plant equipment by Textron Lycoming (Textron), Stratford Division, a subsidiary of Textron Incorporated. We also reviewed the DoD policy for plant equipment rental as provided by FAR, subpart 45.4, "Contractor Use and Rental of Government Property." Further, we evaluated the effectiveness of internal controls over the administration of contractor rentals of plant equipment.

As of September 30, 1988, Textron had custody of 12,046 items of DoD-owned plant equipment with an acquisition cost of $83.0 million. The equipment consisted of 957 items of IPE costing $66.2 million and 11,089 items of OPE costing $16.8 million. The U.S. Army Aviation Systems Command (AVSCOM) provided most of this equipment to the contractor under facilities contract DAAJ09-86-E-A001. In calandar year (CY) 1988, Textron paid $1,033,809 for non-Government use of the plant equipment. The facilities contract was administered by the Defense Contract Administration Services Plant Representative Office, Textron Lycoming, Stratford Division (DCASPRO-Textron).

We conducted the audit at the DCASPRO-Textron and at Textron. We focused on rent paid for non-Government use of DoD plant equipment in CY 1988 and reviewed related documentation from CY's 1977 to 1989. We reviewed contract documents and rental agreements at the procurement and administrative contracting offices, and sales and expense accounts that we selected from the contractor's chart of accounts. We verified the percentage of non-Government use of plant equipment at the contractor location and the accuracy of rental rates and calculations. We also determined whether the equipment was properly authorized for non-Government use.

We contacted industry experts about commercial leasing practices and arranged for an appraisal of the rental value of industrial plant equipment located at Textron. The appraisal attempted to compare the rental value of plant equipment to the amount of rent required using the FAR method and rates. We also worked with industry experts to determine the most practical and equitable changes to FAR policies and procedures for rental of Government-owned plant equipment.

This performance audit was made from February 1989 through March 1990 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included such tests of internal controls as were considered necessary. A list of activities visited or contacted is at Appendix K.

Internal Controls

We reviewed the implementation of the Federal Managers' Financial Integrity Act at the DCASPRO-Textron as it related to our audit scope. The rental of DoD-owned plant equipment was not considered a separate assessable unit at the DCASPRO, but was part of the assessable unit called contract administration. The DCASPRO did not provide specific coverage of the rental of DoD-owned plant equipment during its self-evaluation of internal controls over contract administration. As a result, DCASPRO personnel had not documented internal control objectives or techniques for contractor rentals.

In discussion with management, it was agreed that the internal control objectives for contractor rental of DoD-owned plant equipment are to ensure that:

- the contractor accurately identifies and reports rent-pay use of the equipment,
- the contractor pays the proper amount of rent, and
- the contractor's rent payments are timely.

Internal controls were not adequate to ensure that the contractor adequately identified rent-pay use of the equipment. However, as a result of our audit, changes were made to the rental agreement. The changes should eliminate the problems identified. Details are provided in Part II of this report.

Prior Audit Coverage

Office of the Assistant Inspector General for Auditing, DoD, Report No. 90-013, "Administration of Rental of DoD Plant Equipment at Boeing Helicopters," December 6, 1989, was the first in this series of reports on contractor rental of DoD plant equipment. The report stated that Boeing Helicopter's rental of DoD plant equipment was properly administered. A minor underpayment was identified. The contractor remitted the underpayment before issuance of the report, so the report contained no recommendations.

Office of the Assistant Inspector General for Auditing, DoD, Report No. 90-065, "Administration of Rental of DoD Plant Equipment at Saco Defense Incorporated," May 9, 1990, was the second in this series of reports on contractor rental of DoD plant equipment. The report stated that the rental of DoD plant equipment by Saco Defense Incorporated was properly administered, except for one instance of assessment and collection of $113,586 in interest for prior years' late rent payments. We recommended that the interest be collected from the contractor and that the contracting officers at the Defense Contract Administration Services Region, Boston, be instructed on the handling of interest on late rent payments. The Army and the Defense Logistics Agency concurred with the recommendations and have initiated appropriate corrective action.

The Air Force Audit Agency Report on Project No. 9066411, "Contractor Use of Government Furnished Equipment for Commercial Work," October 30, 1989, disclosed that the Air Force had inadequate procedures for identifying and tracking the use of Government-furnished equipment, and identifying and collecting rents due the Government. Management agreed with the audit recommendations and has taken or has planned actions that are responsive to the recommendations.

PART II - FINDINGS AND RECOMMENDATIONS

A. Contractor Rentals of DoD Plant Equipment

FINDING

DoD was not receiving appropriate rental amounts for non-Government use of plant equipment by Textron Lycoming (Textron), Stratford Division, a subsidiary of Textron Incorporated. The proper amount of rent was not collected from the contractor because DoD allowed an improper credit in the amount of $9,258 for each ALF-502 engine sold by Textron to its commercial customers. In addition, equipment used for non-Government purposes was improperly identified and excluded from the rental calculation, and the rent-free credit percentage was calculated incorrectly. As a result, DoD did not collect $1,202,697 in plant equipment rent in 1988. Textron forecasts sales of 654 ALF-502 engines from calendar years 1990 through 1995, and if the improper credit is allowed to continue, DoD will not receive additional rentals of $6.1 million.

DISCUSSION OF DETAILS

Background. The Federal Acquisition Regulation (FAR) 45.401 defines Government use of property as use in support of U.S. Government contracts. Non-Government use is defined as all other use (including direct commercial sales to domestic and foreign customers). The FAR further states that, as a general rule, Government use is on a rent-free basis and non-Government use is on a rental basis. Defense Federal Acquisition Regulation Supplement (DFARS), subpart 245.4, includes work on foreign military sales contracts in Government use, but requires that such use be on a rental basis. Foreign military sales contracts were considered non-Government use for purposes of this report.

FAR 52.245-9 (a)(3), "Use and Charges," states that the contractor may use the facilities without charge in the performance of other work, if the contracting officer specifically authorizes in writing use without charge for such work. The FAR does not define "other work." We do not believe this exception was intended to include direct sales to foreign customers.

Textron's Total Rent for 1988. Textron paid $1,033,809 in plant equipment rent in 1988. However, DoD did not collect an additional $1,202,697 in rent for that rental period. Of the net $1,202,697, $1,222,056 is an underpayment attributable to improper rental credits for ALF-502 engines sold by Textron to its commercial customers. The remaining $19,359 represents an overpayment of plant equipment rent resulting from a contractor proposed rental agreement for 1988.

ALF-502 Credit. In October 1977, Textron (AVCO at that time) requested a waiver of the full amount of rent for the use of DoD property to produce ALF-502 engines sold commercially. Textron estimated in 1977 that the rent would be $18,516 per engine. Textron's request was reviewed by the then Under Secretary of Defense for Research and Engineering. The Under Secretary approved a 50-percent ($9,258) rent reduction for the life of the HS-146 aircraft program. Textron was advised in writing by the contracting officer to offset the total rent due by $9,258 for each ALF-502 engine sold. The facilities contract was not modified to authorize the credit.

The ALF-502 engine is the power source for the HS-146 aircraft. The HS-146, manufactured by British Aerospace, previously Hawker Siddeley Aviation, is a commercial aircraft and has no military application. Textron estimated in its original waiver request that a total of 2,000 engines would be sold. Textron requested the waiver so that it could compete with a foreign engine manufacturer. Textron stated that the contract would benefit the U.S. Government, since the larger work load would increase the contractor's business base and decrease the Government's share of overhead costs. U.S. subcontractors would also benefit, since production of many of the engine's components were subcontracted.

While the amount of the rental credit remained fixed at $9,258 per engine, the amount of rent paid decreased substantially from the original $18,516 estimated in 1977. In 1988, the rent paid averaged $9,130 per engine. The amount of rent decreased primarily because a larger portion of the engines' components were purchased from subcontractors, and as a result, Textron used fewer pieces of Government equipment. We estimated that in 1988, Textron's credits for the ALF-502 engine exceeded rent paid on the program by $16,852 (Appendix A). In effect, the U.S. Government subsidized Textron's commercial sales by $128 per engine in 1988.

The Divisional Administrative Contracting Officer (DACO) at DCASPRO-Textron recognized the impropriety of the credit. In an October 11, 1988, letter to the U.S. Army Aviation Systems Command (AVSCOM), the DACO suggested rescinding the rental credit. The DACO concluded that the credit was no longer in the Government's best interest. As of the time of our review, AVSCOM had not responded to the DACO's letter.

We discussed this issue with the Office of the General Counsel, DoD, who conferred with the AVSCOM Legal Office and agreed that there is no legal prohibition against rescinding the credit. The General Counsel also advised us that the Procuring Contracting Officer is the appropriate individual to initiate this action.

We presented the issue to the Director, U.S. Army Contracting Support Agency, and to the U.S. Army Materiel Command (AMC). They concurred with our proposed recommendation to rescind the ALF-502 engine credit. The Army determined that continuance of the credit was no longer in the best interest of the Government and requested that AMC take appropriate action to eliminate the credit as soon as practicable.

Textron received credits of $7.3 million from July 1980 through December 1989 against its rental payments for the use of DoD property to produce ALF-502 engines sold commercially. In 1988, Textron's rental payments were reduced by $1,222,056 due to the credit. Textron forecasts sales of 654 ALF-502 engines from CY's 1990 through 1995 that would result in additional credits of $6.1 million. We consider the credits inconsistent with the Federal policy of charging rent for non-Government use of DoD property. In addition, we question the basis for continuing such a waiver of rent (rental credit) associated with a direct commercial sale to a foreign customer.

Rental Calculation. We reviewed Textron's two rental payments totaling $1,033,809 for CY 1988. The first payment covered the rental period from January through June 1988. The second payment covered the rental period from July through December 1988. We identified two issues involving Textron's method of calculating rent. The first issue involved Textron's method of excluding plant equipment that was used exclusively for Government work from the rental calculation. The second issue involved the method used to calculate the rent-free credit percentage.

Property Excluded From the Rental Calculation. Textron excluded $43.6 million of plant equipment from its rental calculation for the second half of 1988 on the basis that the equipment was used exclusively for Government work. We sampled 59 of the excluded items valued at $2.6 million and found that 32, or 54 percent, of the 59 items were not used exclusively for Government work. We discussed the results of our sample with contractor and DCASPRO personnel, and they agreed that the method of identifying exclusions for items used exclusively for Government work was inaccurate.

Rent-Free Credit Percentage. The contracting officer authorized Textron to compute the rent-free credit percentage for plant equipment rent using a method that was inequitable to the Government and not in accordance with the FAR. Two separate rent-free credit percentages were calculated. A real property percentage was calculated by dividing commercial labor by total labor. A personal property percentage was calculated by dividing commercial labor by total

labor less labor associated with dedicated Government work. The lower real property rent-free credit percentage was averaged with the higher personal property rent-free credit percentage, resulting in a lower percentage used in the rental calculation for plant equipment.

We estimated that Textron would have incurred an additional $1 million in rent for 1988 if the excluded items had been disallowed and added back into the rental calculation and if the correct rent-free credit percentage for plant equipment had been applied. Including items dedicated to Government work in the rental calculation was inequitable to the contractor, since we verified that many high-dollar equipment items were used exclusively for Government work. However, the status of all machines could not be verified, since the tracking system for machine use did not include all equipment.

Contractor-Proposed Rental Agreement. Textron proposed an alternative method of computing rent that we believe is equitable to the Government and the contractor. The revised method eliminates improper exclusions for dedicated items of equipment and the inequitable rent-free credit percentage. The contractor and DCASPRO personnel agreed to a revised rental agreement. At the request of the DACO, we reviewed the revised agreement to ensure that its provisions were equitable to the Government.

The revised rental agreement allows Textron to exclude plant equipment from the rental calculation when it can document that the items are used exclusively for Government work. Excluded plant equipment is called "measurable items" in the rental agreement. All nonmeasurable items of equipment in the plant where Government and non-Government work are performed are included in the rental computation. Textron recalculated its rent for 1988 under the revised rental agreement and determined the amount of rent to be $871,846.

The auditors reviewed the revised rental payments for 1988 and determined the rent to be $1,014,450. The difference resulted from the definitions of measurable and nonmeasurable items and exclusions from the rental calculation. We took exception to items Textron classified as measurable when the machine operator did not record actual usage. We also took exception to items that were excluded from the rental calculation because they were reported as not being used during the rental period, when records showed that the items were actually used.

Textron had originally paid plant equipment rent of $1,033,809 for 1988 under the old rental agreement. The auditors' revised calculation of $1,014,450, based on the revised rental agreement, resulted in an overpayment of $19,359. We provided DCASPRO and contractor personnel with our computations and documentation.

As of December 14, 1990, the DCASPRO and Textron had not completed their review of our revised rental calculations. To finalize the 1988 rental payments, the DCASPRO needs to secure revised rental statements from Textron and to ensure that the calculations agree with the revised rental agreement and the rental amounts calculated by the auditors.

RECOMMENDATIONS FOR CORRECTIVE ACTIONS

We recommend that the Commander, U.S. Army Aviation Systems Command:

1. Rescind Textron Lycoming's ALF-502 engine rental credit on all future sales.

2. Require the contracting officer to finalize Textron Lycoming's 1988 rental calculations for plant equipment consistent with the rental amount of $1,014,450 calculated by the auditors.

MANAGEMENT COMMENTS AND AUDIT RESPONSE

As of January 3, 1991, the Army has not provided a response to the recommendations.

B. DoD Policy for Rental of Plant Equipment

FINDING

The rents paid by contractors for non-Government use of DoD plant equipment were not consistent with sound commercial practices. The FAR requires that rental calculations be based on a percentage of the plant equipment's acquisition cost. The rental rates decreased with the age of the equipment, but too rapidly to be consistent with commercial practices. In addition, not all classes of plant equipment were assessed rent based on FAR rates. Finally, when DoD remanufactured or rebuilt equipment, the rental amount remained the same. As a result, DoD was undercharging contractors for the use of plant equipment. At Textron, we estimated additional rental payments of $571,069 would have been paid in 1988 if the FAR had required rental payments more consistent with commercial practices.

DISCUSSION OF DETAILS

Background. FAR 52.245-9, "Use and Charges" clause, establishes the method of computing rent for plant equipment. Table I of the clause establishes monthly rental rates. Rental amounts are determined by applying the appropriate rental rate from the Table to the acquisition cost of the item. The acquisition cost is the total cost to the Government and includes the cost of transportation and installation, if borne by the Government. The rental rates applied to the acquisition cost depend on the age and the Federal Supply Class (FSC) of the property (Appendix B).

The Defense Industrial Plant Equipment Center (DIPEC) defines rebuilding as the return of a machine to a like-new condition in appearance, performance, and life expectancy. DIPEC personnel stated that rehabilitation is synonymous with rebuilding. For purposes of this report, our references to rebuilding include rehabilitation. Retrofitting includes the work specified under rebuilding, and, for example, the replacement of an obsolete numerical control unit with a new unit that has capabilities at least equal to those of the original machine. Remanufacturing includes the same basic requirements as rebuilding and retrofitting, but gives the machine greater capabilities than the original.

We contacted industry experts in the field of equipment leasing, as well as trade associations, to determine how rental or lease values are determined in the commercial marketplace. A list of industry experts and trade associations contacted is in

Appendix C. We also arranged for a sample of plant equipment to be appraised for their rental value by a certified equipment appraiser, using DoD property located at Textron.

FAR Rental Rates. Industry experts informed us that FAR rental rates decrease more rapidly than those in the commercial market. DoD charges 3 percent of the acquisition cost per month for a new item. The rate decreases over time to a low of .75 percent per month after 10 years (Appendix B). These experts suggested that DoD charge the 3-percent rate for at least the first 3 years and that the lowest rate should not fall below 1 percent. The rate after 10 years is .75 percent per month. This rate equates to 9 percent per year (.75 percent times 12 months), which is less than the cost to borrow money at the Prime Rate as of January 15, 1991.

We recognize that the DoD rental environment is not the same as in commercial practice. Commercial rentals do not normally last as long as DoD rentals. However, we believe that if the equipment has utility, regardless of its age, the rental rate should not be less than 1 percent per month.

We believe that appraisals would be the most accurate method of establishing rental values for DoD plant equipment. However, based on our discussions with the certified appraiser who visited Textron, we recognize that appraisals would be impractical, given the large inventory of DoD property. Appraisals are expensive, and different appraisers might give different rental values. We believe that with revision, the FAR method is the most practical method of calculating rents for plant equipment. After reviewing input from the industry experts, we feel the following rates are more equitable and closer to commercial rates:

AUDIT-RECOMMENDED RATES

Age	Percentage Per Month
Under 3 years	3.0
Over 3 to 8 years	1.5
Over 8 years	1.0

Appendix D compares rental amounts for one item of plant equipment, using the current FAR rates, with the audit-recommended rates for the first 12 years of service.

Applicability of FAR Plant Equipment Rental Rates. The rental rates in the FAR "Use and Charges" clause, Table I, paragraph (ii) (Appendix B), apply only to certain FSC's of plant equipment (Appendix E). The remainder of plant equipment, except for automotive and electronic test equipment, is assessed rent at

the prevailing commercial rate, if any, or 1 percent if there is no prevailing rate. Automotive and electronic test equipment is assessed rent at 2 percent per month.

During our audits of the administration of contractor rental of DoD plant equipment and rental of Government real property, we found that prevailing commercial rates were not used for plant equipment excluded from Table I, paragraph (ii) of the "Use and Charges" clause.

For 17 of the contractors reviewed during the two projects, rent for plant equipment in FSC's not listed in FAR, Table I, was based on 1 percent per month. While this provides a method for assessing rent for the excluded FSC's, we find no reason to assess rent for items of IPE any differently from items included in the FSC's covered by paragraph (ii) of Table I. We provided the list of FSC's of IPE in Appendix E to industry experts and received a consensus that all plant equipment within the excluded FSC's should be subject to the audit-recommended rates.

Rehabilitation of DoD Equipment. When DoD property was remanufactured or rebuilt, the associated costs were not added to the original acquisition cost of the plant equipment. The contracting community does not consider rebuilding or remanufacturing of plant equipment as a substantial improvement. However, when an additional capability, such as numerical controls, was added to an item of plant equipment, the associated costs were added to the original acquisition cost.

FAR 52.245-9 requires that when an item is substantially improved at the Government's expense, the acquisition cost of the item shall be increased by the increase in value that the improvement represents, as determined by the contracting officer. Neither the FAR nor the DFARS defines "substantial improvement." The DoD practice of excluding such improvement costs from rental calculations is substantially different from the method used in the commercial marketplace. In private industry, rent is a function of an item's current value. An important determinant of current value is whether the item was rebuilt, remanufactured, or retrofitted. Since the amount of rent depends on the acquisition cost, a significant increase in rent would result if the cost of such modifications were added to the acquisition cost.

Not only does the rebuilt item operate in accordance with the original specifications and conform to original tolerances, but the useful life of the item is extended. When an item is substantially improved, the FAR does not change the rental rate based on the extended life of the item. Since rebuilding extends the useful life of an item and brings the operating efficiency to that of a new item, we agree with industry experts that the appropriate rental rate would be that of a new item (3 percent), and that the cost of the rebuilding should be added to the original acquisition cost. For example, under the FAR, the rental for an item acquired in 1952 at a cost of $44,023 would be $330 per month ($44,023 times .75 percent). Using the current method, if DoD rebuilt the item in 1987 at a cost of $37,500, the rent would remain the same, even though DoD incurred an additional expenditure and the useful life of the asset was extended. Under a revised method, the acquisition cost is increased by the cost of the rebuilding, and the item is then considered new. The rent for the item would be increased by $2,116 per month ($25,392 per year). This calculation is illustrated in Appendix F.

Impact of Commercial Practices. To achieve rental amounts closer to those found in the commercial marketplace, DoD needs to:

- revise the current FAR rental rates,

- expand the list of FSC's subject to FAR 52.245-9, Table I rates,

- increase the acquisition cost of items that have been rebuilt, remanufactured, or retrofitted by the cost of the improvement, and

- change the rental rate of the improved item to that of a new piece of property, based on the year the item was improved.

To measure the impact of these changes, we calculated the differences in rent at Textron for 1988 using the two methods. We estimated that the Government would have received an additional $571,069 in rent (Appendix G). This estimate is based on Textron's actual use of DoD property during the rental period.

Management Actions. As a result of the recommendations in Office of the Assistant Inspector General for Auditing, DoD, Report No. 89-087, June 30, 1989, "Contractor Rental of Government Real Property and Payment of Nonrecurring Costs," an Ad Hoc Group to the Defense Government Property Council was established to formulate policy for real property rental issues. The Deputy for Property Policy and Programs, Office of the Deputy Assistant Secretary of Defense (Logistics), chairs the Group. The Ad Hoc Group has drafted a revised FAR "Use and Charges" clause based on recommendations from Report No. 89-087. The revision includes three provisions for real property that will also affect rental calculations for plant equipment:

- The proper method of determining which items of property are subject to rent.

- The proper method of calculating the rent-free credit percentage.

- Whether the FAR provision for late rental payments is equitable.

We discussed the results of this audit with the Deputy for Property Policy and Programs and the Ad Hoc Group. To expedite the change to the FAR, the Deputy for Property Policy and Programs has agreed to incorporate the plant equipment issues discussed in this finding in the FAR case being developed to implement the recommendations in Report No. 89-087.

RECOMMENDATIONS FOR CORRECTIVE ACTIONS

We recommend that the Assistant Secretary of Defense (Production and Logistics) propose changes to the Federal Acquisition Regulation 52.245-9 to accomplish the following (a markup of these changes is provided in Appendix H):

1. Revise plant equipment rental rates contained in Table I as follows.

Under 3 years old	3.0 percent
Over 3 to 8 years old	1.5 percent
Over 8 years old	1.0 percent

2. Add a statement to Federal Acquisition Regulation 52.245-9, paragraph (c)(2)(ii), to clarify that rebuilding, rehabilitating, remanufacturing, and retrofitting all constitute substantial improvements.

3. Add a statement to Federal Acquisition Regulation 52.245-9, paragraph (c)(2)(ii), to require that when an item has been substantially improved at Government expense, the rental rate shall be changed to reflect the rental rate of a new item and that for purposes of determining the monthly rental rate, the age of the item shall be based on the date of the improvement.

4. Add Federal Supply Classes 3220, 3422, 3424, 3426, 3431, 3432, 3433, 3436, 3438, 3450, 3460, 3461, 3530, 3611, 3615, 3620, 3625, 3650, 3660, 3670, 3680, 3685, 3690, 3693, 3694, 3695, 4330, 4440, 4910, 4920, 4925, 4940, 5220, 5860, 6625, 6630, 6635, 6636, 6640, 6650, 6670, 6680, 6685, and 6695 to the Federal Acquisition Regulation "Use and Charges" clause, Table I, paragraph (ii), to subject the plant equipment to the Table rental rates. (The FSC's are listed in Appendix E).

MANAGEMENT COMMENTS

The Principal Deputy, Office of the Assistant Secretary of Defense (Production and Logistics), concurred with the finding and with Recommendations B.1., B.2., B.3., and B.4. and provided comments on actions taken or proposed. The comments were considered responsive to the recommendations. The complete text of the comments is in Appendix J.

COMPUTATION OF ALF-502 ENGINE CREDITS IN 1988

Percentage of Rent Paid for the ALF-502 Program:

Percentage for first half of 1988 computed as follows.

Direct shop labor for ALF-502	$ 906,544
Divided by: Total commercial shop labor	$1,887,785
Equals: Percentage for first half	48.0216

Percentage for second half of 1988 computed as follows.

Direct shop labor for ALF-502	$1,179,377
Divided by: Total commercial shop labor	$2,138,641
Equals: Percentage for second half	55.1461

Rent Paid for the ALF-502 Program:

Rent for ALF-502 for first half of 1988 computed as follows.

Rent paid for first half (prior to ALF-502 credit)	$1,046,911
Times: Percentage for first half	48.0216
Equals: ALF-502 rent for first half	$ 502,743

Rent for ALF-502 for second half of 1988 computed as follows.

Rent paid for second half (prior to ALF-502 credit)	$1,273,818
Times: Percentage for second half	55.1461
Equals: ALF-502 rent for second half	$ 702,461

Total rent paid for ALF-502 in 1988	$1,205,204
Less ALF-502 credits for 132 engines	
First half (60 times $9,258 equals $555,480)	
Second half (72 times $9,258 equals $666,576)	$1,222,056
Equals: Amount by which credits exceeded rent paid	$ <16,852>

Average Subsidy Per Engine:

Total rent paid for ALF-502 in 1988	$1,205,204
Divided by: Number of ALF-502 engines	132
Subtotal: Average rent paid per engine	9,130
Less: Amount of credit per engine	9,258
Equals: Average subsidy per engine	$ <128>

EXCERPT FROM FEDERAL ACQUISITION REGULATION 52.245-9, "USE AND CHARGES" CLAUSE

Table I

Rental Rates

(ii) For plant equipment of the types covered in Federal Supply classes 3405, 3408, 3410, and 3411 through 3419, machine tools; and in 3441 through 3449, secondary metal forming and cutting machines, the following monthly rates shall apply:

Age of Equipment	Monthly Rental Rate
Under 2 years old	3.0 percent
Over 2 to 3 years old	2.0 percent
Over 3 to 6 years old	1.5 percent
Over 6 to 10 years old	1.0 percent
Over 10 years old	0.75 percent

(iii) For personal property and equipment not covered in (i) or (ii) above, a rental shall be established at not less than the prevailing commercial rate, if any, or, in the absence of such rate, not less than 2 percent per month for electronic test equipment and automotive equipment and not less than 1 percent per month for all other property and equipment.

INDUSTRY EXPERTS CONTACTED DURING THE AUDIT

Machinery Dealers National Association
Association of Machinery and Equipment Appraisers
National Machine Tool Builders Association
Press and Shear Machinery Corporation
McKean Machinery Sales
Perfection Machinery Sales, Incorporated

COMPARISON OF FAR RENTAL RATES TO AUDIT-RECOMMENDED RENTAL RATES

The following chart shows the differences in rental amounts by year, for the first 12 years, of one item of plant equipment using the Federal Acquisition Regulation (FAR) rates and the audit-recommended rates. The calculations assume an acquisition cost of $75,000.

	FAR		Audit		
Age	Monthly Percentage	Rent Per Year *	Monthly Percentage	Rent Per Year *	Difference
0 - 1	3.0	$ 27,000	3.0	$ 27,000	$ 0
1 - 2	3.0	27,000	3.0	27,000	0
2 - 3	2.0	18,000	3.0	27,000	9,000
3 - 4	1.5	13,500	1.5	13,500	0
4 - 5	1.5	13,500	1.5	13,500	0
5 - 6	1.5	13,500	1.5	13,500	0
6 - 7	1.0	9,000	1.5	13,500	4,500
7 - 8	1.0	9,000	1.5	13,500	4,500
8 - 9	1.0	9,000	1.0	9,000	0
9 - 10	1.0	9,000	1.0	9,000	0
10 - 11	0.75	6,750	1.0	9,000	2,250
11	0.75	6,750	1.0	9,000	2,250
Total		$162,000		$184,500	$22,500

* Acquisition cost ($75,000) times monthly rate times 12 months.

FEDERAL SUPPLY CLASSES OF INDUSTRIAL PLANT EQUIPMENT THAT ARE AND ARE NOT SUBJECT TO RENTAL RATES IN FAR 52.245-9, "USE AND CHARGES" CLAUSE, TABLE I

Federal Supply Classes Subject to Federal Acquisition Regulation (FAR) Rental Rates, with Nomenclature:

3405	Saws and Filing Machines
3408	Machining Centers and Way Type Machines
3410	Electrical and Ultrasonic Erosion Machines
3411	Boring Machines
3412	Broaching Machines
3413	Drilling and Tapping Machines
3414	Gear Cutting and Finishing Machines
3415	Grinding Machines
3416	Lathes
3417	Milling Machines
3418	Planers and Shapers
3419	Miscellaneous Machine Tools
3441	Bending and Forming Machines
3442	Hydraulic and Pneumatic Presses, Power Driven
3443	Mechanical Presses, Power Driven
3444	Manual Presses
3445	Punching and Shearing Machines
3446	Forging Machinery and Hammers
3447	Wire and Metal Ribbon Forming Machinery
3448	Riveting Machines
3449	Miscellaneous Secondary Metal Forming and Cutting Machines

Federal Supply Classes Not Subject to FAR Rental Rates, with Nomenclature:

3220	Woodworking Machines
3422	Rolling Mills and Drawing Machines
3424	Metal Heat Treating and Nonthermal Treating Equipment
3426	Metal Finishing Equipment
3431	Electric Arc Welding Equipment
3432	Electric Resistance Welding Equipment
3433	Gas Welding, Heat Cutting, and Metalizing Equipment
3436	Welding Positioners and Manipulators
3438	Miscellaneous Welding Equipment
3450	Machine Tools, Portable
3460	Machine Tool Accessories
3461	Accessories for Secondary Metalworking Machinery
3530	Industrial Sewing Machines and Mobile Textile Repair Shops
3611	Industrial Marking Machines
3615	Pulp and Paper Industries Machinery
3620	Rubber and Plastics Working Machinery
3625	Crystal and Glass Industries Machinery
3650	Chemical and Pharmaceutical Products Manufacturing Machinery
3660	Industrial Size Reduction Machinery
3670	Specialized Semiconductor, Microelectric Circuit Device and Printed Circuit Board Manufacturing Machinery
3680	Foundry Machinery, Related Equipment, and Supplies
3685	Specialized Metal Container Manufacturing Machinery and Related Equipment
3690	Specialized Ammunition and Ordnance Machinery and Related Equipment
3693	Industrial Assembly Machines
3694	Clean Work Stations, Controlled Environment, and Related Equipment
3695	Miscellaneous Special Industry Machinery
4330	Centrifugals, Separators, and Pressure and Vacuum Filters
4440	Driers, Dehydrators, and Anhydrators
4910	Motor Vehicle Maintenance and Repair Shop Specialized Equipment
4920	Aircraft Maintenance and Repair Shop Specialized Equipment
4925	Ammunition Maintenance and Repair Shop Specialized Equipment
4940	Miscellaneous Maintenance and Repair Shop Specialized Equipment
5220	Inspection Gages and Precision Layout Tools
5860	Stimulated Coherent Radiation Devices, Components, and Accessories
6625	Electrical and Electronic Properties Measuring and Testing Instruments
6630	Chemical Analysis Instruments
6635	Physical Properties Testing Equipment
6636	Environmental Chambers and Related Equipment
6640	Laboratory Equipment and Supplies
6650	Optical Instruments
6670	Scales and Balances
6680	Liquid and Gas Flow, Liquid Level, and Mechanical Motion Measuring Instruments
6685	Pressure, Temperature, and Humidity Measuring and Controlling Instruments
6695	Combination and Miscellaneous Instruments

EFFECT ON RENT WHEN REBUILDING OR REMANUFACTURING COSTS ARE ADDED TO ACQUISITION COSTS

Data Used in Calculations:

Year acquired:	1952
Original acquisition cost:	$44,023
Year rebuilt or remanufactured:	1987
Rebuild cost:	$37,500

Rental Calculation Using Federal Acquisition Regulation (FAR) Method:

Original acquisition cost	$44,023
Times: FAR monthly percentage	.75
Equals: monthly rent	$ 330

Rental Calculation Using Audit-Recommended Method:

Original acquisition cost	$44,023
Plus: Cost to rebuild or remanufacture	37,500
Subtotal:	$81,523
Times: Monthly rental percentage	3.0
Equals: Monthly rent	$ 2,446

Difference between FAR and Audit-Recommended Method:

Audit-recommended method	$ 2,446
Less: FAR method	330
Equals: Total difference	$ 2,116

1988 PLANT EQUIPMENT RENT AT TEXTRON: COMPARISON OF METHOD USED TO COMPUTE RENT VERSUS AUDIT-RECOMMENDED METHOD

Current Method:

The maximum rent was computed as follows:	
Acquisition cost of industrial plant equipment	$62,308,637
Less: Rent-free exclusions	35,323,571
Subtotal: Acquisition cost of rent-pay items	$26,985,066
Times: Federal Acquisition Regulation (FAR) 52.245.9, Table I, rental rates	
Maximum rent for rent-pay items	3,308,831
Times: Average rent-pay percentage for 1988 (Rent-pay manufacturing direct labor dollars divided by total manufacturing direct labor dollars)	17.5
Equals: Rent due for 1988	$ 579,045

Audit-Recommended Method:

The maximum rent was computed as follows:	
Acquisition cost of industrial plant equipment	$62,308,637
Plus: Rebuild cost of industrial plant equipment	14,948,046
Subtotal: Acquisition cost plus rebuild costs	77,256,683
Less: Rent-free exclusions	41,247,400
Subtotal: Acquisition cost plus rebuild costs of rent-pay items	36,009,283
Times: Audit rental rates	
Maximum rent for rent-pay items	6,572,083
Times: Average rent-pay percentage for 1988 (Rent-pay manufacturing direct labor dollars divided by total manufacturing direct labor dollars)	17.5
Equals: Rent due for 1988	$ 1,150,114

Difference between Current and Audit-Recommended Method:

Audit-recommended method	$ 1,150,114
Less: Current method	579,045
Equals: Total difference	$ 571,069

RECOMMENDED CHANGES TO FAR 52.245-9, "USE AND CHARGES" CLAUSE

(c)(2)(ii) When any of the facilities are substantially improved at Government expense, the acquisition cost of the facilities shall be increased by the ~~increase in value that the improvement represents~~ [cost of the improvement], as determined by the Contracting Officer. [Rehabilitation, rebuilding, remanufacturing, and retrofitting all constitute substantial improvements. For purposes of determining the monthly rental rate, the age of the item shall be based on the date of the improvement.]*

TABLE I
Rental Rates

(i) For plant equipment of the types covered in Federal Supply classes 3405, 3408, 3410, and 3411 through 3419, machine tools; and in 3441 through 3449, secondary metal forming and cutting machines, [3220, 3422, 3424, 3426, 3431, 3432, 3433, 3436, 3438, 3450, 3460, 3461, 3530, 3611, 3615, 3620, 3625, 3650, 3660, 3670, 3680, 3685, 3690, 3693, 3694, 3695, 4330, 4440, 4910, 4920, 4925, 4940, 5220, 5860, 6625, 6630, 6635, 6636, 6640, 6650, 6670, 6680, 6685, and 6695] the following monthly rates shall apply:

Age of Equipment	Monthly Rental Rate
~~Under 2 years old~~	~~3.0 percent~~
~~Over 2 to 3 years old~~	~~2.0 percent~~
~~Over 3 to 6 years old~~	~~1.5 percent~~
~~Over 6 to 10 years old~~	~~1.0 percent~~
~~Over 10 years old~~	~~0.75 percent~~
Under 3 years old	3.0 percent
Over 3 to 8 years old	1.5 percent
Over 8 years old	1.0 percent

The age of each item of the equipment shall be based on the year in which it was manufactured [or substantially improved], with a birthday on January 1 of each year thereafter. For example, an item of equipment manufactured [or improved] on July 15, 1978, will be considered to be "over 1 year old" on and after January 1, 1979, and "over 2 years old" on and after January 1, 1980.

* Brackets indicate audit-recommended additions.

SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit *
A.1.	Compliance. Rescind ALF-502 credit on future sales (1990 through 1995).	Funds put to better use of $6,054,732.
A.2.	Compliance.	<$19,359> returned to contractor.
B.1., B.2., B.3., and B.4.	Economy and Efficiency. Revision to current method of calculating rent for plant equipment. Will result in additional rent collections in future.	Undeterminable. We cannot project the DoD-wide effect.
Total Benefits		$6,035,373

*Rental receipts are deposited into the U.S. Treasury's miscellaneous receipts account. No specific DoD appropriation is affected by these savings.

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, DC 20301-8000

PRODUCTION AND
LOGISTICS

December 18, 1990

(L/SD)

MEMORANDUM FOR DOD INSPECTOR GENERAL

SUBJECT: Draft Report on the Audit of Contractor Rental of DoD Plant Equipment at Textron Lycoming, Stratford Division, a Subsidiary of Textron Incorporated (Project No. 9AC-0022)

This audit found that: (1) appropriate rental amounts for non-Government use of plant equipment were not being received and that the rent free credit percentage was calculated incorrectly; and (2) changes to the Federal Acquisition Regulation (FAR) should be made so DoD's method of calculating rent for contractors' non-Government use of plant equipment will be consistent with sound commercial practices.

We concur with all of the recommendations that are addressed to the ASD(P&L) for action. The attachment contains our responses to each of your findings and recommendations. Action has been initiated to propose a revision to the FAR, Part 52.245-9, "Use and Charges" clause. These proposed changes should result in improvements to Federal policies for contractor rental of the Government's plant equipment and allow rental rates of DoD plant equipment to be more consistent with commercial rates.

The draft audit report estimates monetary benefits of $6.0 million will result from rescinding Textron's ALF-502 rental credit. Based upon data identified in Appendix I of the audit draft report, we concur with the estimated monetary benefit.

David J. Berteau
Principal Deputy

Attachment

DOD INSPECTOR GENERAL DRAFT REPORT 9AC-0022, October 12, 1990

"CONTRACTOR RENTAL OF DOD PLANT EQUIPMENT AT TEXTRON LYCOMING, STRATFORD DIVISION, A SUBSIDIARY OF TEXTRON INCORPORATED"

DEPARTMENT OF DEFENSE COMMENTS

****

The Findings and Recommendations offered by the DOD IG in the above draft report and the Office of the Assistant Secretary of Defense (Production & Logistics) (OASD/P&L) responses follow:

Finding A: Contractor Rentals of DoD Plant Equipment

DoD was not receiving appropriate rental amounts for non-Government use of plant equipment by Textron Lycoming (Textron), Stratford Division, a subsidiary of Textron Incorporated. The proper amount of rent was not collected from the contractor because DoD allowed an improper credit in the amount of $9,258 for each ALF-502 engine sold by Textron to its commercial customers. In addition, equipment used for non-Government purposes was improperly identified and excluded from the rental calculation, and the rent-free credit percentage was calculated incorrectly. As a result, DoD did not collect $1,202,697 in plant equipment rent in 1988. Since Textron forecasts sales of 654 ALF-502 engines from CY's 1990 through 1995, if the improper credit is allowed to continue DoD will not receive additional rentals of $6.1 million.

DoD IG Recommendations for Corrective Action:

We recommend that the Commander, U.S. Army Aviation Systems Command:

1. Rescind Textron Lycoming's ALF-502 engine rental credit on all future sales.

2. Require the contracting officer to finalize Textron Lycoming's 1988 rental calculations for plant equipment consistent with the rental amount of $1,014,450 calculated by the auditors.

OASD (P&L) Response:

Recommended actions on this finding are assigned to the Army. The DoD IG discussed the issue of rescinding Textron Lycoming's ALF-502 engine rental credit on all future sales with the Office of General Counsel, DoD, who conferred with the AVSCOM Legal Office and

agreed that there is no legal prohibition against rescinding the credit. Based upon data identified in Appendix I, we concur with the estimated monetary benefits of $6.0 million that will result from rescinding Textron's ALF-502 rental credit.

The last sentence of the Audit Section Entitled "ALF-502 Credit" (Page 13, Para 2) should be Revised to Read - "In addition, we question the basis for continuing such a waiver (Rental Credit) associated with a direct commercial sale to a foreign customer." Mr. Joseph, DoDIG and Mr. Gorman, OSD General Counsel have discussed this change. 7

Finding B: DoD Policy for Rental of Plant Equipment

The rents paid by contractors for non-Government use of DoD plant equipment were not consistent with sound commercial practices. The FAR requires that rental calculations be based on a percentage of the plant equipment's acquisition cost. The rental rates decreased with the age of the equipment, but too rapidly to be consistent with commercial practices. In addition, not all classes of plant equipment were assessed rent based on FAR rates. Finally, when DoD remanufactured or rebuilt equipment, the rental amount remained the same. As a result, DoD was undercharging contractors for the use of plant equipment. At Textron, an estimated additional rental payments of $571,069 would have been paid in 1988 if the FAR had required rental payments more consistent with commercial practices.

DoD IG Recommendations for Corrective Actions:

We recommend that the Assistant Secretary of Defense (Production and Logistics) propose changes to the Federal Acquisition Regulation 52.245-9 to accomplish the following:

1. Revise plant equipment rental rates contained in Table I as follows:

Under 3 years old.....3.0 percent

Over 3 to 8 years old.....1.5 percent

Over 8 years old.....1.0 percent

2. Add a statement to Federal Acquisition Regulation 52.245-9, paragraph (c)(2)(ii), to clarify the fact that rebuilding, rehabilitating, remanufacturing, and retrofitting all constitute substantial improvements.

3. Add a statement to Federal Acquisition Regulation 52.245-9, paragraph (c)(2)(ii), to require that when an item has been

substantially improved at Government expense, the rental rate shall be changed to reflect the rental rate of a new item and that for purposes of determining the monthly rental rate, the age of the item shall be based on the date of the improvement.

4. Add Federal Supply Classes: 3220, 3422, 3424, 3426, 3431, 3432, 3433, 3436, 3438, 3450, 3460, 3461, 3530, 3611, 3615, 3620, 3625, 3650, 3660, 3670, 3680, 3685, 3690, 3693, 3694, 3695, 4330, 4440, 4910, 4920, 4925, 4940, 5220, 5860, 6625, 6630, 6635, 6636, 6640, 6650, 6670, 6680, 6685, and 6695 to the Federal Acquisition Regulation "Use and Charges" clause, Table I, paragraph ii to subject the plant equipment to the Table rental rates.

OASD (P&L) Response:

The Assistant Secretary of Defense (Production and Logistics) concurs with the finding and recommendations and an Ad Hoc Committee of the Defense Government Property Council is presently developing changes to FAR 52.245-9, that will be submitted to the DAR Council for consideration. These proposed changes to the regulations should make rental of DoD plant equipment more consistent with commercial rental rates.

DoD Actions Taken:

An Ad Hoc Group constituted by the Defense Government Property Council was established to formulate policy for real property rental issues. A revised FAR 52.245-9 "Use and Charges" clause is being drafted based upon recommendations from DoD IG Report No. 89-087. Because the revision deals with provisions for real property that will also affect rental calculations for plant equipment, the Deputy for Property Policy and Programs has agreed, as Chairman of the Ad Hoc Group, to incorporate the plant equipment issues discussed in this finding in the FAR case already being developed to include the recommendations of Report No. 89-087. All of the recommendations of this report will be considered by the Group for the revision of FAR 52.245-9.

In the proposed clause, plant equipment rental rates are being changed to be more consistent with the commercial rates. The clause will contain a statement to clarify the fact that rebuilding, rehabilitating, remanufacturing, and retrofitting all constitute substantial improvements. A statement is being added to the clause to require that when an item has been substantially improved at Government expense, the rental rate shall be changed to reflect the rental rate of a new item and that for purposes of determining the monthly rental rate, the age of the item shall be based on the date of the improvement.

Federal Supply Classes are being added to the clause, Table I, paragraph ii, to subject additional plant equipment to the Table rental rates to assure that the rental rates of DoD plant equipment are more consistent with the commercial rates.

The proposed changes to FAR, Part 52.245-9, "Use and Charges" clause should result in improvements to Federal policies for contractor rental of the Government's real property and plant equipment and allow for rental rates of DoD plant equipment to be more consistent with commercial rates. The Ad Hoc Group, Defense Government Property Council, is planning to submit a case to the Defense Acquisition Regulatory Council for consideration by March 1991.

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Office of the Assistant Secretary of Defense (Production and Logistics), Washington, DC
Comptroller of the Department of Defense

Department of the Army

Assistant Secretary of the Army (Research, Development and Acquisition), Washington, DC
Army Materiel Command, Alexandria, VA
  Army Aviation Systems Command, St. Louis, MO
  Army Depot Systems Command, Chambersburg, PA
    Seneca Army Depot, Romulus, NY

Defense Agencies

Defense Logistics Agency, Alexandria, VA
  Defense Contract Administration Services Region, New York, NY
    Defense Contract Administration Services Plant Representative Office, Textron Lycoming, Stratford Division, Stratford, CT
  Defense Industrial Plant Equipment Center, Memphis, TN
Defense Contract Audit Agency, Alexandria, VA
  Defense Contract Audit Agency, Textron Lycoming, Stratford Division, Stratford, CT

Non-Government Activities

Textron Lycoming, Stratford Division, a Subsidiary of Textron Incorporated, Stratford, CT

AUDIT TEAM MEMBERS

Nancy L. Butler	Director, Financial Management Directorate
David K. Steensma	Deputy Director, Financial Management Directorate
Michael A. Joseph	Project Manager
Roy Tokeshi	Team Leader
John L. Koch	Auditor
Katherine E. Newman	Auditor

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Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
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