

# ECONOMIC IMPACT OF FEDERAL PROCUREMENT

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HEARINGS  
BEFORE THE  
SUBCOMMITTEE ON FEDERAL PROCUREMENT  
AND REGULATION  
OF THE  
JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES  
EIGHTY-NINTH CONGRESS  
SECOND SESSION

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JANUARY 24; MARCH 23 AND 24, 1966

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# ECONOMIC IMPACT OF FEDERAL PROCUREMENT

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MONDAY, JANUARY 24, 1966

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON FEDERAL PROCUREMENT AND  
REGULATION OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met at 3 p.m., pursuant to call, in room S-407, the Capitol, Hon. Paul Douglas (chairman of the joint subcommittee) presiding.

Present: Senators Douglas, Sparkman, Proxmire, and Jordan; Representatives Griffiths, Curtis, and Widnall.

Also present: Ray Ward, economic consultant; James W. Knowles, executive director; John R. Stark, deputy director; Donald A. Webster, minority economist; and Hamilton D. Gewehr, administrative clerk.

Chairman DOUGLAS. The subcommittee will come to order.

This subcommittee has been concerned in the past about the waste in the Federal procurement and supply management activities which have taken so much economic lifeblood from intended programs and denied it to others of great merit.

We have always contended that our economy can and should bear all needed expense for defense and for other programs, but that it should not be burdened with waste. I have long believed, as have other members of this subcommittee, that annual savings of billions of dollars were practicable.

As an economic approach to the subject, we have endeavored first to have guidelines established as to the proper role of Government itself as compared to the private sector.

Second, we have sought to list, study, analyze and, where feasible, consolidate common-type activities into streamlined operations.

Third, we have thought, as a general principle, that the national economy is best served by placing civilian-type activities in civilian agencies.

We are vitally interested in the economic implications of procurement and related matters since they require about one-third of all Federal expenditures, and, in addition to annual expenditures, the Defense Department alone, as of the 30th of June last year, had an inventory of \$37.6 billion in real property and \$138.7 billion in personal property.

It is obvious that operations of this magnitude affect the local, State, regional, and national economies. If anyone doubts this, he should note the pressures both upon Members of Congress and upon the Defense Department for new installations and the anxious concern about their closing.

It is much easier to start than to close or to curtail an activity, as our witness today probably well knows better than we.

Mr. Secretary, when I wrote to you as Secretary Designate on December 30, 1960,<sup>1</sup> on a number of problems, I despaired of progress after 10 years of frustration, but I want publicly to state that your program of cost reduction, weeding out of unneeded installations, and their restoration to the tax rolls, the integration of common activities and the increase in competitive procurement, to name only a few, are heartening achievements.

I am sure that Congressman Curtis and other members of the subcommittee share my views on this. While I do not want to take credit which is rightfully due to you who have borne the burden of the battle, I should accept responsibility when criticism arises for urging that these things be done.

Mr. Secretary, let me also say, as I said I believe 2 years ago, that I regard you as the ablest Secretary of Defense or Secretary of the Army that we have ever had in the history of the United States. Secretary E. M. Stanton, who was a somewhat eccentric genius, was a great Secretary of War from 1862 to 1865, but he had great personality defects. He indulged in frequent temper tantrums. He was arbitrary in his behavior. And after the conclusion of the war, he went completely haywire.

I think that you are a more well-balanced Secretary, and I await with interest what you have to say, without diminishing the combat effectiveness of the Armed Forces.

I can remember that when you came to the Department of Defense, I believe there were 11 combat-ready Army divisions. I believe that total has now increased to 16. The Marine Corps prides itself on being always ready, but I think we are more ready now than we were then. So you have done this with great efficiency, with great humanitarian spirit, and at the same time a zeal to make the fighting forces of the United States strong and vigorous.

We honor you for this, and I want to express my appreciation in advance of your testimony.

My letter to you of January 20, 1966, about the hearings, will be placed in the record at this point.

(Letter referred to follows:)

CONGRESS OF THE UNITED STATES,  
JOINT ECONOMIC COMMITTEE,  
January 20, 1966.

HON. ROBERT S. McNAMARA,  
Secretary of Defense,  
Department of Defense, Washington, D.C.

DEAR SECRETARY McNAMARA: The press of congressional duties makes it necessary to start the annual hearings of the Subcommittee on Federal Procurement and Regulation as soon as practicable. Accordingly, I will outline the subject matter upon which you and your associates are to testify on January 24, 1966, 3 p.m., room S-407 (AE-1), the Capitol, which is the public hearing room of the Joint Committee on Atomic Energy.

It will be appreciated if you will again cover the cost reduction program which has made such a notable contribution, not only to the Defense Establishment but to the entire executive branch, and the national economic structure.

<sup>1</sup> For text see "Background Material on Economic Aspects of Military Procurement and Supply—1964," materials prepared for the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 88th Cong., 2d sess., April 1964, pp. 2-3.

Of specific interest also will be a statement of progress made in competitive procurement procedures, consolidation or integration of other common supply and service activities, the development of a Federal supply system, standardization of supply items, utilization and disposal of real and personal property inventories, and progress and problems in the Defense Supply Agency.

As was the case last year, you and your staff—i.e., Assistant Secretary Ignatius and Admiral Lyle—may divide the time and subject matter to suit your heavy schedules and responsibilities.

If you have any queries, you may contact Ray Ward, economic consultant to the subcommittee, telephone 173-8169.

With best wishes,

Faithfully yours,

PAUL H. DOUGLAS.

Chairman DOUGLAS. A list of the hearings and reports of the subcommittee, previously printed, will be included in the record at this point for cross-referencing purposes.

(The list referred to follows:)

Report, October 1960: "Economic Aspects of Military Procurement and Supply," report of the Subcommittee on Defense Procurement to the Joint Economic Committee, Congress of the United States, 86th Cong., 2d sess. (Hereinafter called "Report, October 1960.")

Report, July 1963: "Impact of Military Supply and Service Activities on the Economy," report of the Subcommittee on Defense Procurement to the Joint Economic Committee, Congress of the United States, 88th Cong., 1st sess., July 1963. (Hereinafter called "Report, July 1963.")

Report, September 1964: "Economic Impact of Federal Supply and Service Activities," report of the Subcommittee on Defense Procurement to the Joint Economic Committee, Congress of the United States, 88th Cong., 2d sess. (Hereinafter called "Report, September 1964.")

Report, July 1965: "Economic Impact of Federal Procurement," report of the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee, Congress of the United States, 89th Cong., 1st sess. (Hereinafter called "Report, July 1965.")

Hearings, 1960: "Impact of Defense Procurement," hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 86th Cong., 2d sess., Jan. 28, 29, and 30, 1960. (Hereinafter called "Hearings, 1960.")

Hearings, 1961: "Progress Made by the Department of Defense in Reducing the Impact of Military Procurement on the Economy," hearing before the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 87th Cong., 1st sess., June 12, 1961. (Hereinafter called "Hearings, 1961.")

Hearings, 1963: "Impact of Military Supply and Service Activities on the Economy," hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 88th Cong., 1st sess., Mar. 28, 29, and Apr. 1, 1963. (Hereinafter called "Hearings, 1963.")

Hearings, 1964: "Impact of Military and Related Civilian Supply and Service Activities on the Economy," hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 89th Cong., 2d sess., Apr. 16 and 21, 1964. (Hereinafter called "Hearings, 1964.")

Hearings, 1965: "Economic Impact of Federal Procurement," hearings before the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee, Congress of the United States, 89th Cong., 1st sess., Apr. 27, 28, and 29, 1965. (Hereinafter called "Hearings, 1965.")

Staff study, 1960: "Background Material on Economic Aspects of Military Procurement and Supply," materials prepared for the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 86th Cong., 2d sess., February 1960. (Hereinafter called "Staff Materials, 1960.")

Staff study, 1963: "Background Material on Economic Aspects of Military Procurement and Supply," materials prepared for the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 88th Cong., 1st sess., March 1963. (Hereinafter called "Staff Materials, 1963.")

Staff study, 1964: "Background Material on Economic Aspects of Military Procurement and Supply, 1964," materials prepared for the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 88th Cong., 2d sess., April 1964. (Hereinafter called "Staff Materials, 1964.")

Staff study, 1965: "Background Material on Economic Impact of Federal Procurement, 1965," materials prepared for the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee, Congress of the United States, 89th Cong., 1st sess., April 1965. (Hereinafter called "Staff Materials, 1965.")

Staff study, 1966. "Background Material on Economic Impact of Federal Procurement, 1966," materials prepared for the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee, Congress of the United States, 89th Cong., 2d sess., March 1966. (Hereinafter called "Staff Materials, 1966.")

Chairman DOUGLAS. We are very glad to have you, Mr. Secretary

#### STATEMENT OF HON. ROBERT S. McNAMARA, SECRETARY OF DEFENSE

Secretary McNAMARA. Thank you very much, Mr. Chairman.

I am deeply grateful to you for your comments, even though they are not deserved. They do offset some of the equally, I hope, undeserved criticism.

For the fourth time in as many years, it is again my pleasure to appear before you and the members of your committee to report of the Department's cost reduction program.

As you mentioned a moment ago, the Department of Defense cost reduction program, which saved \$4.8 billion in fiscal year 1965, owes much of its inspiration to you personally and to the work of your committee. I recall particularly your letter to me, dated December 30, 1960, to which you referred a moment ago. I received that some 3 weeks before I was sworn into office. In it you outlined a number of the problem areas which have now been incorporated in the cost reduction program.

I recall also the McCormack-Curtis amendment which provided the legal basis for the establishment of several of the consolidated defense agencies which we have set up in recent years, particularly the Defense Supply Agency and the Defense Communications Agency.

Before proceeding with a discussion of the cost reduction program which we have established, particularly its status today, I want to express again not only my appreciation, but the appreciation of all of my colleagues in the Defense Department, both military and civilian, to you personally, to the members of your committee, to the other committees of Congress, and to many notable Americans who have contributed so much of their time and effort to determining ways and means by which our Defense Department, which spends over half of the Federal budget, can operate most efficiently.

Not only have we in effect stolen suggestions from you and from your committee, but from many other Americans as well.

President Hoover, for example, and the Hoover Commission were an important source of ideas for us, and one of my first instructions to my colleagues was to obtain your reports and the reports of other investigative committees, to sift out from them those ideas that had not yet been put into effect, to review each one to determine which of



them could be applied with advantage, and I would say we have probably applied 80 percent of those that came to our attention.

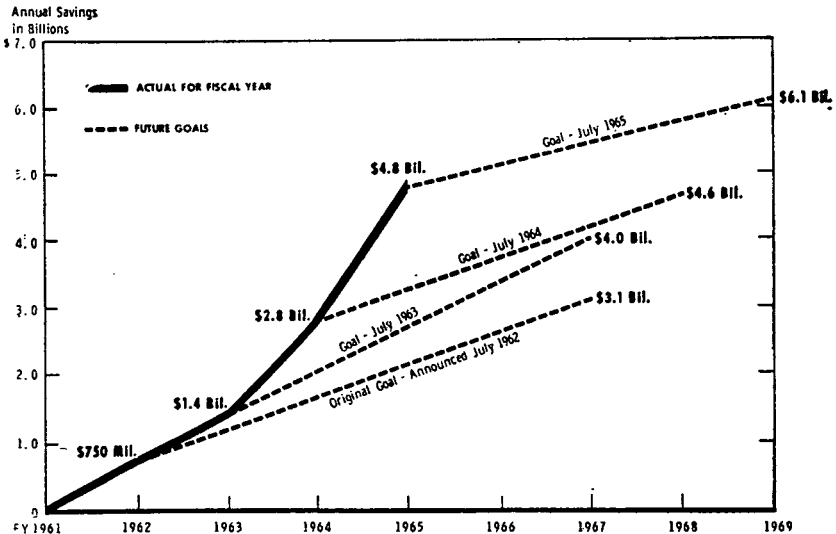
Since my last appearance here the conflict in southeast Asia, as you know, has deepened. Although our day-to-day concerns are understandably focused on the requirements of that conflict, I want to assure this committee, to assure the Congress, and to assure the Nation's taxpayers that our search for economy and efficiency in the management of the Department will continue to be prosecuted with the greatest vigor, and I hope my appearance here today underscores that fact. There is no conflict between efficiency in management in the affairs of the Department and efficiency in combat of southeast Asia.

As a matter of fact, one supports the other.

#### PROGRESS OF DOD COST REDUCTION PROGRAM

The results achieved from the cost reduction program through our last completed fiscal year, 1965, have again far exceeded our expectations, and this is shown in the chart below:

#### PROGRESS OF DoD COST REDUCTION PROGRAM



As you will see from examining this chart, which records the progress of the Defense Department cost reduction program in billions of dollars of annual savings, the savings actually realized in fiscal year 1965 rose to over \$4.8 billion in that single year alone. That was a goal which even as recently as last January we had not expected to reach until 1968.

Although the extraordinary requirements for Vietnam, which have been superimposed on our regular defense requirements, have created some uncertainties as to the results to be expected in fiscal years 1966

and 1967, I still believe that the goal which we established in July 1965, which called for \$6.1 billion in savings in 1969 and in each year thereafter, can be achieved.

The detailed accomplishments in past years and our goal for the future years has been broken into three sections, which I will discuss in sequence.

*Savings realized in fiscal 1965 and goal by fiscal 1969*

[In billions of dollars]

	Savings realized in fiscal year 1965	Savings goal by fiscal year 1969
1. Buying only what we need .....	2.5	2.6
2. Buying at the lowest sound price .....	1.2	1.2
3. Reducing operating costs .....	1.1	2.3
Total.....	4.8	6.1

BUYING ONLY WHAT WE NEED

The first of these, labeled "Buying only what we need," shows that we realized savings in that area of about \$2.5 billion in fiscal year 1965.

The second, which calls for "buying at the lowest price" compatible with the quality and delivery schedules required, shows savings of about one and a quarter billion dollars in 1965.

And the third area of saving, "Reducing operating costs," shows savings in fiscal year 1965 of about \$1.1 billion.

In total, these amount to the \$4.8 billion of savings for that year.

I want to emphasize that these achievements do not represent merely the totaling up of chance economies. Rather, they are the product of a very carefully planned and audited program which enlists the continuing efforts of tens of thousands of defense managers, both military and civilian, at all levels of the Department.

I believe that the savings reported have been objectively measured and validated, and they will continue to be audited with great care.

We have about 200 man-years of auditing each year devoted to this program, to insure that the savings are, in fact, as reported.

In previous appearances before this committee, I have discussed the character of the program in some detail. At this time, I would simply like to give you a progress report, to highlight certain recent developments, and to outline some of our future plans.

Mr. Ignatius, who is the Assistant Secretary of the Department in charge of installations and logistics, is here today. He is prepared to discuss measures we are taking in response to the findings and recommendations contained in the committee's report of last July.

And Admiral Lyle, who is Director of the Defense Supply Agency, can deal with the operations of that Agency.

Now turning to our first major area of savings, which we call "Buying only what we need," I will deal with several subcategories of that, the first of which is the work to refine the requirements calculations, eliminating any requirement for which we cannot develop a sound justification.

Cost reduction efforts in this area continue to yield significant savings. Of course, the more we improve our requirements calcula-

tions, the more we reduce the opportunities for further savings through this means in the future, and this is reflected in the figures in the table attached to this statement, which summarizes the cost reduction program savings and goals.

(The table referred to follows:)

*Department of Defense cost reduction program*

[Dollars in millions]

	Estimated savings to be realized in— <sup>1</sup>				
	Fiscal year 1963	Fiscal year 1964	Fiscal year 1965	Fiscal year 1966	Fiscal year 1969
<b>A. Buying only what we need:</b>					
1. Refining requirement calculations:					
(a) Major items of equipment <sup>2</sup> .....	\$90	\$487	\$1,060	\$747	-----
(b) Initial provisioning.....	163	218	368	184	-----
(c) Secondary items.....	481	643	626	799	-----
(d) Technical manuals.....	-----	10	9	8	-----
(e) Technical data and reports.....	-----	2	6	2	-----
(f) Production base facilities.....	35	14	18	-----	-----
2. Increased use of excess inventory in lieu of new procurement:					
(a) Equipment and supplies.....	-----	57	169	75	-----
(b) Idle production equipment.....	1	-----	4	-----	-----
(c) Excess contractor inventory.....	18	14	8	3	-----
3. Eliminating "goldplating" (value engineering).....	72	76	204	83	-----
4. Inventory item reduction.....	-----	-----	83	72	-----
Total, buying only what we need.....	860	1,521	2,555	1,973	\$2,591
<b>B. Buying at the lowest sound price:</b>					
1. Shift from noncompetitive to competitive procurement:					
Total percent competitive <sup>3</sup> .....	37.1	39.1	43.4	-----	-----
Total amount of savings.....	\$237	\$448	\$641	\$414	-----
2. Shift from CPFF to fixed or incentive price:					
Total percent CPFF <sup>4</sup> .....	20.7	12	9.4	-----	-----
Total amount of savings.....	-----	\$100	\$436	\$599	-----
3. Direct purchase breakout.....	-----	\$5	\$6	\$2	-----
4. Multiyear procurement.....	-----	-----	\$67	-----	-----
Total, buying at lowest sound price.....	\$237	\$553	\$1,150	\$1,015	\$1,170
<b>C. Reducing operating costs:</b>					
1. Terminating unnecessary operations.....	\$123	\$334	\$484	\$551	-----
2. Consolidation and standardization:					
(a) DSA operating expense savings <sup>5</sup> .....	31	42	59	57	-----
(b) Consolidation of contract administration.....	-----	-----	-----	-----	-----
(c) Departmental operating expense savings.....	-----	95	186	95	-----
3. Increasing efficiency of operations:					
(a) Improving telecommunications management.....	80	131	118	129	-----
(b) Improving transportation and traffic management.....	24	7	35	35	-----
(c) Improving equipment maintenance management.....	-----	65	117	108	-----
(d) Improving noncombat vehicle management.....	2	18	24	21	-----
(e) Reduced use of contract technicians.....	-----	20	26	27	-----
(f) Improving military housing management.....	6	13	16	14	-----
(g) Improving real property management.....	23	25	46	27	-----
(h) Packaging, preserving, and packing.....	-----	7	8	3	-----
Total, reducing operating costs.....	289	757	1,119	1,067	\$2,205
<b>D. Military assistance program (MAP): Total MAP.....</b>	-----	-----	19	-----	125
<b>Total program.....</b>	<b>1,386</b>	<b>2,831</b>	<b>4,843</b>	<b>4,055</b>	<b>6,091</b>

<sup>1</sup> Includes certain 1-time savings not expected to recur in the same amounts in future years.

<sup>2</sup> In addition fiscal year 1962 "requirements" for major items of equipment were reduced by \$24,000,000,000. In fiscal year 1963, the Army reduced 1964 pipeline requirements by \$500,000,000.

<sup>3</sup> Fiscal year 1961 was 32.9 percent; fiscal year 1965 actual was 43.4 percent; savings are 25 percent per dollar converted.

<sup>4</sup> First 9 months of fiscal year 1961 was 38 percent; fiscal year 1965 actual was 9.4 percent; savings are 10 percent per dollar converted.

<sup>5</sup> Excludes DSA inventory drawdown without replacement of \$39,000,000 for fiscal year 1962; \$262,000,000 in fiscal year 1963; \$161,000,000 in fiscal year 1964; \$51,000,000 in fiscal year 1965.

<sup>6</sup> Amount reflected in the original fiscal year 1966 budget.

Secretary McNAMARA. With regard to the refining of requirements calculations, I would now like to try to clear up some apparent misunderstandings which have risen concerning cost reductions in this area of the program.

As I have repeatedly noted in my previous appearances before various congressional committees, President Kennedy gave me two general instructions when I took office in January of 1961, and President Johnson has reiterated these instructions to me. They both said first develop the military force structure which is necessary to support our foreign policy, and do this without regard to arbitrary budget ceilings or predetermined financial limits. They both believed, as I do, that we are an affluent nation; that with a gross national product of \$700 billion per year there is absolutely no excuse for not spending every dime that we can effectively spend to furnish the weapons and the men and the other resources needed to protect our security.

But both Presidents have emphasized that, having determined the military force required to support our foreign policy, we should procure and operate that force at the lowest possible cost.

During the entire 5 years of my tenure as Secretary of Defense, I have been guided by these two basic principles. Throughout that period I have insisted that our military strategy and our military plans be related to the threat, that the forces to be acquired and maintained should be related to the strategy and the plans, and that the forces should be adequately supported not only with men, not only with equipment and facilities, but with the war reserve stocks as well, so that they could engage in combat for sustained periods of time.

The achievement of this objective has not always been easy. For many years our military plans, our contingency war plans, far exceeded the forces available to support them, and even the forces available were not in proper balance with one another. There was not enough tactical airpower, for example, to support the existing number of combat-ready Army divisions. In addition, although the concept of a mobile central reserve of combat forces had been generally accepted, the airlift required to move these Reserve Forces was completely inadequate. Nor was there enough amphibious lift to move the Marine Corps Forces. And although a great deal of attention had been paid to nuclear weapons, stocks of ammunition and other combat consumables which were required for nonnuclear war were grossly deficient in many categories.

Since 1960 we have added about \$50 billion to our defense program, exclusive of the supplement to the fiscal 1966 budget now being considered by the Congress. This was added to correct these and other deficiencies. By the end of fiscal 1965, just 6 months ago, we had achieved a 45-percent increase in the number of combat-ready Army divisions. As you noted, it increased from 11 to 16.

There was a 45-percent increase in the number of combat helicopters, a hundred-percent increase in our airlift capacity, a 51-percent increase in the number of Air Force fighter squadrons designed to support our combat Army divisions, a hundred-percent increase in the naval ship construction program in order to modernize the fleet, and a 1,000-percent increase in the Special Forces particularly trained for counterinsurgency.

And while this tremendous increase in our nonnuclear power was underway, we did not neglect our nuclear forces. Indeed, during this same 5-year period, we achieved a 200-percent increase in the number of nuclear warheads and total megatonnage in the strategic alert forces, and a 67-percent increase in the number of tactical nuclear weapons on the soil of Western Europe.

But even while these increases in our military strength were being achieved, we moved ahead vigorously on President Kennedy's second instruction that we "procure and operate this force at the lowest possible cost," and each year since its inauguration in fiscal year 1961, we have been able to increase the savings actually realized through the cost reduction program and to increase its goals for the future. I can assure you that these savings were made without adverse effect on our military strength, and without adverse effect on our combat readiness. Any doubt of this can only be based on a misunderstanding of the way in which we compute our requirements for equipment and for ammunition. As noted earlier, it has been my contention from the very beginning that we should first determine as accurately as possible what we need to support the forces required by our contingency war plans, and then we should buy all of what we need, but only what we need, and we should buy that at the lowest sound price.

In the case of both major equipment and consumables, we must acquire the items needed for the initial outfitting of the forces and for keeping their equipment modern, plus sufficient stocks to meet our peacetime consumption, plus a war reserve sufficient to meet the logistic standards associated with our contingency war plans. All of these requirements are susceptible to calculation and there is nothing to be gained by buying more than we need at any particular time.

I want to emphasize this. No matter how much money is spent, if we are spending it on procurement in excess of requirements, we gain nothing. Indeed, there is much to be lost since nearly all of these stocks are subject to obsolescence and many items actually deteriorate physically over time. Even under the best of circumstances, we have to dispose of billions of dollars of equipment and supplies each year, and, as this committee has repeatedly pointed out, at a mere fraction of their original cost.

Chairman DOUGLAS. Less than 5 percent?

Secretary McNAMARA. Well, I was going to say between 5 and 8 percent. But it is a very, very small fraction of the original cost.

As you know, our excess inventories at the present time amount to something on the order of \$10 billion. That is about \$2 billion lower than it was several years ago, almost 5 years ago, and we have sought to use a portion of it by substituting excess stocks in lieu of new purchases on which I will comment in a moment.

To the extent we buy more than we need, we simply increase the amount which eventually must be disposed of, thus wasting the taxpayers' money without adding anything of value to our actual military strength.

But the question still remains: Why, if we had acquired what we needed, do we now have to increase our procurement so substantially in order to support our military effort in southeast Asia?

The answer to this question has three parts.

First, we are increasing the size of our Active Forces because we do not wish at this time to call up the reserve forces. As you know, we are adding a Marine division. We have added an Army division and the equivalent of another Army division in the form of three brigade forces. The new forces must be equipped and supplied.

Second, we do not normally provide in advance for combat attrition of such major weapon systems as aircraft and ships because of the great cost involved. I understand that a war reserve of aircraft was once considered in connection with the military buildup undertaken during the Korean war, but rejected for the same reason. Accordingly, additional aircraft must be procured as soon as the forces are committed to combat, and this was one of the largest items in our fiscal year 1966 supplemental request, now being considered by the Congress.

Chairman DOUGLAS. For additional aircraft?

Secretary McNAMARA. For aircraft that we will need to replace potential losses.

Representative CURTIS. Is that essentially helicopters?

Secretary McNAMARA. No, it is both fixed-wing and rotary-wing aircraft. The helicopter losses have been very small to date, but we anticipate they may rise, and we are placing helicopters on procurement for that purpose.

In the case of the helicopters the great bulk of the new procurement, however, is to add to the number of helicopter companies in our forces, because the experience in southeast Asia has demonstrated to us that the value of helicopters even exceeds our previous expectations. We have more than doubled the number of helicopter companies authorized for the total Army worldwide, and therefore, the bulk of the new helicopter procurement is, as I say, to expand the force rather than to replace lost helicopters. Helicopter losses have been very small to date.

Third, we provide, in our war reserve stocks only those quantities of combat consumables needed to tide us over until additional stocks can be acquired from new production. This means that, as soon as we start to consume significant quantities of war reserve stocks in combat, we must start to procure replacement stocks. For such items as ammunition, wartime consumption rates are many times peacetime rates.

For example, in the case of ammunition, we have added to the \$1.1 billion included in the original fiscal year 1966 budget \$800 million from the August amendment and \$2.1 billion from the supplemental request now before the Congress—giving us a total of about \$4.1 billion for ammunition in fiscal year 1966. And another \$3.7 billion of ammunition is included in the fiscal year 1967 budget.

Obviously, it would be entirely impractical to attempt to carry in stock the huge amounts of ammunition required when our forces actually engage in combat. And there is no need to do so, as long as we have on hand the essential margin between consumption and production. This margin we have, except in those few cases where ammunition is being used in Vietnam in ways and quantities which were never anticipated; for example, the 2.75-inch rocket recently adapted to helicopters and which is now being fired in great quantities from helicopters.

This is not to say that every one of the tens of thousands of Defense Department supply points is without a single "inventory shortage." Anyone who has had experience with large supply systems knows that somewhere, sometime, something will be lacking. No matter how much we spend for defense, someone somewhere in our farflung organization will be short some item at a particular time.

This has nothing to do with the amount of funds requested and appropriated. It simply reflects the fact that no system involving literally hundreds of thousands of people and millions of different items spread around the globe can be 100-percent perfect. Mistakes in distribution or requirements calculations will be made, and these mistakes will be reflected in an inventory shortage, or overage, somewhere in the system. This is true of private industry as well as government, and it is up to management at all levels to see to it that these mistakes are held to a minimum and corrected promptly when discovered.

Accordingly, the entire question of shortages must be reviewed in perspective. The acid test of our logistic system or any logistic system is the ability of our forces to take the field and engage in combat. I submit that the rapid deployment and support in combat of a force of over one-quarter of a million men—including those aboard ships off the coast of southeast Asia—to an area 10,000 miles from our shores clearly demonstrates that our logistic system has that capability. Never before has this country or any other country been able to field and support in combat so large a force in so short a time over so great a distance, without calling up the reserves and without applying price, wage, and material controls to our civilian economy. That is why General Abrams, the Vice Chief of Staff of the Army, was able to say last June:

The Army is in the best peacetime condition in its history. I make this statement based on my experience as a battalion commander in Europe for 22 months beginning in 1949, and as commander of an armored cavalry regiment for 14 months thereafter, as a division commander in Europe from October 1960 to June 1962, and as corps commander from July 1963 to July 1964. From this background and from my association with soldiers and their equipment, I can state unequivocally that the readiness conditions in the U.S. Army are the highest that have been attained in my 29 years of service.

That is why the Secretary and Chief of Staff of the Army, General Johnson, were able to report last August that:

The Army was never in a better position in peacetime than it is today—with respect to both training and equipment, it is fully prepared to carry out its mission of sustained land combat. From the point of view of materiel, this is the direct result of the significant equipment procurement and modernization program that has taken place over the past several years, and the provision of combat reserve in depth to enable our forces to engage in sustained combat.

That is why General Wheeler, the Chairman of the Joint Chiefs of Staff who had been Chief of Staff of the Army previously, was able to say last year about our forces in Europe:

I have never known, historically or otherwise, of any Army in peacetime as well equipped, as well trained, as well manned as the 7th Army today.

Now, turning to the second category of actions leading to a savings in connection with "buying only what we need," which deals with the increased use of excess inventories which I alluded to a moment ago.

At end of fiscal year 1961 the long-supply stocks of the Defense Department totaled \$13 billion; by the end of fiscal year 1965, they had been reduced to about \$10 billion. Even so, we succeeded in reutilizing within the Defense Department \$1,451 million of such stocks in fiscal year 1965 compared with \$956 million in fiscal year 1961 when the total available was about \$3 billion greater. Much of this improvement can be attributed to the new screening procedures which require that all proposed procurements be matched against long-supply stocks to determine if they can be used in lieu of new purchases. Our progress since fiscal year 1961 is shown below:

*Value of long-supply stocks*

[In millions of dollars]

Fiscal year	Returned to productive use	Increase over fiscal year 1961
1961.....	956	-----
1962.....	1,080	124
1963.....	1,120	164
1964.....	1,287	331
1965.....	1,451	495

I would point out that in the last column we have shown in each year we have been able to use more of the excess inventory. Here are some recent examples of how these stocks were reutilized:

Army received 913 excess RT-178 ARC-27 radio receiver-transmitters from the Air Force for use in Army aircraft and helicopters, saving \$1,386,800; Marine Corps received 6,078 120-millimeter projectiles from Army saving \$551,000; Air Force used 24 excess aircraft engines to support the RC-135B production contract, saving \$2,776,000.

The third category of "buying only what we need," this relates to eliminating what we call goldplating through value engineering. Very simply, it means to simplify the specifications to insure that they provide all of what we require, but no more than what we require in combat.

To insure that we do not buy quality features in our weapons and equipment which are not necessary for military effectiveness, design specifications must be continually challenged in order to rid them of frills or goldplating. The analytical techniques and systematic processes that pinpoint and eliminate these unneeded qualitative features are called value engineering.

Last year, value engineering saved us \$204 million, or \$128 million more than in fiscal year 1964. Our objective is to save at least \$500 million by fiscal year 1969. We are now adding 265 more value engineering specialists throughout the Department, confident that the efficiencies they achieve will not only pay their salaries many times over, but will also make a positive contribution to military effectiveness, and I think this is extremely important, because, as we simplify the device, we not only reduce its cost but we substantially increase its reliability.

I should emphasize now what perhaps I should have stated earlier, that our primary job in the Defense Department is not to save money.



Our primary job is not to achieve maximum efficiency. Our primary job is to achieve combat readiness. But in 20 years of managing large organizations, I have found that efficiency of management can be translated both into cost reductions and into, in this instance, combat readiness. One goes hand in hand with the other. And particularly in this case, where we simplify the product and simplify its design, we reduce cost and we increase reliability, and it is the reliability and effectiveness of the weapon that is our primary objective.

Whenever appropriate, defense contracts now provide for the producer to share in savings resulting from value engineering improvements proposed by him. The incentives contained in these contracts have been made more attractive by:

Enabling a contractor to share in follow-on contracts the savings resulting from his earlier value engineering improvements;

Providing for a larger contractor share where his value engineering change produces savings in such collateral functions as maintenance or logistic support;

Extending value engineering sharing incentives to subcontractors, as well as to the prime contractors.

Partly as a result of these changes, the number of value engineering proposals received from contractors has increased dramatically in the last 2 years. About 700 such proposals were approved in fiscal year 1965, more than double the number accepted in fiscal year 1964.

Here are some examples of recent savings achieved by eliminating goldplating:

*Savings achieved on procurement by elimination of "goldplating"*

	Unit cost		Savings on recent procurement
	Before redesign	After redesign	
Change in injector housing, LANCE missile system: Machining costs were reduced by using an aluminum alloy casting in place of forging.....	\$2, 933. 60	\$2, 656. 85	\$125, 500
Redesign of XM169 cartridge case: Number of component parts were reduced from 6 to 3.....	1. 15	. 54	1, 073, 500
Redesign of waveguide tube for SP8-52 radar: Machining operations were eliminated by reducing the wall thickness on the waveguide tube.....	48. 04	12. 42	108, 400
Elimination of nonessential items—C-130 stall warning system: "SCAT" system for alerting crew to impending stall replaced by simplified "Monitair" system.....	14, 650	1, 820	3, 877, 200

INVENTORY ITEM REDUCTION

Our continuing effort to reduce the variety, sizes, and types of items in use was even more productive in fiscal year 1965 than in the preceding year. Through the standardization and identification of interchangeable and substitute parts, the services and DSA were able to eliminate nearly 632,000 individual items from their respective inventory lists, an increase of more than 48,000 over fiscal year 1964.

Chairman DOUGLAS. Mr. Secretary, those figures are almost incredible.

Secretary McNAMARA. These are gross figures. This is not a net reduction. But it is a drastic change from the previous level of gross reductions. In 1961 the reduction was about 293,000, for example, in terms of deletions. We have not yet done as much standardization

as I think we can, and it is through this standardization that we are able to eliminate these parts that are unique and have but a narrow field of application.

And not only are we eliminating substantial numbers, as I indicated some 632,000 items, but we are reducing the number of items added to the catalog, with the result that last year for the first time we had a net reduction of some 87,000 in the number of items carried in our catalog.

#### CATALOGED ITEMS

Chairman DOUGLAS. How many items are carried?

Secretary McNAMARA. I should know. It is now slightly over 3.8 million if I recall the figure correctly. (Information subsequently furnished by the Department: "As of October 31, 1965, the total of cataloged items was 3,821,400.") But, of course, it is so large that no one can intelligently deal with it, so that this standardization and item elimination effort is not only going to reduce costs, but it is going to lead to a much more intelligent management of the entire inventory system.

#### BUYING AT THE LOWEST SOUND PRICES

The second major category of action under which we group a series of subprograms for cost reduction has to do with buying what we buy at the lowest sound price.

I believe that we have made good progress during the last 5 years in improving the effectiveness of our contracting activities. As you know, at an early stage in this program, we established two principal objectives in this area:

(1) To increase the use of competition in our procurement, and this, of course, has been one of the primary recommendations of you and the members of your committee; and

(2) To limit the use of cost-plus-fixed-fee (CPFF) contracts to a minimum.

Our progress to date in both areas continues to exceed substantially our earlier expectations.

During the next 2 years, our efforts must be directed toward holding on to these gains and, to that end, we are further streamlining our contracting procedures and improving the skills of our procurement personnel through intensified training programs.

As shown in the chart (p. 15), 43.4 percent of our prime contracts were awarded on the basis of price competition during fiscal year 1965, an increase of 3.5 percentage points over our goal for the year. It is almost a 10-point increase, about a 30-percent increase over the level of 1961.

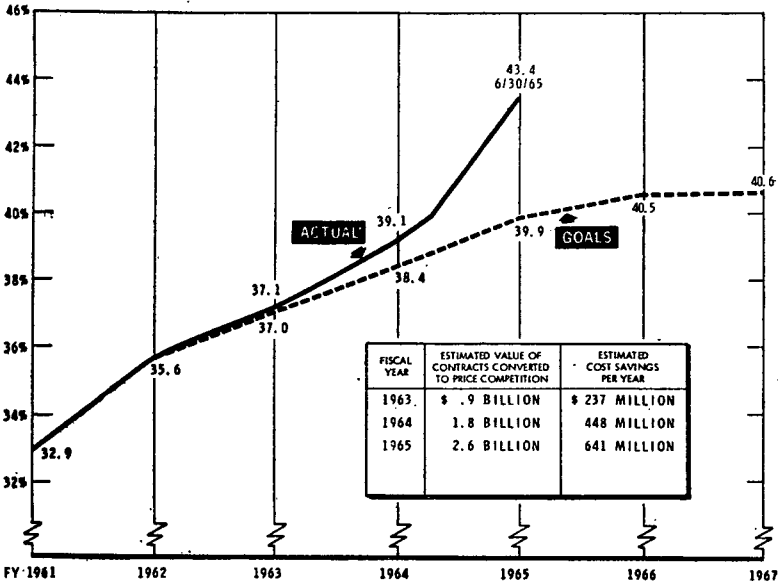
#### FORMAL ADVERTISED PROCUREMENT

While I do not show it on the chart, I should draw your attention to the fact that total formal advertised procurement increased from 11.9 percent in 1961 to 17.6 percent in 1965.

I know this has been an area of particular interest and concern to the committee.

(Chart referred to follows:)

**CONTRACTS AWARDED ON BASIS OF COMPETITION  
AS A PERCENT OF TOTAL CONTRACT AWARDS**



Representative CURTIS. Mr. Secretary, could I ask you this? I think it is obvious, but I want to be sure.

In doing this you also broaden the number of firms that are participating, do you not?

Secretary McNAMARA. Yes, in many cases that is true. In most cases it is true as a matter of fact, and, of course, it is through this device that we get greater competition.

Representative CURTIS. Yes.

Secretary McNAMARA. And it is through that broadening of the base that we also achieve the savings.

As you can see in the little table on the chart, we estimate we have converted about \$2.6 billion of contracts per year at the 1965 rate, from noncompetitive to competitive procurement.

Our audits show us that we save at least 25 cents of every dollar shifted from noncompetitive to competitive procurement, and I want to emphasize that this doesn't mean that American defense industry has been profiteering at the expense of the Government. Such is not at all the case. The point is that, as we move to competition, each firm is given greater incentive to find cheaper ways of doing things, and they find those cheaper ways.

ACCEPTANCE OF LOW BIDS

Chairman DOUGLAS. Congressman Widnall.

Representative WIDNALL. Excuse me for interrupting right now, Mr. Secretary, but in competitive procurement what do your figures

show as to acceptance of low bids when the actual low bidder is accepted? Or do you actually take a qualified low bidder rather than the actual low bidder?

Secretary McNAMARA. Well, it depends.

I would say in formal advertising we take the low responsible bidder. We are required to do so.

Now, there is a qualification to that which relates to what we call two-step advertising. It is a relatively small part of the total, but it is important.

There, in the first step, we qualify a series of firms, normally something on the order of six. We qualify them by inspecting their manufacturing facilities, examining the competency of their management, reviewing the drawings and specifications for the particular product, to determine that the firm's product will meet our general requirements.

And then, having qualified a set of firms, we accept the low bid without question from any one of those firms. All other formal advertising requires that we accept the low responsible bidder without any qualification.

In price competition generally, we retain the right to throw out the low bid if we feel it comes from a company that from its record or for other reasons appears not to be qualified to meet our specifications and our delivery dates, and periodically we will on that basis throw out a low bid.

It does not happen very often, but when it happens it is very, very important for us to do it. We have learned by experience that the low bidder is not always the cheapest source.

Representative WIDNALL. I can understand this. The reason I raised the question is that a number of times in my own district someone who has been low bidder has been thrown out on the bid, and sometimes a person who is third has been taken as the qualified bidder.

So competitive competition does not necessarily mean you take the low bidder?

Secretary McNAMARA. No. However, we split competitive procurement into two categories. This figure of 43.4 percent that you see here is made up of what we call formal advertising to the extent of 17.6 percentage points of the 43.4, and 25.8 percentage points of other price competition. In this category of price competition we reserve the right to throw out the low bidder.

There are items where design is so important that it is very, very difficult to say that the low price with the cheapest overall design is acceptable from the point of view of the Department.

But in the formal advertising process, we are required by the specifications of the bid to accept the low responsible bidder.

Chairman DOUGLAS. And your percentage of formal advertising—

Secretary McNAMARA. Has risen from 11.9 to 17.6.

Chairman DOUGLAS. So it has risen by about 6 percent?

Secretary McNAMARA. Yes, 6 percentage points, from 11.9 percent—almost 50-percent increase.

Chairman DOUGLAS. That is almost 60 percent.

Secretary McNAMARA. And this I know has been a matter of great interest to the members of this committee. We have given particular

attention to it for that reason, and I must say that the committee was right. It has paid off in tremendous savings.

Chairman DOUGLAS. I want to say Congressman Curtis has joined me in this urging more competitive bidding.

Representative CURTIS. Oh, indeed. This has been a great subject of our concern.

Secretary McNAMARA. I know it has. I know that from your written reports and also from your personal discussion with me. It came hard. The increase in formal advertising as a percentage of our total procurement has been the most difficult part of this program to comply with, for the very reason that you mention, Congressman Widnall, because it does require that we accept the low bid, and that carries with it a great danger if the low bidder proves incompetent for one reason or another.

So we have had to qualify the product of the low bidder in some cases, and that we have done, through what we call the two-step process.

Of the 17.6 points that represent procurement through formal advertising, 2.7 points of the 17.6 are what we call this two-step process, which we devised a couple of years ago to allow us to achieve the advantages of formal advertising while protecting us against fly-by-night companies who were not qualified really to carry on.

Representative CURTIS. A great deal of this has come through your breakouts of the prime contractors?

Secretary McNAMARA. I am glad you mentioned that. That is exactly right. I should have mentioned that before.

We have required that our prime contractors break out through their engineering drawings subitems that we can place on prime contract competitively through formal advertising, where possible.

And also, we have required that the prime contractor submit sets of drawings early enough in the process so we can bring other manufacturers into the bidding on the basis of those drawings.

Now, in that case we do it ordinarily not through formal advertising, but through a competitive bidding process.

Chairman DOUGLAS. Mr. Secretary, if the situation in Vietnam becomes more serious, or remains as serious as it is, and we are going to be under great pressures of time, do you think you can hold to this percentage in view of the pressure of time?

Secretary McNAMARA. I was about to comment on that in a moment. My answer is a qualified "Yes." I realize that the competitive procurement process takes more time in some cases than a noncompetitive process. But, in most instances, our inventories are sufficient to allow us to take that time, and we propose to do so. The result is that I have asked that any significant shift from a competitive to a noncompetitive basis of procurement receive the prior written approval of Mr. Ignatius, my Assistant Secretary, Mr. Vance, my Deputy Secretary, or myself, before it is authorized, because I do not wish to give up under the guise of urgent conditions the tremendous gains that we believe we have made in the last several years in this procurement program. I think this should be frozen into the Department and become an established part of it, and I don't want to see it disappear at the present time.

Chairman DOUGLAS. Good.

Representative CURTIS. Could I comment further here? This is to me the main thrust, to assist small business. Part of this breakout, I would observe, directly assists this area. At least our studies have shown that the incidence of small business participation goes up as advertised bidding over negotiated bidding goes up. Would your studies conform to that?

#### SAVINGS FROM COMPETITIVE BUYING

Secretary McNAMARA. Yes, I think that is true, and it is particularly true when the prime contractors are given an incentive to introduce more competition into their subcontracting, and this we have done also, and particularly in the subcontracting we are finding more and more competition, which means drawing on more and more small business firms.

To resume, we shifted \$2.6 billion of our procurement from non-competitive to competitive contracts at an estimated average savings of 25 cents on each dollar shifted, and from that we have saved about \$641 million in fiscal 1965. I show below some of the recent examples of such shifts, and the savings that resulted therefrom.

(The table referred to follows:)

*Examples of procurement shifts and resultant savings*

Item	Non-competitive unit price	Competitive unit price	Percent reduction	Savings on recent procurement
Power control box.....	\$1.50	\$1.11	26	\$214,838
Extendible earth anchor.....	75.43	52.25	30	231,800
Radio set (AN/PRC-47).....	4,370.87	2,797.67	36	1,296,317
R-1051 receiver.....	24,473.00	11,750.00	52	4,016,718
Portable ship instrumentation package.....	795,777.00	595,987.00	25	399,554
Bomb fuze, M-905, tail assembly.....	18.06	15.14	16	168,797
Power supply (PP-2058/ULA-2(V)).....	1,238.59	834.10	32	27,118
Shroud, steering control module (SP GAX-5766).....	750.00	538.00	28	27,560
Doppler navigation radar (AN/APN-153 (V)).....	2,924.00	1,567.00	46	4,221,135

Secretary McNAMARA. Thus far in the current fiscal year, the level of competitive contracting has held near or above the record level of fiscal year 1965. And this despite the emphasis on increased procurement for South Vietnam. But with respect to the chairman's question of a moment ago, I must caution that much of the procurement associated with our southeast Asia effort will be, essentially, additions to ongoing contracts and, therefore, may not qualify as competitive procurements. Nevertheless, we have no intention of relaxing our efforts in this area, and I am hopeful that 1966 will see as high a level of competitive procurement as did 1965.

#### "TOTAL PACKAGE" CONTRACTING

One of the most encouraging developments in this area of increasing competition in our procurement during the last year has been the evolution of the "total package" contracting concept which we have recently applied to the C-5A transport aircraft program. This is a transport aircraft which, as you know, will carry about a quarter of a million pounds, something on the order of 3,000 miles. It is a tremendous airplane. In my judgment, the C-5A award represents a

major breakthrough in contracting techniques. Heretofore it has proved most difficult to avoid sole-source procurement of major weapon systems such as missiles or aircraft which require extensive development effort. The development contractor, having already amortized large engineering and tooling costs in his development program usually has such a great advantage in bidding for the production contract that meaningful competition, for all practical purposes, is impossible. Furthermore, in these large, technically complicated projects, contractors are often prone to propose unrealistically low prices on the development phase when we have some competition, with the expectation of making their profit on the production contract. Under the new "total package" concept, however, a single competitive contract is awarded covering not only the development but also production and system support for a specified time period.

In the case of the C-5A, the airframe contract covers the development, test, and production of 58 aircraft, with specifically priced options for 57 more, and a formula priced option for another 85. The engine contract parallels the airframe contract. There was intense competition among our airframe and engine manufacturers for these contracts. Three of the largest airframe manufacturers and the two largest engine contractors survived the preliminary competition and participated in the final competition. We finally chose one airframe contractor and one engine contractor and awarded to the two contractors work totalling about \$2 billion for the development and production of this aircraft. I think it was probably the largest single development and production contract ever awarded at one time.

#### "THE ORDEAL OF THE PLANE MAKERS"

Representative CURTIS. Mr. Secretary, could I interrupt just to ask this one thing. There is an article which appeared in Fortune magazine in December 1965, "The Ordeal of the Plane Makers," which seems to describe this very thing. I just wanted to know whether you had read this, and whether in your judgment this is a good exposition of this?

Secretary McNAMARA. I frankly have not read it, but I will be happy to do so and give you an opinion on it.

Representative CURTIS. I would like to have it put in the record at the end of the testimony here. (See p. 56.)

(Comment on the article referred to was supplied by the Department and appears on p. 63.)

Secretary McNAMARA. I would say this. There is no question but what they went through an ordeal, and when you are bidding on a major contract, the airframe manufacturers' share of the \$2 billion contract was about \$1.3 billion and the engineer manufacturers' share was the balance—it is an ordeal, there is no question of that—

Representative CURTIS. I think this is a complimentary article.

Secretary McNAMARA. I would also say it is a very profitable venture for an efficient manufacturer, because I want to emphasize that while we are putting intense pressure on defense industry, and while we are shifting billions per year of contracts from non-competitive to competitive procurement, and still additional billions from cost plus to fixed price or price incentive contracts, all of which

is an ordeal for our defense manufacturers, we also are insisting that we increase the profits of efficient manufacturers at the same time that we penalize inefficient manufacturers. And by this emphasis on incentives we insure that the efficient producer has an opportunity for a reasonable return on his investment, while protecting the Department by insisting, as I say, that an inefficient producer be penalized in the future in the way he has not been in the past.

In the past there was a level of profit that was very small dispersion around the median. The range was very small, and it simply meant that inefficient and efficient producers received essentially the same profit rate, and as a matter of fact because profit was so often awarded on the basis of cost, the higher the cost estimate the higher the absolute profit. We have sought to get away from that, as I say, by increasing the percentage of contracts awarded through a competitive process, by shifting from cost plus to fixed price and price incentive, and by insisting that a contractor who did not perform effectively suffer a loss or no profit.

Both the aircraft and engine contracts of this C-5A award employ flexible incentive features which, by holding out the possibilities of higher profits, are designed to induce the contractors to assume more responsibility for cost overruns, thereby increasing the incentive for cost reduction. The contracts, of course, are written so as to limit the Government's liability if they have to be terminated before completion.

Representative WIDNALL. Mr. Chairman, might I ask a question at this point?

#### RENEGOTIATION OF CONTRACT

Chairman DOUGLAS. Yes.

Representative WIDNALL. Does this in any way change the ability of the Government to renegotiate a contract?

Secretary McNAMARA. No, it does not. Of course, under the Renegotiation Act, renegotiation applies regardless of the form of the contract and applies to the total profits of the firm. This in no way changes that possibility.

Representative WIDNALL. The formula you are suggesting now you say is to sort of give the incentive to higher profits. They look for the higher profits and they end up by renegotiating and losing the higher profits, don't they?

Secretary McNAMARA. No, because the Renegotiation Board takes account of the efficiency with which a contractor performed the contract, and allows higher profits for a more efficient producer. So I think that this will be quite compatible with the renegotiation standards. And the contractors are very pleased with this opportunity. We have a means of discussing it periodically with them, and I found no criticism of this emphasis on incentive for high performance. American business firms, at least those we deal with, are quite prepared to assume the responsibility for relating profit to performance. We have not given them an opportunity to do so many times in the past.

The main elements of the total package concept are also being extended to the major subcontractors. Being committed to overall target costs and performance specifications before completion of the detailed design, the major subcontractors, as well as the prime con-



tractors, have great incentives to design for more economical production, higher reliability and greater ease of maintenance.

In a significant departure from traditional shipbuilding practice, the Navy, too, is now applying the total package concept to the construction of fast deployment logistic ships. This is a total change in ship procurement procedure. Interested bidders were requested last December to submit their qualifications and a formal request for proposals is scheduled to be issued late this spring. Later, in the summer, two or three successful bidders will be selected to conduct a 6-month study of the program. Contract definition, which involves the design, should be completed by the spring of 1967 and negotiation on the total procurement package should begin in the summer.

Bidders for these ships will be asked to submit costed proposals to meet performance and reliability standards, rather than detailed ship characteristics or material specifications. By avoiding rigid specifications and requiring the bidders to guarantee their cost estimates and ship performance proposals, we hope to provide them with a strong incentive to engineer and design for maximum efficiency. The final contract award will cover the design, construction, and selected support aspects of a fleet of these ships. By employing a multiyear contract, and taking advantage of "learning curve" economies, we should be able to reduce construction costs considerably as well as obtain a highly desirable degree of standardization in this class of ship.

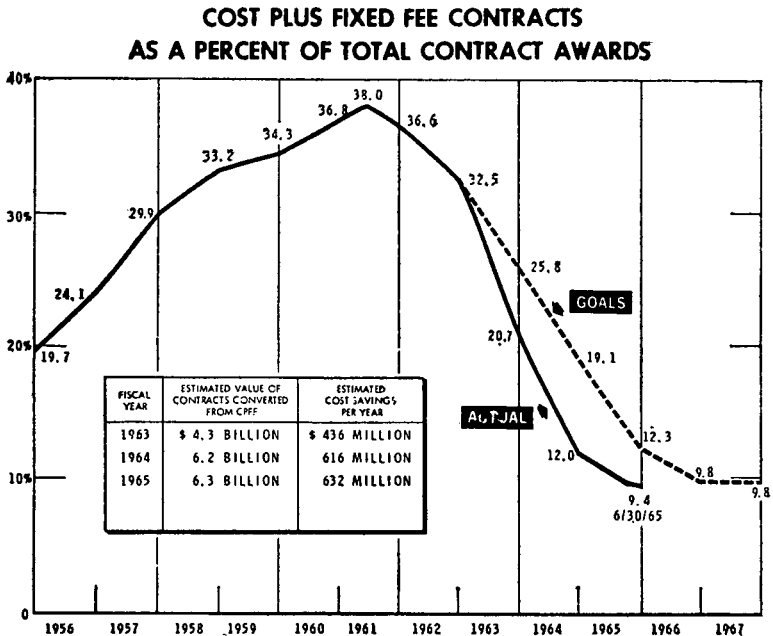
I think it is fair to say that our construction costs for this kind of ship which in some ways is comparable to commercial ships, have far exceeded commercial costs. This was because of particular material specifications or design specifications we inserted in the program. Here we are saying to our shipbuilding industry, we want ships that will do certain things, move at certain speeds, carry certain bulk tonnages, obtain certain efficiencies in loading and unloading, and we want the best possible design to do that. We ask you to prepare that design, to tell us what it will accomplish, to certify that it will, to stake your profit on accomplishing that, and to bid a total price for a given number of ships, including the design. This they are doing.

The Air Force is presently planning to develop and procure the short range attack missile (SRAM) under the "total package" concept and the Army may employ a modified version of it for the advanced aerial fire support system. As we and our contractors gain more experience with this new method of procurement, we may be able to widen its use considerably.

The second major objective under "Buying at the Lowest Sound Price," as I mentioned earlier, was shifting from cost-plus-fixed-fee to fixed price and incentive contracts.

A contractor's motivation for good management and tight cost control usually varies in direct proportion to the degree of risk he bears. CPFF contracts, being virtually risk free, provide no such motivation. In contrast, fixed price or incentive contracts offer strong inducements for managerial efficiency because they impose serious financial penalties on the contractor who exceeds his cost estimates, defaults on his delivery schedule, or who fails to meet the performance specification. As shown in the chart below, in 1956 the cost plus

contracts were about 19 percent of our total. They doubled in relation to other contracts between 1956 and 1961, rising to 38 percent, as you can see by the peak of the curve in the following chart. We have reduced them to 9.4 percent.



Chairman DOUGLAS. Mr. Secretary, I think this is a magnificent performance. I have read most of the reports on specific contracts made by the General Accounting Office, and those reports in a large majority of instances were leveled against ways which had crept in because of the cost-plus-fixed-fee contractor.

Secretary McNAMARA. Many, many of them have emphasized that. You are quite correct.

Chairman DOUGLAS. It is not quite as bad as cost-plus-percentage of cost contracts, which we had in the First World War, but almost as bad.

Secretary McNAMARA. Yes, and the contractors had no incentive to minimize costs, and it was not that they were sloppy. It is just that in a very real sense the trite phrase "Necessity is the mother of invention" is correct. And as we provided incentive to the contractor, and as it became necessary for him to either reduce costs or reduce profit, he found ways to reduce cost.

The conversion of these contracts amounted to about \$6.3 billion in 1965, and resulted in savings of about \$436 million in that year.

Representative CURTIS. Mr. Secretary, just one thing to be certain. On these you may have time deliveries, and I just assume throughout that the schedules have been met, too.

Secretary McNAMARA. Yes. Well, the incentive contracts normally put a premium on meeting a time delivery schedule.

Representative CURTIS. That is right, yes.

Secretary McNAMARA. And in the event that schedule is not met, the profit is reduced according to the original terms of the incentive.

Representative CURTIS. I felt certain that was so, but I wanted to make the record clear on that.

Secretary McNAMARA. Yes, that is correct. And again it is true that performance in terms of delivery and in terms of reliability so often correlates directly with the performance in terms of cost. It is the contractor who meets his cost objective that also meets his time schedule, and correspondingly it is the contractor who fails to meet his cost objective who usually fails to meet the delivery schedule.

To continue: Now that contracts entailing higher risks for the contractor predominate in our procurement, we are seeking ways to eliminate some of the administrative controls heretofore required under CPFF contracts for the Government's protection. These controls will be eliminated on an individual contractor basis, depending on the degree to which he has assumed the cost risks on his current contracts.

In addition, we are extending our contractor performance evaluation program, which centrally records the past performance of major contractors in meeting their commitments, i.e., delivery schedules, technical specifications, and costs. As I reported last year, our procurement offices are required to evaluate these records before selecting a contractor for a new development project, and before negotiating fees on noncompetitive contracts. We are now planning to use this information wherever applicable.

#### BUYING AT LOWEST SOUND PRICE

A third section under "Buying at Lowest Sound Price" has to do with multiyear procurement. This year for the first time, savings resulting from multiyear procurements are being included in our cost reduction program. By insuring longer production runs, we enable the contractor to avoid annual startup costs, thereby making it possible for him to offer us lower prices. In fiscal year 1965, the first full year of this effort, savings from multiyear contracts totaled \$67 million. Shown below are some recent examples: There is a fertile field for saving here that we have hardly tapped up to the present time.

(The table referred to follows:)

*Examples of savings resulting from multiyear procurement*

	Unit price		Percent reduction	Savings on recent procurement
	Single year	Multiyear		
Truck ¼-ton, M-151A1 less engine.....	\$2, 293	\$2, 035	11	\$1, 419, 000
Digital data computers (CP-624B/USQ. 20V) ..	170, 060	125, 000	26	
General purpose bomb (MK-81, model 1 empty).....	101. 34	87. 37	14	537, 845
Wing tank and pylon assembly.....	912	844	17	314, 160
Pylon assembly.....	1, 967	1, 547	11	292, 320

#### REDUCING OPERATING COSTS

Secretary McNAMARA. The third major area of saving has to do with "Reducing operating costs." In 1965, through this category of action, we realized savings of about \$1.1 billion. The first and by

far the most important section of this program has to do with terminating unnecessary operations.

Because the defense program is greatly influenced by changes in the international situation and in military technology, frequent and, at times, drastic shifts in requirements for weapons, manpower, and facilities cannot be avoided. Even while we have been steadily increasing our military strength, many existing military installations have become surplus to all foreseeable peacetime and wartime needs. These facilities must be closed if the defense program is to be managed efficiently and waste eliminated.

Although the impact of scientific and technological progress on weapons is generally well understood by the American people, not so well understood is its effect on our requirements for military facilities. Yet, the very fact that radically new weapons are continually replacing old ones means that we must often build new specialized facilities even though existing facilities become idle.

The impact of technological change on our installation complex goes very deep, affecting not only the operational facilities but also training, support, maintenance, and supply facilities. The depth and scope of this impact is well illustrated by the shift from manned bombers to strategic missiles which has taken place over the last 5 or 6 years. At the end of fiscal year 1961 we had about 2,500 strategic bombers and tankers compared to about 100 strategic missiles. By the end of this fiscal year, July 1966, we will have about 1,300 bombers and tankers and almost 1,500 missiles; and during this same period we phased out some 180 Atlas and Titan I missiles, which became obsolete. Such a major shift in weapons was bound to have a major impact on the required base structure; and the same kinds of changes, although to a lesser extent, have been taking place in the other services.

In addition, the improvements in logistics management which both you and we have been striving toward, in themselves, result in reduced requirements for supply and maintenance facilities.

It was in recognition of these changes that the Defense Department in 1961 undertook a comprehensive, systematic review of all of its thousands of major and minor military installations around the world. These installations were examined category by category—the Army's supply and distribution facilities, the military ocean terminals, the naval shipyards, the Strategic Air Command base structure, the Air Force's supply and maintenance depots, et cetera. In each case, the facilities excess to our present and foreseeable requirements, including all emergency and mobilization needs, were identified and scheduled for closure or reduction.

Let me give you just one specific example to demonstrate the way in which these studies were carried out. In 1960 the bulk of the Air Force's supply and maintenance workload was being performed by nine major depots—this was the year in which the phaseout of the B-47 force began. Since that time, the total workload of these depots has declined very sharply and is projected to decline still further. Depot stocks, for example, declined from about 3.2 million tons to about 2.4 million tons by end fiscal year 1964, and a further reduction to about 1.8 million tons is projected by fiscal year 1970. The number of maintenance personnel (which is a good measure of the maintenance workload) declined from 57,000 to about 45,600 during the fiscal year

1960-64 period and is projected to decline to about 44,500 by 1970. In the light of these trends and on the basis of a detailed study of its depot needs over the balance of this decade, the Air Force concluded that five depots would provide all the warehousing required and more than enough maintenance capacity. Accordingly, a year ago last November we decided to close three depots, in addition to the one closed in 1963. The closing of these three depots will free almost 4,300 acres, eliminate about 7,500 positions, and save about \$86.5 million annually when completed.

The present status of the program to terminate unnecessary operations—on a “when completed” basis—is shown below. We have taken 852 actions to close or to substantially reduce bases or installations around the world. We released 1,752,378 acres of land. That is over 2,738 square miles of land. We have made 66 industrial plants available for commercial use. We have eliminated over 200,000 job positions, and this will result, when completed, in savings of about a billion and a half dollars per year.

Chairman DOUGLAS. Mr. Secretary, this is something that has been needed for a long time, and I think you have been the first Secretary to have the courage to put it into effect. Am I right in my understanding that a good many of the Navy yards were established in the days of sailing ships, when the distances in days between the Navy yards was relatively great, because the speed of the ships was low?

Secretary McNAMARA. Yes, sir; that is true. Many of the Navy yards go back into the early part of the 19th century, and one as I recall into the 18th.

Chairman DOUGLAS. And isn't it also true that many of the Army posts were established in the days of the Indian wars?

Secretary McNAMARA. Yes, that is definitely true, and it is necessary to—

Chairman DOUGLAS. The Indians are no longer a menace to the internal safety of the United States.

Secretary McNAMARA. We think not and believe not.

Representative CURTIS. Mr. Chairman, at this point let me join in your observation, because this has been a very difficult thing to do politically. I wish the press would note this. They did not note it the last time it came up. It is perfectly true that Senators and Congressmen will speak up when a base is being closed in their district, and indeed they should. But the bulk of the Members of both the House and the Senate, I would observe, have supported your position. I certainly have. I think that it did require political courage, but there were many that were backing you. I notice what you are going on to state about the economic adjustments. I think you have done a magnificent job there, and this shifting, Mr. Chairman, is one of the major areas that the Joint Economic Committee must be concerned about. So I want to join with the chairman in commending you in this regard.

Secretary McNAMARA. I much appreciate the compliment you have given me. Obviously, I could not have done this without the support and as a matter of fact at the insistence of two Presidents, nor could I have done it without the support of a majority of the Members of Congress. I think it is entirely appropriate that our citizens should

question actions of this kind that so directly affect their lives and livelihood, and it is entirely appropriate that their representatives in Congress should question them, and it is incumbent upon us to be able to answer those questions. We recognize that responsibility, and I hope we can carry it out. So I expect, if not criticism, at least questions, in connection with base closings. But I do believe that our citizens must understand that when they advance their parochial interests at the cost of our Nation, that they are sowing the seeds of inefficiency which become frozen in our system, and which translates into declining rates of productivity, and which ultimately cause basic balance-of-payments problems of the kind that other nations have faced over time, and which ultimately will substantially reduce our standard of living and in the process of doing so affect our security. In any case, I consider it my responsibility, as I know the Congress considers it is theirs, to act in accordance with the national interest and not the interest of a particular citizen or geographic area, and it is that standard that we seek to apply in connection with the analysis of our base systems.

Representative CURTIS. Mr. Secretary, I think that we might also suggest to our citizens, particularly the eager chambers of commerce, and so forth, that when they seek to have military installations come into their communities, in a sense they are taking on a burden, because this by nature is a business of rapid obsolescence. I think if they will be a little more cautious in the beginning, then the efforts that you now are making to move with the times will be better understood.

Secretary McNAMARA. I could not agree with you more. A military installation by its very nature is an unstable element in an economy.

Representative CURTIS. That is right.

Secretary McNAMARA. And no section of our country should base its economy on that, if it can possibly avoid it.

Representative CURTIS. Amen.

Secretary McNAMARA. Nor should we place an installation in an area in which it is the foundation of the economy, unless it has a reasonable prospect of staying there for some extended period of time. And then after that, we have the responsibility which I am going to describe now, in connection with the closing of such installations, to handle those closing actions in a way that softens and minimizes the impacts on the community and the individuals affected.

#### DISPERSAL OF FACILITIES

Representative WIDNALL. Mr. Secretary, how important is the factor of dispersal of facilities? Now we have been very, very fortunate as a country. We have never been under attack, under any major attack. We can concentrate our facilities and close those facilities to the point where we are counting on just two, three, or four major places, that subject to an attack could cost us dearly, where we did not have the dispersal that we have today. Now, how important is that factor?

Secretary McNAMARA. Well, I would say that dispersal of some elements of our system is absolutely fundamental to our security. A good example is the MINUTEMAN system, and dispersal therefore is taken account of in locating military facilities or weapons.

On the other hand, dispersal in nine depots in the Air Force instead of five provides no security whatsoever, because what we have done is actually concentrate all the activity associated with one system, such as an F-105 maintenance system, in one depot, and we might just as well put that in with another system in the same depot. So I think that the 852 actions that we have taken so far either to eliminate or substantially reduce base activity have not in any way reduced our security. If anything, it has increased it, because it has concentrated some inventories and allowed us to operate with far greater efficiency as a result.

I checked on the efficiency resulting from one of these moves. The move was not made to increase efficiency, but it did do so, because it put like activities together and raised the level of efficiency as a result.

Representative WIDNALL. Where do we find in the budget or in your own accounting the cost of the actual moving from one facility to another?

Senator McNAMARA. In accounting for these savings, which we state to be \$1.4 billion when the actions are completed we take account of the moving cost, to be sure that we are not making a saving which is more than offset by the moving costs. The actual cost of moving, by the nature of the congressional appropriation process, appears in the several appropriation accounts. In construction, for example, there may be provided funds at one base to construct facilities necessary to duplicate those that are being closed in another base. Those new construction costs are not segregated in the appropriation accounts, but they are integrated when we consider the question of whether we should or should not close the first installation, and we offset them against those costs and report them to the Congress periodically.

Representative WIDNALL. I have in mind, I believe, in closing Brooklyn Navy Yard—some of the things that have taken place there are going to be moved to Bayonne?

Secretary McNAMARA. Yes.

Representative WIDNALL. Now does the new appropriation just cover the additional construction cost, or would that cover also the cost of moving equipment from one place to the other?

Secretary McNAMARA. It would cover the cost of moving equipment to Bayonne in that case, and when we estimated the savings to accrue from the closing of the Brooklyn Navy Yard, we took account also of the cost of moving its personnel, many of whom were moved to Philadelphia, for example, and we offset that against the potential savings to be sure that there was a net saving to the Government after taking account of all moving expenses.

Representative WIDNALL. Thank you.

#### ECONOMIC IMPACT OF BASE CLOSURES

Secretary McNAMARA. Obviously some of these base closures could have a serious impact on the employees and communities involved, at least in the short run. But it should be clear to all Americans that the continuing obsolescence of existing military facilities is one of the inescapable consequences of our efforts to keep our Armed Forces modern and equipped with the latest products of our extensive research

and development program. No one would argue that we should retard the progress of military technology simply because it causes obsolescence. Yet, when technological progress makes facilities obsolete, there is frequently resistance to closing them, even though we have no further military requirement for them. Keeping unneeded facilities open not only results in inefficiency and unnecessarily increases the cost of national defense, but, even worse, deprives our Nation of the use of very valuable human and physical resources—without contributing one iota to our military strength.

The dislocations created by the onrush of science and technology are not unique to the Defense program. Indeed, their effects on the economy as a whole are not much different, either in kind or degree, from those which periodically take place as a result of changes in civilian demand or technology, or the exhaustion of natural resources in a particular geographic area. Under our free enterprise system, competition in the marketplace eventually forces the reallocation of resources from older, less efficient uses to new, more efficient uses and no business firm can long survive unless it responds promptly to these market pressures. The ability of our system to adjust to such changes quickly is one of its greatest strengths and is one of the major factors contributing to the growth and efficiency of our economy. And I think this is the important point. But while the Nation as a whole benefits from the prompt shift of resources from old to new uses, the employees and the communities directly involved may, temporarily, be adversely affected. From the viewpoint of both social equity and economic efficiency, these people should not be asked to bear by themselves the full burden of such adjustments unaided. The Defense Department, therefore, has adopted the policy of assisting in such adjustments to the extent that the law permits and its own capabilities allow.

With respect to its own employees who are dislocated by the closing of military installations, the Defense Department bears a special responsibility, both as an employer and as an agency of the Government. To assist in carrying out this responsibility, the Department has adopted a seven-point program, making full use of all existing legislative authority. Under this program we guarantee a new job opportunity to each displaced employee. This is the foundation of the program:

To carry that out we operate a nationwide system for matching displaced employees with job vacancies;

Restrict hiring of new workers, giving preference to displaced employees;

Facilitate the placement of dislocated employees by the temporary waiver of job qualifications and by retraining programs;

Protect the income of displaced employees during the period of transition;

Reimburse a displaced employee for the costs of moving to a new job in the Defense Establishment; and

Make full use of the "job finding" resources of the U.S. Civil Service Commission and the State employment offices.

This continuing employment opportunity program, which we started in the latter part of 1963, is designed to protect the job security of the Department's employees, to minimize personal hardships resulting from defense program shifts, to preserve the talents and



experience of our work force, and, over the long run, to improve the climate for change itself.

Every Defense Department career civilian employee dislocated by a base closure is offered another job opportunity, and wherever possible, he is given a choice of location. For example, between January 1, 1964, and December 1, 1965, over 59,000 of the 74,600 civilian employees affected by base closures, reductions, et cetera, were placed in other positions. (Military personnel affected by such actions are simply reassigned to other duties, a completely normal feature of service.)

A centralized referral activity has been established to aid in this process in Dayton, Ohio. Here, with the help of a computer, displaced employees reported to the center are matched against job vacancies elsewhere in the Defense Establishment. The releasing activities provide the center with information on the skills of the employee and the grades and locations he is willing to accept. Every 2 weeks the center sends to each defense installation at locations for which displaced employees have indicated a preference, a "stopper list" of the job categories for which these employees qualify. The installations receiving these lists must stop hiring new employees to fill vacancies in those job categories, and report their requirements to the centralized referral activity. An exception is allowed where the vacancy is filled by a transfer of a displaced employee within the same military department or defense agency. In the first 10 months of the operation of the referral activity, about 9,000 registrants were placed in new jobs. Since excess military installations are phased out over extended periods, in some cases as long as 3 to 4 years, there should be sufficient time for normal personnel turnover to provide new job opportunities for displaced employees.

To facilitate further the placement of employees affected by base closings, the Defense Department has secured the agreement of the Civil Service Commission to waive, temporarily, qualification requirements for certain positions and to permit on-the-job and off-the-job training of such employees to help them qualify for those positions.

Chairman DOUGLAS. Mr. Secretary, I think this is the greatest miracle of all, to be able to get the Civil Service Commission to modify its stringent rules.

Secretary McNAMARA. They have been very cooperative with us, Mr. Chairman, because they realize that it is through this device that we reduce the social cost of these dislocations. Instead of throwing a man out of work and perhaps placing him in a situation where he has to stay out of work for a year or two, until he can find another job, we maintain him constantly employed, and there is a tremendous reduction in what I call social cost to our economy as a result. They see that, and they are very happy to cooperate.

Chairman DOUGLAS. Well, may I say I extend my congratulations to the Civil Service Commission. It indicates that there is hope for everybody.

Representative GRIFFITHS. I am sure it won't affect your Department as much, Mr. Secretary, but it is my understanding that in some areas where an establishment has been required to rid itself of some female employees, it has done so by offering transfers, who, of course, could not take the transfer. It then has fulfilled the require-

ments. Those women quit and that took care of the problem. So that it resulted in one type of treatment if the husband worked for the Federal Government, and another type of treatment if the wife worked for the Federal Government; where the husband worked, he was not required to move away and his wife held her job in the city or whatever else she might have been doing. But if the wife worked for the Federal Government, she was required to quit. I assume that you would not have as much a problem, but in Internal Revenue it is quite a problem.

Secretary McNAMARA. There may have been some instances of that type in the Defense Department. I don't know of any. We would not under our policies expect that to happen, because I have insisted that in offering a guaranteed job opportunity—and I think we are the only Department in the Government that does this as a matter of fact—but in offering a job opportunity guarantee, that we offer it first in the local geographic area, if it is at all possible, and do this without regard to whether it is a married woman or a man, because no matter whether it is a man or a woman, to move from that geographic area to another area is costly. It is costly for us since we pay the moving expenses, and it is very, very costly in heartbreak and financial means to the individual involved. So we try to avoid it. Obviously it isn't always possible. And in some cases, individuals turn down the opportunity because they do not wish to move.

#### EMPLOYEES LOSSES ON BEING TRANSFERRED

Representative CURTIS. I wish we could get our Internal Revenue Code updated on moving expenses. You and other employers give moving expenses that we then don't grant as a tax deduction.

Secretary McNAMARA. Yes; I know that is true. An even greater problem, I think, is associated with loss on disposal of property under these circumstances. It is very, very serious.

Representative CURTIS. Yes.

Secretary McNAMARA. And as you will see in a moment, we are seeking to develop a formula to take care of it, but we have not been very successful yet.

Representative CURTIS. Some of our companies, like the Bell System, have worked out some excellent arrangements in this.

Secretary McNAMARA. Yes. They get very complicated though, and it is even worse for us, and particularly so when we go into a community, as we have in certain parts of the Far West, where practically all the houses in the area are owned by Defense Department employees, and if we begin to procure those, we end up owning 4,000 or 5,000 houses in an area for which there is no economic use. On the other hand, would it not be better for us to own them than for individuals who can't afford to accept the loss to be saddled with it? And this is the problem we are seeking to solve at the moment.

#### TRAINING DISPLACED DOD EMPLOYEES

Agreement has also been reached with the Department of Labor for the training of displaced Defense Department employees for non-Federal jobs under the Manpower Development and Training Act

of 1963, as amended. Over 500 applications for such training have been submitted by employees of the New York Shipyard, and we hope many more of our displaced employees will take advantage of this opportunity to gain new skills.

To minimize the financial impact on displaced employees who have to move to new defense jobs at other locations, the Department now pays the moving expenses. Moreover, career employees may now continue to receive their present pay for a period of 2 years when they accept a lower paying job or move to a lower pay rate area.

Finally, the Defense Department is utilizing fully the resources of the Civil Service Commission in locating job opportunities in other Government agencies and those of the State employment services in finding jobs in industry for displaced Defense Department employees.

To ease further the financial burden on displaced employees, the President last year requested new legislation, applicable Government wide, which would provide for severance pay and more liberal payments of moving costs. The severance pay provision has already been enacted. An eligible employee can now receive 1 week's pay for each year of service up to 10 years and 2 weeks' pay for each year of service beyond 10 years, plus an additional 10 percent of severance pay for each year he is over 40 years of age, providing the total does not exceed 1 year's pay. This was a long-needed reform and it will be very helpful to us.

As I mentioned a moment ago, we are also developing a plan for the implementation of section 108 of the National Housing Act of 1965, which authorizes, but does not appropriate, funds to permit the Secretary of Defense to acquire private dwellings owned by Defense Department personnel affected by base closures.

We hope to have legislation before the Congress that will appropriate funds for that purpose.

Experience to date with the new employment opportunity program has been very encouraging. I am going to report now on 42 base closures, relatively few in number, but in total they displaced 6,600 career civilian employees. As you can see in the table below, all of the employees were offered job opportunities, fulfilling the guarantee. Seventy-three percent accepted a new position or a transfer to a new location in the same position, and only 906 out of the 6,600 declined the job offer; 748 more retired.

(The table referred to follows:)

*Experience with the employment opportunity program at 42 bases where closing action has been completed*

	Employees	
	Number	Percent
Moved to another Department of Defense job .....	4,096	62.1
Placed in another Federal job .....	595	9.0
Placed in a non-Federal job .....	153	2.3
Declined job offer, transfer, or placement assistance .....	906	13.7
Retired or resigned .....	748	11.3
Other (death, military service, etc.) .....	102	1.5
Total employees affected .....	6,600	100.0
Separated without job opportunity .....	None	None

Of the 4,844 employers who accepted a new position (or transfer), about 72 percent made the change at the same or higher grade (or job level); a substantial proportion of those who accepted lower grades did so without loss of pay due to the "pay saving" policy I mentioned earlier.

#### OFFICE OF ECONOMIC ADJUSTMENT

The Defense Department's efforts to help its own employees do not necessarily solve the problems of the communities affected by base closures, especially when the new jobs offered are at other places. We recognize and accept our responsibilities to these communities to do what we reasonably can to alleviate the impact. It was for this reason that I established, in March 1961, the new Office of Economic Adjustment. As you know, this office provides, on request, advice and technical assistance in the development of economic recovery programs and helps mobilize the resources of the entire Federal Government in support of these efforts. Since its establishment, the Office has helped some 53 communities in 29 States. In order to provide these communities with a maximum amount of time to do their planning and prepare for the necessary adjustments, we announce these closings at the earliest possible time and where feasible, we extend the closing over a period of years.

#### NONDEFENSE USES OF CLOSED BASES

The land and facilities released by the base closing program can usually be turned to productive nondefense uses, to the ultimate benefit of the community and the entire economy. In the little table that follows I have shown the disposition of military property released during 1961-65, and you can see the number of locations affected, the number of acres disposed of for civil airports, schools and universities, parks and other recreational purposes, private industry, small commercial concerns, and for federally owned reserved lands and other Federal agencies.

(The table referred to follows:)

*Disposition of military property released during 1961-65*

New use	Number of locations	States	Acres
Civil airports.....	23	13	6,478
Schools and universities.....	98	34	11,617
Parks, recreation, community development.....	78	32	39,486
Private industry for production.....	37	18	12,647
Individuals and small companies.....	171	39	55,472
Federally owned reserved lands.....	6	3	627,785
Other Federal agencies.....	57	25	36,336

Secretary McNAMARA. In many cases, the facilities released can be converted directly to civilian industrial use. You may recall one of the earliest examples in this category, the Navy Ordnance Plant at York, Pa. The closure of this facility, which employed some 1,100 skilled workers, was announced in January 1963, to be completed in mid-1965. The General Services Administration invited competitive bids to acquire the entire plant and complete ongoing work. The American Machine & Foundry Co. purchased the facility, hired the work force without loss of retirement pay or other benefits and has

since increased employment by over half of the original number. This does not happen in every case, but it is sufficiently typical to be illustrative of the net value to the community and to the company of a well supervised program of base closure and property disposal.

#### BUILDING THE TAX BASE

Representative CURTIS. That gets back in the tax base, too.

Secretary McNAMARA. I should have mentioned that. Exactly, it becomes tax producing instead of tax consuming, and it is an extremely important development in the interests of, as I say, both the local communities and our Nation.

Last year I told you that we were trying to make a similar arrangement for the disposition of the Naval Ordnance Plant at Macon, Ga. Last November this facility was sold by the General Services Administration to Maxson Electronics Corp. under the same conditions and with the same employee privileges as the York transaction. Employment at this plant is already back to the presale level.

A somewhat different example is the Army Signal Depot at Decatur, Ill. At the time the closure of this facility was announced, there was much concern in the community as to the future of the local economy and efforts were made to delay or forestall the closure. Yet, by 1964 the community was urging us to speed up the closure so that they could capitalize on industrial interest in this 200-acre property, and we accommodated them by moving out some 3 months earlier than originally planned. Now, the General Electric Co. and the Firestone Tire & Rubber Co. employ well over 50 percent more civilians than were formerly employed by the Army.

Chairman DOUGLAS. Mr. Secretary, may I underscore that example? When the announcement of the closure was made public, I was held partially responsible for it by the officials of Decatur, and I am very happy that I was able to stand my ground on this. What has happened has been exactly what you say. These two companies have moved in. There is more employment than was there before. The jobs are stable and not subject to the potential gully taken of military necessities. The Congressman from Missouri is completely correct. They are on the tax base now. Revenues of the city have increased. They now think this closing is the best thing that ever happened to them. And they are inclined to believe that they originated it.

I want to say in this connection that Mr. Steadman who was formerly head of your Office of Economic Adjustments, was tremendously valuable, and I hope his successor is of the same stamp as Mr. Steadman.

Secretary McNAMARA. Yes, Mr. Don Bradford has succeeded Mr. Steadman and I think you will find that communities where he has worked have the same high regard for him that they had for his predecessor, Mr. Steadman.

A more recent case is the Erie Army Depot at Port Clinton, Ohio, which employed about 1,700 civilians and is now phasing out. Already, one modern large warehouse has been sold to Uniroyal and we have every reason to expect that the rest of this facility will be sold for industrial use; and I would not be at all surprised if private employment eventually exceeds the original 1,700 level.

Many installations, with their large barracks areas, dining halls, and shop and classroom facilities are uniquely suited to the expanding educational needs of the Nation. The following are several examples of surplus military facilities being used for this purpose:

Lake Charles, La.: McNeese State College has expanded onto the former Chennault Air Force Base, establishing a new school of engineering.

Salina, Kans.: A regional vocational school had already been established on the former Schilling Air Force Base and special legislation authorizing the establishment of a statewide technical institute has been enacted by the Kansas Legislature.

Waco, Tex.: Waco, Tex., is a particular interesting case because there the James Connally Air Force Base is scheduled to lose its two major training missions late this spring. Through the foresight of the State government and with the assistance of the Department of Defense, the entire base is rapidly being converted to a statewide technical institute under the supervision of the Texas A. & M. University. The first technical training course started on January 11 with some 70 students. Facilities have been made available to the university for an anticipated resident enrollment of over 500 in September of this year. The 867 family housing units at the base are scheduled for use by faculty and students and other personnel associated with the technical institute.

It is a magnificent example of what can be done by cooperation between the State and local communities and the Federal Government. Instead of fighting us, they strove to cooperate and find an economic use for the area, and between the two of us we did it, and did it in time to permit educational use to be phased into its military use.

As I mentioned, the Job Corps program of the Office of Economic Opportunity has been another important user of surplus defense installations.

Large urban Job Corps centers for men have been established at eight former defense installations, including Camp Kilmer, N.J.; Camp Parks, Calif.; Camp Atterbury, Ind.; Camp Breckinridge, Ky.; and Camp Gary, Tex. At Camp Gary, for example, there are now in excess of 2,500 Job Corps trainees working and learning to fit themselves into our complex society.

Smaller defense installations are being used for other Job Corps activities, such as the conservation camps at the former Cottonwood Air Force Station, Idaho, and the former Dickinson Air Force Station in North Dakota.

One of the major requisites for community economic progress is the availability of modern air transportation facilities. The large investments in airfield facilities found at surplus Air Force bases are of unique value in this regard. The following are some examples:

Albuquerque, N. Mex.: The transfer of the airfield portion of Kirkland AFB to the city of Albuquerque has assisted that community in its efforts to update and modernize its terminal and other airfield facilities.

Salina, Kans.: The Salina Municipal Airport is small and unsuited for modern jet aircraft. The runways and aircraft parking areas at the former Schilling Air Force Base represent a major resource since they can handle any aircraft now in use. With the assistance of the Federal Aviation Agency and GSA, plans have been developed to

close the present municipal airport and relocate all commercial flying to the Schilling complex.

Harrisburg, Pa.: The airlines using the present Harrisburg-York State Airport are converting to jet equipment this year. There was some fear that the inability of the present airport to handle these jets safely would affect airline service into the Harrisburg area. The planned closing of the nearby Olmsted AFB has given the State an opportunity to update its airfield resources at minimal cost. The State now intends to take over the Olmsted airport as a modern regional jet facility, beginning this calendar year—some 3 years before the final closure of the Air Force base.

Because many military installations are communities within themselves, containing industrial, residential, and community facilities, they lend themselves readily to a number of community needs. Following are two of the most recent examples of multiple use. They are relatively complex situations, in which large installations are turned over to a variety of public and private sectors usage, all for the benefit of the communities.

Olmsted Air Force Base, Middletown, Pa.: This depot, which employed in excess of 11,000 civilians, is being phased out over a 4-year period, from June 1965 to June 1969. Through the joint efforts of the Department of Defense, the Commonwealth of Pennsylvania, and local citizens, plans have been developed for productive civilian use of the entire base, beginning early in the phaseout period. The major features of the plan involve:

(1) Industrial use of two modern warehouses (660,000 square feet). The Defense Department has expedited the movement of supplies from these warehouses so that they can be made available for civilian use during 1966.

(2) Use of the office building on the base (some 199,000 square feet) as the center of a new Pennsylvania State University campus. University staff personnel have already occupied a portion of this building and are planning for classes to begin this fall.

(3) Use of the family housing (141 units) on the base for graduate students and junior faculty members.

(4) Use of the airport facilities as a modern regional jet airfield, beginning this calendar year, as I noted earlier.

Dow Air Force Base, Bangor, Maine: These B-52 and fighter-interceptor facilities are scheduled to be vacated early in 1968. The community of less than 40,000 has taken vigorous steps to use this base for—

(1) A modern university campus for first- and second-year students at the nearby University of Maine;

(2) A modern jet airport;

(3) An industrial park designed to attract air-associated industries; and

(4) A residential community for college personnel and low-to medium-income families (the base has 1,010 military family housing units).

#### CONSOLIDATION AND STANDARDIZATION OF OPERATIONS

Significant operating economies, usually accompanied by increases in efficiency, can often be obtained when common support activities are consolidated. During the past year we have continued to seek out

such opportunities, and to improve the operating procedures of the Department as a whole.

#### ANNUAL DSA SAVINGS OF \$59 MILLION

The consolidation of common supplies and services in the Defense Supply Agency continues to yield impressive savings. In fiscal year 1965, DSA achieved savings in annual operating costs of \$59 million. This saving, before taking account of the reduction in inventories, was made possible by the greater efficiency in operations.

#### CONSOLIDATED CONTRACT ADMINISTRATIVE SERVICES

As reported last year, we are consolidating under single management the 150 offices and 20,000 people involved in the administration of defense contracts after their award. The contract administration field offices of the military departments are being merged into 11 Defense Contract Administration Services regions under the management of DSA.

#### DEFENSE CONTRACT AUDIT AGENCY

We have now also established a Defense Contract Audit Agency which will bring under 1 management the audit activities previously performed by some 3,600 people in the 3 military departments. Up to 5 percent of these positions will be eliminated when this Agency becomes fully operational a year from now, although that was not the major objective of the move.

Savings in departmental operating expenses are usually the product of the thousands of actions taken at the lower management levels to improve administrative procedures. Many of these changes produce annual savings of less than \$100,000 each, and many stem from individual employee suggestions. Total savings reported in fiscal year 1965 were \$186 million.

#### LOGISTIC SUPPORT SERVICES

The final category of cost reduction projects is concerned with the logistic support services of communications, transportation, maintenance, the management of real property, et cetera. In fiscal year 1965, savings totaled \$390 million as a result of our actions in these areas. As a group, these activities offer a very great potential for future savings and we intend to exploit this potential intensively.

#### SAVINGS GOAL OF \$6.1 BILLION IN 1969

Mr. Chairman, as I noted last year, our contractors, who account for well over half of the dollars spent for defense, are making a major contribution to our cost reduction program. They are cooperating far in excess of what we expected, to their advantage and to ours. It is these efforts plus the efforts of almost literally hundreds of thousands of military and civilian individuals in the Defense Department which led to the \$4.8 billion savings in 1965, and which I am confident will make possible the achievement of our goal of \$6.1 billion in 1969 and every year thereafter.



I am very grateful again, Mr. Chairman, for the help we have received in this program from you and the members of your committee, not only in the investigation you have carried on before I entered the Government in 1961, but in your continuing support and continuing suggestions since that time.

I would be very happy to try to answer your questions.

*Department of Defense cost reduction program*

[Dollars in millions]

	Estimated savings to be realized in— <sup>1</sup>				
	Fiscal year 1963	Fiscal year 1964	Fiscal year 1965	Fiscal year 1966	Fiscal year 1969
<b>A. Buying only what we need:</b>					
1. Refining requirement calculations:					
(a) Major items of equipment <sup>2</sup> .....	\$90	\$487	\$1,060	\$747	-----
(b) Initial provisioning.....	163	218	368	184	-----
(c) Secondary items.....	481	643	626	799	-----
(d) Technical manuals.....		10	9	8	-----
(e) Technical data and reports.....		2	6	2	-----
(f) Production base facilities.....	35	14	18		-----
2. Increased use of excess inventory in lieu of new procurement:					
(a) Equipment and supplies.....		57	169	75	-----
(b) Idle production equipment.....	1		4		-----
(c) Excess contractor inventory.....	18	14	8	3	-----
3. Eliminating "gold plating" (value engineering).....	72	76	204	83	-----
4. Inventory item reduction.....			83	72	-----
<b>Total, buying only what we need.....</b>	<b>860</b>	<b>1,521</b>	<b>2,555</b>	<b>1,973</b>	<b>\$2,591</b>
<b>B. Buying at the lowest sound price:</b>					
1. Shift from noncompetitive to competitive procurement:					
Total percent competitive <sup>3</sup> .....	37.1	39.1	43.4	-----	-----
Total amount of savings.....	\$237	\$448	\$641	\$414	-----
2. Shift from CPEF to fixed or incentive price:					
Total percent CPEF <sup>4</sup> .....	20.7	12.0	9.4	-----	-----
Total amount of savings.....		\$100	\$436	\$599	-----
3. Direct purchase breakout.....		\$5	\$6	\$2	-----
4. Multiyear procurement.....			\$67		-----
<b>Total, buying at lowest sound price.....</b>	<b>\$237</b>	<b>\$553</b>	<b>\$1,150</b>	<b>\$1,015</b>	<b>\$1,170</b>
<b>C. Reducing operating costs:</b>					
1. Terminating unnecessary operations.....	\$123	\$334	\$484	\$551	-----
2. Consolidation and standardization:					
(a) DSA operating expense savings <sup>5</sup> .....	31	42	59	57	-----
(b) Consolidation of contract administration.....			95	95	-----
(c) Departmental operating expense savings.....			186		-----
3. Increasing efficiency of operations:					
(a) Improving telecommunications management.....	80	131	118	129	-----
(b) Improving transportation and traffic management.....	24	7	35	35	-----
(c) Improving equipment maintenance management.....		65	117	108	-----
(d) Improving noncombat vehicle management.....	2	18	24	21	-----
(e) Reduced use of contract technicians.....		20	26	27	-----
(f) Improving military housing management.....	6	13	16	14	-----
(g) Improving real property management.....	23	25	46	27	-----
(h) Packaging, preserving, and packing.....		7	8	3	-----
<b>Total, reducing operating costs.....</b>	<b>289</b>	<b>757</b>	<b>1,119</b>	<b>1,067</b>	<b>\$2,205</b>
<b>D. Military assistance program (MAP): Total MAP.....</b>			<b>19</b>		<b>125</b>
<b>Total program.....</b>	<b>1,386</b>	<b>2,831</b>	<b>4,843</b>	<b>4,055</b>	<b>6,091</b>

<sup>1</sup> Includes certain 1-time savings not expected to recur in the same amounts in future years.

<sup>2</sup> In addition fiscal year 1962 "requirements" for major items of equipment were reduced by \$24,000,000,000. In fiscal year 1963, the Army reduced 1964 pipeline requirements by \$500,000,000.

<sup>3</sup> Fiscal year 1961 was 32.9 percent; fiscal year 1965 actual was 43.4 percent; savings are 25 percent per dollar converted.

<sup>4</sup> First 9 months of fiscal year 1961 was 38 percent; fiscal year 1965 actual was 9.4 percent; savings are 10 percent per dollar converted.

<sup>5</sup> Excludes DSA inventory drawdown without replacement of \$38,000,000 in fiscal year 1962: \$262,000,000 in fiscal year 1963; \$161,000,000 in fiscal year 1964; \$51,000,000 in fiscal year 1965.

<sup>6</sup> Amount reflected in the original fiscal year 1966 budget.

Chairman DOUGLAS. Thank you very much, Mr. Secretary.

I think your record has been magnificent, and I do not believe it can be stressed too much to say this apparently has been done along with an increase in the combat effectiveness of our forces rather than a reduction, because I know that the vultures are gathering not to devour you but to try to curb your style.

Now you were kind enough, the Department was kind enough to make a statistical report to us, which I am going to ask unanimous consent to have printed as a part of our staff report.<sup>2</sup> We have gone over that, and there are a number of features of that report which I think are significant, and I would like to have you confirm or deny some of the things which I felt have been developed.

Now, according to the analysis which I have, defense expenditures as a percentage of the gross national product are down 1.1 percent since last year.

Am I right on that?

Secretary McNAMARA. Inclusive of the fiscal 1966 supplement—well, first, let me go back to 1965. I take it that is the year you were speaking of.

Chairman DOUGLAS. Yes.

Secretary McNAMARA. Defense expenditures in fiscal 1965 were 7.3 percent of gross national product compared to 8.4 in 1964, down 1.1 percentage points.

Chairman DOUGLAS. Percentage points?

Secretary McNAMARA. Percentage points, exactly.

Chairman DOUGLAS. Which would be a reduction of about 12 percent?

Secretary McNAMARA. That is correct.

Chairman DOUGLAS. Now I do not know what the cost of the operations in Vietnam have been, and I do not know that anyone can precisely estimate them, but I formed the rough judgment that as of last year that the costs of the operations in Vietnam have been largely met by economies in the operation of the Department.

Am I right?

#### ECONOMIES IN FISCAL YEAR 1965 EXCEEDED VIETNAM COSTS

Secretary McNAMARA. Well, I think that they, as we anticipate them, in 1966 fiscal year and 1967 will be larger than the economies in the Department, but in fiscal 1965 the economies substantially exceeded the cost of Vietnam. But even in fiscal 1966 and 1967, because of the economies in the Department, and because of the actions in past years, the defense expenditures as a percentage of gross national product in each of those years will be less than in 5 of the past 6 years.

Chairman DOUGLAS. That is a very impressive record.

Do I understand that the total value of procurement is down by almost \$1 billion?

Secretary McNAMARA. Yes; that is correct, in fiscal 1965.

Chairman DOUGLAS. And that the use of long stocks has increased by about \$164 million?

<sup>2</sup> Staff materials, 1966.

Secretary McNAMARA. Yes.

Chairman DOUGLAS. To about \$1.4 billion now?

Secretary McNAMARA. Yes; exactly.

Chairman DOUGLAS. That formally advertised procurement is up 4 percentage points, or by about one-quarter?

Secretary McNAMARA. Mine shows 3.1 percentage points, and about 22 percent. I may be in error, Mr. Chairman.

Chairman DOUGLAS. Now Congressman Curtis mentioned the fact that if you advertise bids, it results in a greater diffusion of the bids and the smaller companies get a larger percentage of the total business because they have a chance to get in, instead of being excluded by the supply officers who tend to deal inevitably with a restricted group of companies.

Am I right that the figures show that the 100 largest companies, while they received virtually 69 percent of the prime contracts, were down 4½ percentage points from last year, which again would be around 7 percent?

Secretary McNAMARA. Yes; I believe that is correct, Mr. Chairman, and I think the figures also show that, over the past 5 years, the percentage of contracts going to small business has increased.

Chairman DOUGLAS. In other words, if you give a chance to competition, small business firms turn out not to be as inefficient as they are sometimes said to be?

Secretary McNAMARA. Yes.

Within certain limits I do not think size can be taken as a gage of efficiency.

Chairman DOUGLAS. I understand.

Now there has been a good deal of publicity given to shortages in ammunition. Do you want to make any comments on that?

Secretary McNAMARA. Yes; I would like to, Mr. Chairman.

I think that such comments as have appeared in the press relating to shortages in ammunition or equipment in South Vietnam completely misstate the case.

As I tried to point out in my statement, any large supply system, at times and in some places, has inventories below planned levels. That is the purpose of having an inventory in the first place. If at some times inventory levels did not fall below plan, there would be no need to carry an inventory. So that is exactly why you have them. And I would not want to indicate that we do not have some inventories some places in the world below our planned levels. Of course we do.

But the point is that no amount of money would have prevented that. These discrepancies result from maldistributions and misestimates of requirements which are common in large supply systems.

The point I want to make is, and I think it is an extremely important point, that no such shortage has impacted on operations at any time in South Vietnam, and when I say that, I use the exact words of General Johnson, the Chief of Staff of the Army, when he reported to me on January 10, approximately 2 weeks ago, following his return from South Vietnam. And, that statement of General Johnson, the Chief of Staff of the Army, is supported by similar statements from General Westmoreland, the commander in Vietnam, by Admiral Sharpe, the commander in the Pacific under whom General Westmoreland functions and by General Wheeler, the Chairman of the Joint

Chiefs of Staff who reported to me exactly the same statement, and who confirmed it this morning in an executive session before the Senate Armed Services Committee based on his trip to Vietnam in December and earlier this month.

Chairman DOUGLAS. I am very glad to get that, because while your program has saved billions of dollars to the taxpayers who have also been going through an ordeal in the past, and has not been adverse to the contractors, nonetheless that inevitably arouses certain opposition among certain groups, and every effort is made to discredit the program, and from time to time stories are issued saying that our fighting men lack bullets and so forth.

Of course you are going to pay continuing attention to ammunition, are you not?

Secretary McNAMARA. Yes.

As I mentioned earlier, my primary responsibility is not to reduce costs. It is not to increase efficiency. It is to insure a maximum degree of combat-readiness consistent with the threats we face, and that is the objective to which I devote the majority of my time.

This cost reduction program is a labor of love, and it happens to be consistent with, and I believe contributing to, achievement of the primary objective of combat-readiness. But I want to emphasize with respect to Vietnam that no other nation in the history of the world has ever done what we have accomplished in providing forces and their logistical support in Vietnam.

When the Vietcong built up in the spring, and when their monsoon offensive demanded on very short notice a quick response by the United States, we put 100,000 men in Vietnam 10,000 miles away from here in about 120 days. We now have approximately a quarter of a million men in combat in southeast Asia, including the naval forces off the coast of Vietnam. They are operating over 1,500 helicopters, which is substantially in excess of the total operational helicopter inventory in the Army General Purpose Forces worldwide when we came to the Department a few years ago.

They are using a new type of combat division, the Air Cavalry Division, the concept of which developed from a committee we set up under General Howze about 2 years ago. The division was not even organized until July of this year. It moved to Vietnam in September. It deployed to combat in October. It carried out the famous operation in the Ia Drang Valley in November.

The air operations in that area this month will drop over twice the bomb tonnage of the average month of the Korea war. We are prepared to expand air operations in southeast Asia. We are prepared to add to our deployments there, if that becomes necessary.

As the President has said, we will send what our combat commanders request and when they request it. And I want to emphasize we are doing it all without the callup of a single man from the Reserve, without material controls, without price controls, without wage controls, and with defense expenditures planned for fiscal 1966 and fiscal 1967 at levels which, in terms of percentage of gross national product, are lower than in 5 of the past 6 years.

And as I said in repeating General Johnson's words when he reported to me upon his return from South Vietnam 2 weeks ago, without any shortage which has impacted on combat operations at any time.

Chairman DOUGLAS. My time is up.

Congressman Curtis?

Representative CURTIS. Mr. Secretary, I want to again say I am very much impressed with the report that you have given us, updating your last report to us. I am now going to move to areas of further concern.

DEFENSE CONTRACT ADMINISTRATIVE SERVICES

First before I do that, let me say that I was very impressed with the briefing that your people gave us on the development of the Defense Contract Administration Services, and inasmuch, Mr. Chairman, as we actually held hearings, or rather had this recorded, I wonder if it would be appropriate to make this a part of this record.

Chairman DOUGLAS. Unless the Secretary objects.

Secretary McNAMARA. I would be happy to. (See appendix 8, p. 305.)

Representative CURTIS. I did have one question, not realizing at the time that you were going to be here, that I directed to you by letter. I was a little surprised to find that you had not put the procurement officers in this new Defense Contract Administration Services.

Would you care to comment now or would you prefer to comment in answer to the letter?

Secretary McNAMARA. I would rather answer it more directly in reply to your letter. But let me say that we put a few of the former procurement responsibilities in it, but we have not put the procurement responsibilities or officers for the major weapons systems in the new service.

Representative CURTIS. Then I had a misunderstanding.

I would not expect that necessarily to be so, although certainly the testimony did reveal that the liaison between your contract service officer and your procurement officer is very close. And of course they of necessity would be.

But in thinking over when you originally suggested to this committee, I think a year or two ago, that you were contemplating this, and the committee was very much impressed I believe by this development, I myself had thought that perhaps the procurement officers would be put in this new service too.

Secretary McNAMARA. Let me check exactly how far we have gone. I have forgotten the numbers and the specific responsibilities we have put in those and we have left out, and I will reply to your letter.

(Further information was subsequently received for the Secretary of Defense and is reprinted below:)

THE SECRETARY OF DEFENSE,  
*Washington, D.C., February 2, 1966.*

HON. THOMAS B. CURTIS,  
*House of Representatives,*  
*Washington, D.C.*

DEAR MR. CURTIS: This is in response to your letter of January 19, 1966, and supplements my remarks before the Subcommittee on Federal Procurement and Regulations on January 24, 1966. When the Defense Supply Agency (DSA) was established, it was our aim to consolidate the procurement and supply functions pertaining to items which were common to the military departments. One of the steps in this direction was the assignment to DSA of the responsibility for

purchasing common items. The establishment of the contract administration services activity was compatible with our objective to place in DSA common support-type functions.

To the extent that DSA has both purchasing and contract administration responsibility for certain items, it is proper to say that the purchasing function has been assigned, together with the contract administration function, to DSA. The DSA contract administration services responsibility also extends to certain contracts which have been entered into by the Departments for items for which purchasing responsibility has not been given to DSA. This is the consolidation of the departmental geographic contract administration offices which provide support at plants not assigned to the Departments. This consolidation eliminates the duplication that would otherwise result from the necessity for the Departments to establish overlapping capabilities for inspection, production surveillance, and other contract administration functions. Finally there are weapon systems and particular types of contracts for which neither purchasing nor contract administration responsibility has been assigned to DSA. The necessity for close technical monitoring by the requiring activity and the importance of these major systems and categories of contracts to military effectiveness have justified the retention of purchasing and contract administration responsibility in the Departments. Certainly, until the assumption by DSA of its newly assigned contract administration responsibilities has been in effect for a reasonable period, we must be cautious in the assignment of additional responsibilities involving critical systems procurement. We intend to remain alert, however, to the possibilities for further adding to the purchasing and contract administration responsibilities of that agency.

I have asked Mr. Ignatius to respond to your letter to Captain Ryder of January 13, 1966, by giving you available data on the categories of contracts which are not assigned to DSA for the performance of contract administration services.

Sincerely,

ROBERT S. McNAMARA.

(See appendix 8, p. 305.)

#### RENEGOTIATION ACT

Representative CURTIS. All right, thank you.

Now we have the extension of the Renegotiation Act up again this year I believe before the Ways and Means Committee. I think in the body of your testimony here you have relieved me of a lot of the concern I had. I felt that our procurement officers and contract service officers would tend to use the Renegotiation Act as a crutch instead of developing the very techniques that you have developed here. But not to anticipate you, let me ask it this way rather than assume any conclusions.

Have you had under review whether or not you feel that the Renegotiation Act is serving an actual purpose?

Secretary McNAMARA. Well, it is under review at the present time. I actually have not received the report of those who are studying it, and I would rather not take a position on it at the moment.

Representative CURTIS. No, I would not ask you to. You have answered my question.

Secretary McNAMARA. Yes, it is definitely under review, and before the Department takes a position, the results of the study will come to me and I will examine them. I have not looked at it myself since it has not required any position from me for several years, and I would rather examine the study before giving you my opinion.

#### USE OF GSA BY DOD FOR COMMON USE ITEMS

Representative CURTIS. Now one of the things this committee has kept in its sights is the utilization of the GSA for common use items,

and you did not report on that. I wonder if you could supply us with an up-to-date report.

Secretary McNAMARA. Yes. I can tell you my policy.

Do not buy a single thing in the Defense Department you can get anybody else to buy for you as efficiently because we are not in the business of buying. We are in the business of fighting, or being prepared to fight.

It has been my experience over the past 5 years that when we turned something over to GSA to procure for us, they did an excellent job.

Representative CURTIS. I was going to ask that question, whether or not in the Vietnam situation you found that GSA was responsible.

Secretary McNAMARA. I have not had a single complaint brought to my attention. It does not mean there may not be some problems, but not a single problem has been serious enough to have been brought to my attention. And I would not expect them to be. They are quite competent to procure the types of items that we have turned over to them for procurement.

#### PROCUREMENT OF CLOTHING

Representative CURTIS. I saw an item in the newspaper to the effect that some clothing manufacturers were not accepting the contracts that were needed for procuring certain clothing.

Is there anything to that?

Secretary McNAMARA. Mr. Ignatius, who I think is here, might want to comment on that.

Representative CURTIS. I will wait to ask him.

Secretary McNAMARA. I have not heard of any. (See p. 56.)

Representative CURTIS. I have one other specific question that has to do with this problem of single source procurement.

At the time of the strike of the Olin-Mathieson Co. in East Alton, statements were made that this was the only source available for this particular kind of ammunition. Is this true, and if it is, how does this conform with our policy to try to develop multiple sources?

Secretary McNAMARA. Well, it is true that it was the single source, but it is also true that I personally made the decision not to request application of the Taft-Hartley Act, because since it was a single source, we had carried an adequate inventory to carry us through any reasonable strike, and I did not feel that it was desirable for the Government to intervene in the free collective bargaining process by asking for the application of Taft-Hartley under those circumstances, and therefore I did not, and the strike did not affect our ability to supply our combat operations, nor did it unduly draw down our inventories.

Now since that time we have put in a second supplier, but not as a protection against strikes, but simply because forecasts of possible requirements indicated that would be desirable.

Representative CURTIS. My comments were that that is another reason for trying to develop diversified sources.

Secretary McNAMARA. Yes.

Representative CURTIS. Rather than a single source. But I did not know what the full facts were.

## THE GOVERNMENT IN BUSINESS

Now another big area of concern to this committee has been Government in business. We are trying to develop guidelines as to the proper role of Government as a producer or manufacturer or operator of many of its programs, and one reason of course is the fact that this private participation becomes part of the tax base. I might say the Hoover Commission recommendations directed a lot of attention to this.

This committee has been asking the Bureau of the Budget for some time to update its policy statement on this. I think it is numbered 60-2 and this policy statement has been forthcoming for several years, but it still is not out. This is a big problem in defense. (See p. 208.)

One of the first things I did in the Congress on the Bonner subcommittee was point out some of these areas. Take examples like coffee roasting, rope making, paint and so on. I wonder if you would, because of our concern, state what your views are now or would you rather wait for the Budget Bureau's overall statement of policy?

I assume you are in consultation with them.

Secretary McNAMARA. Yes, although I have not actually discussed that regulation, a new draft of it, with them to the best of my knowledge for months, if not years.

But my own belief is that we in Defense should not be carrying on any activity that the private sector can handle for us. Now of course there are qualifications, because in wartime it may be necessary for us to operate a Navy Yard in order to carry out emergency repairs on vessels, and provide certain skills that a private naval yard or a private shipyard could not be expected to carry between wars.

But I would simply say that reflects the standard I apply; that in that instance the private shipyard could not provide the service we need. But with that qualification, I do not believe we should carry on activities that the private sector can provide for us equally well, and we are not, to the best of my knowledge, carrying on such activities.

Representative CURTIS. I know we agree on the principle, but in order to make it meaningful, so we can find out where there is disagreement or agreement, these guidelines should be developed. You and I have had correspondence, for example, on the commissaries, and I only use it as one example. (See p. 196.)

Here I felt that the guidelines were established. At least we had something you and I could argue about. But when you do not have guidelines, and this is what we are hoping that the Bureau of the Budget will develop, it makes it pretty difficult to take specific cases and follow the progress of this matter.

Secretary McNAMARA. Surely.

## COMMISSARIES AS A FORM OF PAY

Well, I think the commissaries are a good example, although perhaps almost a unique example, of the kind of activity that we are carrying on that should be considered for the private sector.

In that particular instance, the commissaries, by tradition are selling below commercial prices, and the difference between the commissary



price and the commercial price is recognized as an element of compensation.

Representative CURTIS. That is right.

Secretary McNAMARA. And it is now agreed within the Government it will be taken account of as an element of compensation when making compensation studies. So I think there we have met the standard of not doing anything that can be performed by the private sector equally well.

Representative CURTIS. Well, I have always said that I would take that into consideration, but that it had not been, or at least there was some confusion as to whether it had been taken into consideration. I would still say, though, that this should be changed by law. I think it was the guidelines that we did establish which gave no justification for keeping the commissaries open here in the Washington, D.C. area, for example. The law I think was quite clear.

Secretary McNAMARA. I think you are absolutely right. It is entirely a question of tradition, and as I say, in this case I do not think there can be any dispute about the way in which we are handling the difference between commercial price and commissary price.

Now it is handled as an element of compensation. It is recognized in all of our statistical studies as an element of compensation, and in a very real sense I think the question is not primarily one of should we be running the commissaries. It is really not a very important matter.

The much more basic question is: Is that the best way to pay compensation? I think there is a lot of question on that issue.

Representative CURTIS. Yes, that is one, and my time is up. But the other is, this illustrates the point of what should the military or any governmental agency be doing directly.

Secretary McNAMARA. Yes.

Representative CURTIS. Or what should it contract out?

Secretary McNAMARA. There is no question but what the guidelines are desirable. I will do everything I can to speed their development.

Chairman DOUGLAS. Senator Proxmire.

Senator PROXMIRE. These hosannas have become kind of embarrassing, I suppose, to you.

Secretary McNAMARA. They do not come very often, Senator Proxmire.

Senator PROXMIRE. Before this committee I think they certainly come often, not only from the standpoint of economy but these details you have mentioned, in which you show this perfectly immense increase in combat readiness and power and capability to respond and so forth are very, very impressive.

The fact that you could do this and at the same time save money, I think if we leave Vietnam aside and apart, your testimony indicates that we are doing these things for a less aggregate amount than we were in 1960, or do I misunderstand?

Secretary McNAMARA. No, sir; the aggregate amount is up.

Senator PROXMIRE. Leaving Vietnam aside?

Secretary McNAMARA. Well, it gets rather complicated. The increase in the compensation level has been almost unbelievable in that period of time.

For example, in the fiscal 1967 budget, the payments to retired personnel and the increased compensation to military and civilian

personnel above the level of 1961 amounts to \$4.3 billion. If you take out Vietnam, and take out just that portion of the increase in compensation level, then I think your statement is approximately correct.

#### CIVILIAN PERSONNEL CUTS

Senator PROXMIRE. It is a remarkable showing.

I would like to ask something that I know you can answer, and although the question may sound hostile, it is not meant that way.

A year ago the President estimated that the Defense would cut 24,000 personnel.

Secretary McNAMARA. Civilian personnel.

Senator PROXMIRE. Civilian personnel, about 2½ percent.

Now you ended up increasing civilian personnel about 10 percent, and I wondered if you would give us an explanation of that.

Secretary McNAMARA. Increasing it in the budgeted level for fiscal 1967, but not in the actual.

Our actual as of the end of fiscal 1965, my recollection is it came down to just about the budgeted figure. But then we did two things.

First, and by far the most important in its effect on civilian personnel, was to substitute 58,000 direct-hire civilians in the fiscal 1966-67 budgets for 75,000 military jobs, believing—and I think we can prove—that we can replace 75,000 soldiers with 58,000 civilians. This in part is because by the very terms of the draft or our voluntary enlistments the soldiers are on hand for such a short period of time that, in addition to having one on the job, we have to have, let's say, a third of a man behind him being trained and being made ready to go on a job.

So when we cut out a military job, we cut out the one-third of a man behind him. The net is that we can take out 75,000 military, replace them with 58,000 civilians. This we have done. And that acted to increase the civilian total in 1967 over 1965.

Then, second, the expansion of about roughly 500,000 military jobs for the Vietnamese war has brought along with it a necessary expansion in civilian personnel.

Senator PROXMIRE. The figures that I see on page 398 of the budget just issued by the administration show an original 1966 estimate as of June of 950,000, and a current estimate for 1966 of 1,067,000, or an increase of 117,000.

Secretary McNAMARA. Yes. That includes the 58,000 civilians introduced after the 1966 budget was prepared, in order to substitute for the 75,000 military.

I have here, if the committee would like to have it in the record, an analysis of both the military and civilian personnel for 1966 that shows the shift of the 75,000. We reduced the military goal by 75,000, raised the civilian by 58,000, for a net saving as a result of that move of some 17,000 men.

Senator PROXMIRE. On the basis of your experience with this, would it be wise to make this reversible?

Secretary McNAMARA. No.

Senator PROXMIRE. In other words, if the Vietnam situation were over, would you return to the level of civilian personnel you had before?

Secretary McNAMARA. I would go back to the original 1966 goal plus the 58,000 civilians and minus the 75,000 military, for a net

reduction below the 1966 figures you have there for military and civilian combined of about 17,000 men.

Senator PROXMIRE. And how would it compare with the estimate, as of June 1966, which was 950,000?

Secretary McNAMARA. Well, give me the military estimate for the same date, let's call it  $x$ , so it is  $x$  plus 950,000, and the new figure would be  $x$  plus 950,000 minus 17,000. There is an absolute net saving as a result of this shift from military to civilian.

Senator PROXMIRE. Now you said the small business share was up in the last 5 years. Do you have figures for last year?

Secretary McNAMARA. I do have them but I do not have them here with me.

Senator PROXMIRE. Up or down?

Secretary McNAMARA. I would like to submit them for the record. I just do not remember exactly.

I know that over 1961 it is up, but I do not recall what happened in the last year.

(Information later supplied by the Department states that in fiscal 1965 the "small business" share of total prime contract awards was 20.3 percent; in fiscal 1964 it was 18 percent.)

#### USE OF PROCUREMENT TO MAINTAIN WAGE-PRICE GUIDELINES

Senator PROXMIRE. Now, because this committee is responsible for reports to Congress on the economy, I wonder if you could give up your idea of the role that the Defense Department plays in the manipulation of procurement to help maintain the wage-price guidelines.

I am thinking of steel, aluminum, perhaps leather eventually, et cetera.

Secretary McNAMARA. Well, I think that we can effect the wage-price guidelines in several ways.

One, by the degree to which we recommend increases in military and/or civilian compensation for Defense Department employees. Such recommendations as we make should be consistent with the guidelines.

Two, in the extent to which we put pressure on the economy, which pressure can be translated into actions designed to exceed the guidelines. For example, we cut back the authorized and appropriated construction budget for fiscal 1966 by just about 50 percent. About \$1.250 billion was authorized and appropriated. We have deferred indefinitely \$620 million of that construction program in order to reduce the pressure on construction labor in this country, which pressure, if not reduced, could have been translated into wage increases in excess of the guidelines.

We can recommend and have recommended reductions in stockpiles, Government-owned stockpiles such as aluminum, at times when, because of increased defense procurement, metals were falling into short supply, and had there not been a recommendation for a reduction in the stockpile, stockpiles that had been procured for exactly this purpose, the scarcity of metal could have led to price increases that would have exceeded the guidelines.

Senator PROXMIRE. In this aluminum area, for example, you think in terms of the supply-demand situation and the effect of defense

buying or selling on the price, rather than any idea of discipline or retaliation for action by individual companies?

Secretary McNAMARA. Well, without really discussing the specific aluminum situation, I would simply say that where we have a stock pile, in a situation where the metal or other material is in short supply, we can assist in the maintenance of the guidelines by releasing from the stockpile. And I think it is entirely appropriate that we do so.

#### DOD POLICY ON EMPLOYEE SAVINGS

Senator PROXMIRE. Do you follow any policy now, in view of the inflationary tendencies in the economy, of trying to persuade the very large amount of people you have in the Defense Department, both in the military and civilian personnel, to save a large proportion of their income?

Secretary McNAMARA. No.

Senator PROXMIRE. The kind of program we had during World War II. Would that be wise?

Secretary McNAMARA. With a few exceptions, we do not have any special voluntary savings program. We do give full support to the savings bond program, and I have urged our employees to participate fully and actively in that. But I have not urged them to do that recently any more than I have in the past.

It has been our practice to do that for 3 or 4 years.

We have put into effect special voluntary savings programs overseas, seeking to reduce the foreign exchange costs of defense operations. But we have domestically only the programs that are consistent throughout the executive branch of the Government.

Senator PROXMIRE. Do you think that it might be sensible to consider that now, in view of the inflationary pressures in the economy?

Secretary McNAMARA. It might be.

To tell you the truth, I have not given any thought to it, and I will be happy to do so.

Senator PROXMIRE. Then I am concerned about this: You demonstrate in your statement and elsewhere in your testimony a perfectly remarkable job of placing your personnel after you have closed installations. Now, this is easier to do when you are expanding the Defense Department, as you were.

As I say, you increased the number of people 93,000, and, of course, the civilian economy also is growing, and looking for personnel. Would it not be a great deal more difficult in a different situation that you might have in a peace period?

Secretary McNAMARA. It is more difficult in a contracting than in an expanding environment. But the environment was contracting during the period that I discussed in this statement, because I believe that our total civilian payroll numbered about 1,070,000 in 1962, possibly even 1963. And it went down to about 985,000 I would say, in 1965. And the period I discussed in my statement was the period prior to July 1965.

So we made those placements during a period of contraction. We were able to do it, of course, because even in a period of contraction there is a very substantial turnover each year, about 18 percent. And we used that turnover as an important tool to assist us in this placement period.

From now on when we are expanding our civilian personnel, as we will be doing between now and the end of this year, it will be much easier to place dislocated employees than it has been in the past.

Senator PROXMIRE. But in 1963 and 1964 you had an expanding economy and a diminution in unemployment.

Secretary McNAMARA. Yes, but the placements we are talking about here were in a contracting section of that economy, specifically in the personnel of the Defense Department.

Senator PROXMIRE. That would affect the number of people leaving the Defense Department for their jobs and so forth?

Secretary McNAMARA. Yes, but as you saw, we placed a substantial part of the personnel affected by base closings in other defense jobs and I think we can always do that, whether it be an expanding or contracting economy, just so long as we set up the procedures to insure that we do not hire a new person where we have a person that has been in our employ some time and well trained for the job.

It is those procedures that have been set up that make the system possible in either a contracting or an expanding economy.

Chairman DOUGLAS. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Secretary, I want to commend you for the very excellent statement you have given here today. I got a lot of good information out of it.

I am impressed particularly with the closing of bases and the dislocations that have been handled by your Office of Economic Adjustment.

#### FUTURE BASE CLOSINGS

You tell us that you have closed or reduced 852 bases. Are we correct in assuming that the bulk of them that are likely to be closed in the immediate future have been closed or reduced?

Secretary McNAMARA. Well, I keep thinking so, Senator Jordan.

A year ago November when we announced a series of actions that had associated with them reduction in costs of about \$500 million, I doubted that we would at any time in the near future find it possible to make similar savings by additional base closings. And yet in November of last year, November 1965, just 60 days or so ago, we came up again with a series of actions that had savings of \$400 million plus, associated with them. We were able to do this because in the intervening 12 months, between November 1964 and November 1965, we again went over our base systems, and flushed out these opportunities for saving.

Now to be quite frank with you today, I do not know where there is another \$400 million of savings associated with base closings that might possibly be announced in November of 1966, but I would hesitate to say that between now and then we cannot find a very substantial opportunity for further saving.

#### CLOSED FACILITY AT POCATELLO, IDAHO

Senator JORDAN. Mr. Secretary, several years ago in Pocatello, Idaho, we had a naval gunnery facility that was closed. It is still idle and unoccupied. Would you think that your Office of Economic Adjustment properly might direct its attention to this facility?

Secretary McNAMARA. We would be happy to, Senator Jordan. I do not know enough about the situation there to be able to give any opinion on whether we could interest a private corporation in use of it, or whether we might find some other defense use for it, but I would be very happy to look at it.

Senator JORDAN. I shall be in touch with your people.

Secretary McNAMARA. All right, sir.

Senator JORDAN. It is a very fine facility and it should be used.

Secretary McNAMARA. We would be very happy to do what we can to help.

Senator JORDAN. I am impressed, too, Mr. Secretary, with the reductions you have made in the amount of defense procurement that falls outside of competitive procurement practices. You estimate that 43.4 percent of our defense needs come under competitive procurement.

Do you anticipate that this percentage will be increased, or are we reaching a plateau?

Secretary McNAMARA. As you could see from the chart on competitive procurement we thought the plateau was about 40.5 percent. We are quite a ways above that now. (See chart, p. 15.)

We are concerned in the near future about maintaining the 43.4 percent because of the problems associated with Vietnam which I mentioned earlier. I think we will do very well in 1966 to hold to 43.3 percent.

It is my objective to do so. I think there is a pretty good chance of accomplishing that objective.

In future years I think we can go above it, although my opinion is not shared by some others. I think we can.

Senator JORDAN. You said that 25 percent of each dollar spent in noncompetitive procurement might be saved if it could be moved over into the competitive procurement category.

Secretary McNAMARA. Yes; I did, and we get that figure by examining each shift of a contract from noncompetitive to competitive, and adjusting the noncompetitive price for any changes in circumstances such as a higher volume on the competitive contract than the noncompetitive or something of that kind to be sure we do not overstate the savings, and then actually compare the old price to the new price.

The 25 cents in terms of our recent experience, if anything, understates the savings. I think it is closer to 30 percent in recent months.

Senator JORDAN. That is very good.

Now you have reduced by something over 600,000 the individual items from your inventory lists.

Secretary McNAMARA. We took out 600,000 items. I do not want to mislead you into thinking that it is a net reduction, because we also added some new items.

Senator JORDAN. Yes.

Secretary McNAMARA. But there was a net reduction in 1965 of 87,000 items. These figures are subject to a few qualifications, because of the technicalities of the data, but essentially that is what happened.

Senator JORDAN. What does the figure 632,000 represent?

Secretary McNAMARA. Those are items that were in the catalog or inventory lists of DSA and the services—specific stock numbers

which we removed because we were able to substitute a standard item in place of two specialty items, or something else of that kind.

We simplified the stock system by the extent of 632,000 items.

Senator JORDAN. I think you said too, although it is not in your statement, that there are presently over 3.8 million total items in the catalog.

Secretary McNAMARA. Yes, I did. I want to check that figure. That was from memory, but I think I am correct in saying that. (See p. 14.)

Senator JORDAN. This is a continuing study with you, of course?

Secretary McNAMARA. Yes, and to show you the trend that is developing, in 1961 there was a net addition of 235,000 items. In 1963 a net addition of 17,000. And last year there was a net reduction of 87,000. So a lot of progress has been made.

If you except the South Vietnamese period of conflict, I think that progress can continue.

Senator JORDAN. Mr. Secretary, I have heard the criticism that in order to achieve combat readiness in South Vietnam, we have had to rob some of our stateside defense units. Will you address yourself to that statement, please?

Secretary McNAMARA. Yes, I would be happy to.

We have not robbed them. Obviously we have transferred men and material from the United States to South Vietnam. Of course that was the purpose of maintaining the forces and the inventories in the United States. But I do not think it is appropriate or proper to say we have robbed them.

The statement is frequently made we have robbed units in Europe, for example. There it would be much more serious than saying we moved units from the States. Units are kept in the States in order to move to some foreign territory, but units are not kept in Europe to move to South Vietnam, and the fact is we have not moved units or equipment from Europe to South Vietnam, with but a handful of exceptions.

I have issued, or did issue many months ago, perhaps last April, instructions to all the departments that requires that any movement of units or materiel from Europe to South Vietnam receive the prior written approval of Mr. Vance or myself, and we have given such approval in only a handful of small unimportant cases.

The most immediate one that comes to my mind is that I approved the movement of five RB-66 aircraft, which are a special type of reconnaissance aircraft, from Europe to South Vietnam. But the magnitude of the movement is on that order. So I do not think it is correct to imply that our South Vietnamese deployments have been at the sacrifice of Europe, or, for that matter, U.S. units.

Senator JORDAN. Then I would assume we could meet the challenge of another one or two South Vietnamese situations, simultaneously.

Secretary McNAMARA. Well, without indicating how many, I can simply say that we can meet the challenge of more, and that the contingency war plans, which take account of multiple challenges and the capability of our potential opponents for facing us with multiple challenges have been supported by the necessary forces and equipment.

Senator JORDAN. Thank you, Mr. Secretary. My time is up.

Chairman DOUGLAS. Mrs. Griffiths?

Representative GRIFFITHS. Thank you.

I would like to ask you, Mr. Secretary, how do you estimate the demand for any particular item in Vietnam that is a perishable item or a hardware item?

Secretary McNAMARA. Well, in the case of a hardware item, the services have developed rates of expenditure based on prior combat experience, and they have varying levels of expenditure, depending upon intensity of combat.

We have built our inventories based on a certain number of days or weeks of very intensive combat, and a greater number of days and weeks of less intense combat, and have applied these expenditure rates to the number of forces that we anticipate putting in combat under varying contingency war plans.

We have added to that the necessary pipeline factors and inventory requirements, have examined the production flow in relation to the inventory levels and the possible expenditures, and based on that have determined our procurement program.

In the case of the fresh foods, I frankly don't know how they determine the detailed requirements or the extent to which they decide upon furnishing the troops an A-ration as opposed to a B-ration menu. At the present time most troops are being fed on the A-rations. This involves bulk fresh foods shipped primarily from the United States.

As a matter of fact, when General Johnson came back and reported to me January 10 and made the statement he did about no shortage having any impact on combat operations at any time, he added this statement: that when troops are being fed on A-rations involving substantial quantities of fresh foods, which fresh foods come from the United States, you can be absolutely certain that the logistical system is functioning.

This doesn't mean we didn't have a large backlog of ships awaiting unloading, because we did. But in passing, let me simply say that the backlog, including ships unloading and ships in the holding areas, amounting to about 122 in November was reduced to 81 on the 11th of January, compared to a normal of about 59, so the ship backlog which one hears so much about has been substantially cut.

But to answer your specific point, the commanders are serving the men a high percentage of their meals on A-rations, and how they determine what percentage to serve on A-rations versus B-rations, which has a lesser content of fresh foods I frankly don't know, but I will be happy to check it and let you know.

(Statement which follows was subsequently supplied by the Department:)

As a general rule, troops will be fed A-rations except when limited by operational considerations (e.g. combat) or logistical considerations (e.g. lack of refrigeration facilities).

Representative GRIFFITHS. Do you know how your method of determining the requirements, for instance, of hardware differs from what might have been in effect 10 years ago?

Secretary McNAMARA. Well, I would say the difference is in what I would call balance. Many times in the past the defense budget and the procurement sections of it have been developed against a financial ceiling of  $x$ , let's say \$44 billion, and then that \$44 billion was spread rather arbitrarily in some cases among the items to be produced.



Now we operate on the policy that there is no upper financial limit, but it is absolutely essential there be a balance in all elements of the program, and if we provide for 16 Active Army divisions, as we do, and as we did for 6 priority Reserve divisions, 22 divisions in total, there are expenditure rates for every item of equipment and every item of ammunition, for every one of those divisions, and there are assignments for every one of those in our contingency war plans.

In effect what we do is say we will have 22 divisions worth of men, and we will provide in the military personnel appropriations for that, and then we will insist that the procurement program buy 22 divisions worth of equipment, and that the Air Force provide in effect 22 divisions worth of close air support, and that the Military Air Transport Command provide 22 divisions worth of air transport capability. So we have a balance between all elements of the program. And I think that is the major difference between the basic policy affecting procurement today and what might have been applied in the past.

Representative GRIFFITHS. The inventory control system, too, would have some effect.

Secretary McNAMARA. Yes, the inventory control system is, I hope, better today than in the past, but it is far from perfect.

Representative GRIFFITHS. I would like to tell you that, during World War II, one afternoon we had had an order canceled on ammunition, which the next day was reinstated, and I was complaining because they didn't seem to know what they wanted. The general who was handling the operation explained the method of determining Army requirements. He told me that in World War I, for example, some kid out on the field fighting with five other people said to his sergeant, "Say, I need a blanket."

The sergeant wrote down one blanket, and then thought, "Gee, we had better get six," and as it went through each train of command, it was multiplied by the number of people that that person was responsible for, so that any order that came in, the general told me, was multiplied by anything from 20,000 to 500,000.

You could easily have divided any order, any requirement, by 100, and have come out with fantastic supplies for everybody. So that I would assume, and I think the general was probably correct, that as much as price control, and as desirable as it is that you use your purchasing powers to reduce the costs, I would think that the ability to estimate with some accuracy what you need has by far the greatest effect on maintaining this economy on an even keel, supply the Defense Department, and still do it all without wage or price controls.

Secretary McNAMARA. Yes, I think that is an important point. And the result is that because it is important, I have here in front of me—and I have insisted that each of the Service Secretaries and the Chiefs of Staff maintain in front of them for each of the major items the major items of ammunition, ground and air—an estimate of consumption by month in southeast Asia, of production by month, of inventories by month, and of other worldwide consumption by month, between now and June of 1967—which is the end of the period that we are providing financing for in the fiscal 1967 budget—and I expect them personally to review this every month, and to report to me whenever it appears that the consumption that we have projected by

month through this period exceeds the actual level, in which case we should cut back our procurement, or even perhaps more importantly, if the consumption estimates fall under the actual level, in which case we should increase our procurement.

So that the inventory controls on the major items of ammunition, ground and air, Navy, Marine, and Air Force, are now in the hands of the Service Secretaries, and each of the Chiefs, plus Mr. Vance and myself.

And I will guarantee you that no sergeant or anybody else is going to multiply these by 10 and get by with it very long, because it will show up in these monthly reports. And we are doing this for two reasons.

One, we don't want to end up with another huge excess inventory, such as we ended up with after the Korean war and, two, we don't want to run out of anything. If I have to do anything, I am going to end up with excess instead of a shortage.

Representative GRIFFITHS. Obviously, of course. No matter what you asked for, you are going to get it in requirements. So that I think it is more commendable that you are actually trying to control the inventory and the requirements than anything else you could do, because you could get any requirement you asked.

Secretary McNAMARA. Yes.

Representative GRIFFITHS. So that this is even greater than the price, and I am not going to be half as complimentary on price, but I think it is marvelous that you are controlling the inventory.

Secretary McNAMARA. I think we will have to wait for a few months to see how this works out.

Representative GRIFFITHS. You are doing pretty well already.

Secretary McNAMARA. But I think that it will work out well. We have already within the last week or so as a matter of fact noticed some very serious variations in this report, that if it continues for maybe another 60 days it should indicate we could in some cases cut back rather substantially.

There are one or two cases where I think if it continues another 30 or 60 days, we ought to increase the order, but this is the sensitive control that we are applying to I would guess maybe 25 or 30 key items, which comprise both the most important items from the point of view of the troops, and also the largest items from the point of view of ammunition procurement.

Representative GRIFFITHS. Thank you, Mr. Chairman.

Chairman DOUGLAS. We have kept the Secretary here for two hours and a half.

Senator PROXMIER. May I ask just one final question? I hate to prolong his agony. He has done a marvelous job.

Mr. Secretary, I want to ask you about the inflationary effect of the Vietnam situation in your judgment, and see if these figures are right or if they distort the situation.

The gross national product is now approximately five times as large as it was in 1942. There is a lot of inflation in there, but even if we eliminate inflation it is more than twice as large—two and a half times what it was at the time of the Korean war. Allowing for inflation it is still 50 percent bigger.

It would seem to me that in view of the present scope of the Vietnam conflict, and assuming that the proposals that we send 400,000 people

to Vietnam instead of 200,000, even if this is pursued, it would seem to me that the inflationary impact would be of a far lesser order than in Korea, and that we should be able to meet this situation in Vietnam without great fears as to inflationary effect. What is your judgment on this?

Secretary McNAMARA. Well, based on the initial qualification that you inserted, that the expenditures for defense do not exceed our present plans, I strongly concur with what you have said.

In the case of Korea, the defense expenditures as a percentage of gross national product rose 250 percent in 24 months. Here, as I mentioned, the expenditures that we are proposing for fiscal 1966 and fiscal 1967 in relation to gross national product are lower than in 5 of the past 6 years. So the pressure on our economy from defense, even though defense expenditures are rising today, is far less than it was at the time of Korea.

Now it is true that our economy is operating at a rather high level, but it is also true that there is still a substantial amount of unemployment in our society, and while the plant is operating at close to what might be called optimum rates, it is also true that there have been very large plant expenditures in recent months induced in part by the depreciation credits and other tax incentives, and that these large investments in production capacity will be coming into production during the next 12 months, and I think that will offset some of the pressure resulting from the high demand, which in turn also reflects some tax action.

But my own personal conclusion is that if we act with reasonable discipline and restraint, there is no need for wage and price controls now, and there won't be any in the future, based on present military plans.

Senator PROXMIRE. Thank you very much, Mr. Secretary.

Chairman DOUGLAS. I shall waive any further questions.

Mrs. Griffiths?

Representative GRIFFITHS. On this requirement determination problem are the requirements for items matched against the inventories at Battle Creek?

Secretary McNAMARA. I can't answer the question as to where they are matched.

Representative GRIFFITHS. You can find out, though?

Secretary McNAMARA. Yes, surely. I will be happy to, and insert it in the record.

(Department later supplied the information that requirements are matched against inventories of the Defense Logistics Service Center located in Battle Creek, Mich.)

Chairman DOUGLAS. Thank you very much, Mr. Secretary. I continually marvel at you. Two and a half hours of testimony, meeting every question on the nose with precision. It is an amazing performance. You were before another committee this morning. You are, I understand, going to go before still another committee either tomorrow or Wednesday.

Secretary McNAMARA. Both.

Chairman DOUGLAS. I hope you get a good sleep tonight.

Secretary McNAMARA. I am afraid I will need it.

Chairman DOUGLAS. Thank you very much.

Secretary McNAMARA. Thank you, sir. I appreciate it.

Chairman DOUGLAS. We also asked Secretary Ignatius and Admiral Lyle to come, but in view of the fact that it is getting late, unless other members of the committee object, it will be advisable to have them appear at our next session. Is that agreeable to all?

Representative CURTIS. Could I just ask a question on this one item that I read about in the newspaper? We ought not to leave it hanging here. Are you having difficulty getting clothing manufacturers to accept military contracts? Is there any basis for that?

Admiral LYLE. I believe your original question was to the point whether we had any producers refuse.

Representative CURTIS. Yes, or had difficulty letting out these contracts.

Admiral LYLE. We have had some difficulties, but we haven't had any refusals. We have run into cases of producers who normally were not engaged in defense business, or who were fully committed at the time that we requested bids, who were, let us say, unenthusiastic about submitting bids, and we have had to invoke the process of direct orders under the Defense Production Act.

Representative CURTIS. That was the next question. We do have authority, do we not, under the Defense Production Act, so that they have to accept these bids?

Admiral LYLE. Yes, we do, Mr. Curtis, and we generally have had favorable response when we have placed these orders. There have been no cases of refusal.

Representative CURTIS. Thank you.

Chairman DOUGLAS. I may say that I have heard only favorable reports of your work, Admiral, and also Secretary Ignatius.

Thank you.

(Whereupon, at 5:35 p.m., the committee was adjourned.)

(The article reprinted below was referred to in the proceedings by Representative Curtis. See p. 19.)

[From *Fortune*, December 1965]

## THE C-5: PART II—THE ORDEAL OF THE PLANE MAKERS

(By John Mecklin)

The competitors for that \$2 billion C-5 program were also fighting for a dominant position in the future commercial market for jet transports. And the Pentagon was testing some tough new procurement rules. A surprise behind-the-scenes switch in Washington provided the climax.

There are rare occasions when a single decision can change the evolutionary direction of great enterprises. Such was the weight of the decisionmaking that led to the selection last September of a manufacturer for the giant C-5 jet transport. Within both the Government and the aircraft industry, the repercussions of the C-5 project have already been as dramatic in their way as the anticipated impact of the plane itself on U.S. strategy and, ultimately, on the Nation's whole transportation system.

The competition for the contract was memorably exhaustive, generating, among other things, no less than 35 tons of documents. The competitors—Lockheed, Boeing, and Douglas for the airframe, General Electric and Pratt & Whitney for the engines—spent some \$60 million of their own funds and committed more than 4,000 of the Nation's top engineers to the undertaking. They committed themselves to this grueling exercise because they were aware that stakes were appreciably greater than the \$2 billion program itself. The winners could expect to get a corner on the commercial market for a plane that promises eventually to become a standard workhorse of the air transport business.

For the Pentagon, the experience was no less harrowing. It was the most exacting, complex, and imaginative effort the Government had ever mounted to spend \$2 billion sensibly. The C-5 competition was the first trial of a new procurement concept applying extraordinarily precise, computerized methods to defense contracting. It came as a follow-on to the systems analysis technique which Secretary of Defense Robert McNamara has used so effectively to suppress interservice warring over weapon systems. The procedure probably will be applied to a large segment of Pentagon procurement—some \$25 billion annually—and thus represents a critical new phase of McNamara's managerial revolution.

So far-reaching were the implications of the C-5 contract, however, that cold, impersonal computer calculations could not be given the last word. In the end, human judgment—and human controversy—came into play. An Air Force source selection board recommended, on the basis of evaluation studies at Ohio's Wright-Patterson Air Force Base, that Boeing should get the award to build the airframe. But Washington was of a different mind. After a dramatic behind-the-scenes debate, the Wright-Patterson recommendation was overruled and the contract went to Lockheed. Whether or not the issue was decided on the merits of the companies' proposals, the reversal had the effect, as will be seen, of preventing the impact of such a major contract from endangering the overall health of the aircraft industry.

However unprogramed it may have been, the surprise finale by no means discredited the overall value of the new procurement procedure. On the contrary, this procedure proved itself in the C-5 competition to be an important step toward solution of a problem that has frustrated thrift in the Pentagon since the early years of World War II. The problem results from the immense cost of designing and producing the prototype of a new airplane—or practically any other modern weapon system—a cost that makes it financially impossible for contractors to offer "flying samples" as they did in the thirties. Instead, the Government has been forced to buy planes off the drawing board. In the past, this involved so many unknowns that initial contracts were usually limited to the development phase alone, often on the basis of open-end cost-plus-fixed-fee arrangements. That left the price of the eventual production model to be negotiated later, when the Government no longer could bargain by threatening to go elsewhere. Since development can amount to as little as 15 or 20 percent of the long-haul cost of a system, most of the true price lay hidden and unknown during the procurement process. Around the Pentagon, this has come to be known as "iceberg procurement"—with the taxpayer often playing the role of the *Titanic*.

#### REDISCOVERING THE LAW OF SUPPLY AND DEMAND

The new technique for exposing the iceberg is officially called "total package procurement," but it is better known as the Charles plan after the man who invented it: Robert H. Charles, Assistant Secretary of the Air Force for installations and logistics. In surprising contrast to the ferocity with which he attacked the problem, Bob Charles at 52 is a gentle, unassuming man. He also is eminently qualified. Before coming to the Government in 1962 he was No. 2 man at McDonnell Aircraft Corp., where he served for 19 years and participated intimately in many a contract tussle with the military. The objective now, he says, is to "rediscover, in defense industry, the law of supply and demand. We seem to have mesmerized ourselves into believing that there is a nonmarket in the weapons acquisition process."

The main innovation of the Charles plan is its requirement that the manufacturer propose a price covering the total cost of development and production of the system. He must also analyze his proposal in such astonishing detail that the system's long-term value to the Government per dollar invested—i.e., its "cost effectiveness"—can be compared scientifically with his competitors' proposals. The effect is to impose unprecedented discipline on the competitors, making them prove every claim, however minor, while dispensing with the hard-sell "brochuremanship" that has featured past competitions.

Thus, in the C-5 contest, the package bid submitted by each manufacturer had to cover not only the cost of design and testing of the prototype but also the cost of 58 planes (the initial Air Force purchase), and the price of supplementary equipment to keep them flying indefinitely. The contract guarantees maximum maintenance costs, and fixes prices for spare parts—e.g., the price of a nosewheel tire in 1975—loading facilities, and flight-crew training equipment. The manufacturer committed himself to meet minimum reliability standards, such as a

guaranteed time of at least 1,000 hours initially between engine overhauls. Additionally, the Charles plan required that each bid contain an option for the Air Force to purchase 57 more planes at a fixed price, and 85 more under a rigid price formula, calculated on a declining scale to compensate for the manufacturer's "learning curve" production savings, and covering the same long-term commitments to keep the planes flying. A morass of secondary requirements ranged from exact production timetables to an analysis of the management control systems the competitor proposed to install if he got the contract.

On top of all these disciplines, the Charles plan calls for an ingenious pricing formula that gives the contractor a "flexible incentive" to make good on his cost commitments. In effect the contractor can hope to increase his profit by exceptionally good performance; but he also faces losing a good deal of his profit if his costs run above his estimates. (The formula is described on p. 62.) As one planemaker remarked, the plan "makes the contractor put his money where his mouth is." Another called it "a great theoretical carrot," but in general the competitors liked the idea.

The Air Force is already using the Charles plan in a second competition—for the SRAM (short-range attack missile), an air-to-ground weapon system. The Navy is considering its use for the two FDL (fast deployment logistic) ships authorized by the last Congress. The Pentagon believes the procedure is feasible for any type of procurement, except for projects pushing the frontiers of knowledge, where the technical unknowns are so great that advance commitments are impractical.

The mother hen of the C-5 was a system program office (known as the SPO, pronounced to rhyme with woe) of the Aeronautical Systems Division, Air Force Systems Command. This SPO was set up at Wright-Patterson in December 1963. The following summer it awarded contracts, in varying amounts, totaling \$1,600,000, to the five competitors for "parametric studies." In effect, the three airframe manufacturers were asked whether an outside jet transport was feasible, while the two enginemakers were invited to say whether they could build a powerplant big enough to get such a plane off the ground. The replies, delivered in September, were unanimously in the affirmative, and the Air Force decided to go ahead. It kicked off the competition at a special meeting at 8 p.m. on December 11, 1964, in the SPO offices, at which the representatives of each company received 13 copies of a formal "Request for proposals" (REP), a massive, hard-covered document of 1,287 pages.

The message in the "Request for proposals" was as rough and tough as it was voluminous. It gave the competitors 4 months, officially called "the contract definition phase," to come up with comprehensive data on every detail of the package they hoped to sell to the Air Force.

#### AN INVITATION TO HARA-KIRI

And the "Request for proposals" was only a starter. During the following weeks the manufacturers bombarded the SPO with 1,783 questions. The SPO responded with 1,600 pages of "Clarifications and revisions," including 294 specific changes in the request requirements. Air Force "scrub teams" of 100 men or more—so called because their mission was to clean up the competitors' troubles—made two separate inspection tours of the five plants. Back at Wright-Pat, the SPO staff itself did a series of exhaustive independent studies—e.g., a 2,000-page cost analysis, to have ready for comparison with the forthcoming proposals from the competitors. Colonel W. F. Rankin Jr., director of the SPO, had the good humor to send the C-5 project chief in each company a wooden hara-kiri sword with a note reading: "Why wait?"

Boeing and Douglas each spent close to \$20 million of their own funds, Lockheed about \$16 million—on top of the \$6 million they each received from the Air Force to help pay for the exercise. Each company created regimental size C-5 teams; 1,800 at Douglas, 1,300 at Boeing, and 1,750 at Lockheed. Douglas further beefed up its resources by forming an alliance with Martin Marietta and North American Aviation, which contributed technical know-how in hopes of winning major subcontracts. They all developed extraordinary complex systems of computerized management, and all ran exhaustive field tests. Lockheed, for example, built a mock-up cargo hold at Fort Benning, Ga., to study loading problems with Army vehicles and GI drivers. At Harper Dry Lake, Calif., Boeing outfitted a four-engine jet plane with experimental high-lift devices and multiple-landing gear to test takeoffs from ground so soft that the wheels sank 6 inches into the mud. "It was grim," says one plane maker, "but it was the only game in town and we came to play."

Somehow the competitors all met the late April deadline, creating what must have been the biggest blizzard of bureaucratic paper of all time. The proposals themselves were encyclopedic—Douglas, for example, submitted some 60,000 pages in 625 volumes—and the Air Force had required 40 copies of everything. The competitors went into the publishing business, using production-line methods to assemble their documents and delivering them by special planes.

Now came the Wright-Patterson round of the "evaluation phase." A source-selection board of four generals prepared a preliminary recommendation for the contract awards on the basis of studies by a staff of some 500 officers and civilian technicians. To prevent leaks that could influence the stock market and otherwise disrupt orderly analysis, security precautions were so stringent that the competing companies were referred to by code names. Cost analyses were rigidly isolated from technical studies, and the competitors' price proposals, which were particularly sensitive, were circulated only on a need-to-know basis. Under a don't-call-us-we'll-call-you edict, company representatives were barred from the Wright-Patterson headquarters.

#### A THOUSAND PAGES, USUALLY IN COLOR

Like everything else about the C-5, the evaluation process was memorably exhaustive. Models provided by the competitors were tested intensively at the Government wind tunnel at Langley Air Force Base, Va. Specification of the competing planes were fed into computers, and the evaluators ran off simulated emergency airlifts to southeast Asia and Europe, first with an imaginary armored division, then an infantry division, to determine which plane could do the job most efficiently. Repeatedly the SPO went back to the competitors for better documentation of their proposals; for instance, they had to submit reliability records of their previous planes to check against their claims for the C-5. On such occasions the response was electric. "Even on minor points," says an SPO officer, "the answer would be in a thousand pages, bound in hard covers, and usually in color."

It was by no means a one-way flow of paper. During this period the Air Force peppered the competitors with some 600 suggestions on ways to correct "deficiencies" in their proposals, asking them in each case to consider whether the corrections were feasible and to estimate any additional cost.

When all the data was in, the source selection board considered the three traditional questions in airplane procurement: (1) Who offers the best airframe? (2) Who the best engine? (3) Whose product is cheapest? In the C-5 evaluation, for the first time, all this was then related to a fourth question: Who offers the best cost effectiveness? The answer was based on a \$2-billion equation:

$$\text{Cost effectiveness} = \frac{(\text{U.E.}) \times \text{U} \times \text{V}_b \times \text{P} \times \text{C}_p}{\text{Cost}}$$

In this symbolic formulation (U.E.) stands for unit equipment, the number of planes for six squadrons; U is utilization rate, hours in the air per day;  $V_b$  is block speed, the time between two given points at most efficient cruising speed plus 15 minutes; P is payload.  $C_p$  is correction of payload for terminal effectiveness, meaning minimum landing runway length required; this determines how many airstrips the plane can use in areas like southeast Asia. Cost is the price of the six squadrons plus 10 years' operating expenses.

#### A COMPUTERIZED DEAD HEAT

The decision on the engine was relatively painless. On August 5 the Air Force revealed that it had ceased financial support for development of the Pratt & Whitney offering. This meant that GE was the victor, although the contract award would not be formally announced until the airframe winner had also been selected. The GE engine was more advanced technologically, and dramatically more efficient in fuel consumption. Lockheed has estimated, for example, that to accomplish a 6,300-mile flight with a minimum payload of 50 tons, one of the Air Force's basic requirements, the Pratt & Whitney engine would require at least tons more fuel than the GE design.

As from the airframe competition, however, all was silence. The explanation was as heartening for ordinary humans as it was embarrassing to the Air Force. The 35 tons of paper, the hundreds of thousands of man-hours, and the mountains of computer printouts had defined the problem far better than ever before—

but they had not solved it. The gap that remained could be bridged only by a human judgment, and the experts, as usual, were divided.

The crisis began behind the scenes on August 23, when the source-selection board forwarded a report to Washington recommending that the airframe contract be awarded to Boeing. The report said that Lockheed had been the lowest bidder, by several hundred million dollars, and Boeing the highest. But it argued that the Boeing plane promised so much better performance than either of the other competitors that it was worth the additional cost.

Boeing's design was the most sophisticated of the three. The source-selection board particularly liked the fact that it was faster and could land on runways several hundred feet shorter than would be required by the Lockheed plane. Boeing achieved this performance by a number of advanced high-lift devices, notably a blown-flap system wherein engine exhaust is directed across the trailing edge of the wing to reduce the stalling speed.

The source-selection board rated Lockheed second in performance, citing shortcomings in the two areas where Boeing had won praise—speed and lift. Lockheed's optimum long-range cruise speed was the slowest of the three—507 miles per hour or 7 percent below Boeing's. Lockheed engineers had deliberately chosen the slower speed because, among other advantages, it would allow a wing sweep of only 25 degrees versus 35 degrees in the other two designs. They calculated that this would provide sufficient lift to dispense with special devices. On the basis of its own studies, the source-selection board disputed this, and suggested that Lockheed might not be able to meet even the minimum requirements for short takeoff and landing.

Douglas ran third in performance. This was mainly the result of a prolonged dispute between Douglas and Air Force engineers on the aerodynamic drag of the Douglas design. The Air Force said the drag would be excessive and the plane might therefore be unable to meet the minimum range and payload requirements. Douglas staked both its reputation and the risk of great financial loss (if a fault had to be corrected in a prototype) on its contention that it was the Air Force experts who were wrong. The dispute could be finally resolved only by flight tests, and the Air Force was unwilling to take a chance on prolonged delays.

#### ANOTHER WET TOWEL LIKE TFX

The Pentagon reacted to the board's recommendation about the way it does to campus demonstrations against the war in Vietnam. Air Force higher ups placed a high value on the big difference in price between the Boeing and Lockheed bids. They were impressed by the fact that, for long hauls, the Lockheed design offered lower ton-mile operating costs and greater payload than Boeing's. And they felt that the source-selection board had not given enough weight to the better loadability features of the Lockheed design. These included a wider cargo floor (19 feet versus Boeing's 17.5), better clearance, and full-width ramps at each end. In citing this advantage, Pentagon specialists were mindful that GI's in field conditions make mistakes that can't be cranked into computer estimates, like running a tank through the side of a fuselage when there is insufficient space to maneuver.

The source-selection board was never intended to be the final judge; indeed there has been talk of changing its misleading name. But it could not be lightly overruled after its long months of intensive study, especially in view of the awkward parallel with the 1962 award of the multibillion-dollar contract for the TFX, a biservice fighter ("the \$7 Billion Contract That Changed the Rules," *Fortune*, March and April 1963). A source-selection board also chose Boeing in that competition, only to be overruled by Washington, and a stormy congressional investigation ensued. Accordingly, Secretary of the Air Force Eugene Zuckert moved cautiously this time, remarking to a friend, "You don't need a wet towel like TFX slapped in your face more than once to get the idea."

First he set up a review group of senior officers, chaired by a two-star general. Then all three companies were asked to try to improve their proposals. Lockheed improved the lift of its design, adding 400 square feet to the wing area, extending the span from 215 feet, 4 inches to 222 feet, 7 inches. Boeing and Douglas reduced their bids. But Lockheed was still the lowest. Under the Charles plan limits (i.e., assuming an overrun of 130 percent), the maximum price the Government might have to pay under the Lockheed bid was \$1.663 billion for the total package purchase of 58 planes. Boeing's bid was still the highest of the three, \$1.955 billion, or \$292 million more than Lockheed's. Unsurprisingly, the review group voted for Lockheed.



The issue then proceeded through the usual channels: the Air Council (an advisory group composed of the vice chief of staff and seven three-star generals), the commanders of the three interested commands (air transport, systems, and, logistics), the three Air Force assistant secretaries, and finally the chief of staff, Gen. John P. McConnell. Only three lower ranking officers voted for Boeing. On September 23, Zuckert wrote a formal report to McNamara, concluding that the contract should go to Lockheed. McNamara concurred and informed President Johnson, who did not object. On September 30, at a Pentagon press conference, McNamara made the announcement, noting that "the combination of performance and price of the Lockheed proposal is superior to that of the other competitors."

At Marietta, Ga., moments after the news was flashed over the Dow-Jones ticker, a voice boomed over the public address system to 14,000 workers in the Lockheed plant: "Please stop your work and cut off your machines for an important announcement \* \* \*". Then there was pandemonium. At Seattle, Boeing President William M. Allen said, "We are disappointed, of course, but we are not complaining \* \* \*. I have no doubt that price was the determining factor."

#### A PENALTY FOR SUCCESS?

But was price the determining factor? Looked at in terms of its broader economic effect, the Lockheed victory could hardly have been more convenient—so much so as to raise the question whether Washington would have reacted the same way if the Boeing and Lockheed price bids had been reversed. Lockheed's Georgia division would have faced a bleak future without the C-5. The plant at Marietta, which Lockheed leases from the Government, is probably the world's biggest aircraft production facility under one roof (76 acres). It employs almost 22,000 workers, more than any other single plant in the Southeastern United States. Yet its only substantial existing business, the C-141 jet transport, is being cut back drastically (to a probable 284 planes from an original plan of at least 396) as a result of the Air Force decision to order the C-5, and the C-141 program will phase out entirely in 1968. Without the C-5, at least 10,000 jobs would probably have been lost over the next few years.

Contrarily at Boeing, loss of the C-5 will cost no jobs at all, nor seriously damage the company's financial position in the immediate future. Boeing has the biggest backlog of commercial orders in its history—445 jet airliners worth \$2.4 billion on order as of September 30—and it is a prime contender for the supersonic transport (SST). The suggestion that Boeing's commercial good health could have been relevant to its loss of the C-5 award outrages Bill Allen. "That would be a penalty for success in the free enterprise system," he says; "It's un-American." Nevertheless the question arises: In any award as important as this one, would it not be mandatory for the Air Force to give some weight to the welfare of a great national asset like the Marietta plant?

There is also a question of the national interest in the long-term implications of the C-5 award for the evolution of the American aircraft industry. It is highly likely, as *Fortune* reported last month, that long-haul air transport in the seventies will polarize into two distinct categories—supersonic planes for fast, high-cost passenger travel, and huge subsonic planes for cargo and low-cost passenger travel. The C-5 and its successors may well become the standard planes for such subsonic duty during the last quarter of the century. The Air Force award, subsidizing development of the C-5, thus gives Lockheed an immediate competitive advantage that can count for a long time to come.

Of course, this has happened before. Government purchase of the KC-135 jet tanker, the military version of the 707, enabled Boeing to get a big jump on its rivals at the beginning of the jet-airliner age. Despite the Boeing lead with the 707, however, Douglas was able belatedly to buy into the jet market by spending some \$300 million of its own money to develop the DC-8. But it is highly unlikely that anyone will be able to buy into the C-5 market. The plane's initial development costs will come to some \$750 million. For a commercial version the figure may be somewhat less, but probably still more than any manufacturer can afford to pay out of his own pocket. And the market may not be big enough to support two manufacturers anyway, at least not for a long time. The plane will carry such enormous loads that the most optimistic estimates put the total world demand at only 300 commercial C-5's by 1980 or even 1985. Thus if Lockheed is alert to the airlines' needs and modifies the C-5 for effective commercial use, it may just possibly parlay its Air Force contract into a monopoly in the field of very big subsonic transports.

Another clearly discernible effect of the C-5 verdict is the severe blow it dealt to Douglas' hopes of regaining its one-time supremacy in the air-transport business. The company is still paying the price of the crisis it went through in the late fifties, after it gambled mistakenly on one more piston plane, the DC-7, before going into jets. Douglas undertook a sweeping survival reorganization in 1961, and it now has a healthy \$1.3 billion backlog of orders for the DC-8 and the short-range DC-9, the first of which is going into airline service this month. But all this took a heavy toll of its resources, and because it couldn't handle both competitions at the same time, it was forced to choose between bidding for the SST and for the C-5. Now that the try for the C-5 has failed, Douglas' future in big planes is questionable. The company is doing well in space, recently having won a big chunk of a \$1.5-billion Air Force program for the manned orbiting laboratory (MOL). But to stay in the commercial-transport business at all in the coming era of the C-5 and SST, it must live mainly off short and medium-range planes.

This is by no means an unattractive market, for there will always be a considerable demand for such planes. But it is a highly fluid and therefore dangerous market, cluttered with unknowns. Boeing has the upper hand, at least for the moment, with a commercial backlog twice as big as Douglas'. Since the C-5 decision, both companies have indicated that they plan to increase their efforts in this market with new models, a Boeing 747 and a Douglas DC-10, but neither has yet decided where to aim. There are three main choices: (1) an intermediate-sized long-range plane, carrying, say, 300 to 350 passengers, to fill in during the 8 or 10 years before the C-5 and SST; (2) a small jet airliner, with 25 to 50 seats, for short, less-traveled routes; or (3) a jet "air bus" designed to haul 200 to 300 passengers on congested short-range routes like New York-Washington. All three are risky since even the airlines are far from making their minds up as to which types, if any, are really needed.

#### WHO WILL GET THE SST?

In the case of engine manufacturers, the C-5 award to GE was also significant. Its main effect is to bring GE solidly into the air-transport market after a good many years of near misses, such as its \$90 million-loss on the engines for the unsuccessful Convair 880 and 990 airliners. Pratt & Whitney can hardly be said to be in trouble, however. Not only will it make the engines for the current deluge of airline orders, but it is also reported to be testing a new turbofan engine with some 30,000 pounds of thrust, which will be a natural power plant if the airlines decide to invest in big intermediate planes before the C-5-SST era.

Of all the unknowns still before the industry, the key question is who will build the American SST. The winner of this competition, to be sponsored by the Federal Aviation Agency, will acquire an advantage in the supersonic future as great as or even greater than Lockheed's corner on big subsonic transports. Except for the absence of Douglas, the competitors are the same: Boeing and Lockheed for the airframe, GE and Pratt & Whitney for the engines. The FAA has kept them at work on research with sporadic subsidies for more than two years, but a final decision has not yet been reached.

There has been widespread speculation that the C-5 award to Lockheed makes Boeing a shoo-in for the SST, once the go-ahead decision is reached. There are persistent rumors, moreover, that FAA studies have found the Boeing SST design, featuring a wing with a variable sweep, to be superior to Lockheed's double delta wing. The Government, of course, dismisses this kind of speculation as premature since the decisive SST competition has not even begun. But if the Government were to give the SST to Lockheed on top of the C-5, it would need some exceptionally eloquent arguments to escape another barrage of wet towels.

#### CARROTS AND STICKS: THE PENTAGON'S NEW INCENTIVE PRICING FORMULA

The procurement procedure devised by Assistant Secretary of the Air Force Robert H. Charles, and applied in the C-5 competition, contains an ingenious pricing formula that rewards efficient performance and penalizes "overruns"; i.e., costs in excess of the original estimate. Broadly, it works this way:

The contract fixes a target cost plus a 10-percent profit for the contractor. If costs rise above the target, 15 percent of the excess comes out of the contractor's profit, while the Air Force pays the other 85 percent. If costs fall below the target,

the contractor receives 15 percent of the savings, and the Government gets the rest. The contract stipulates, however, that the Government will in no case pay more than 130 percent of the target cost. Thereafter all additional costs are on the manufacturer, and his profit declines to zero if costs reach 135.5 percent of the target.

For example, assuming a target cost of \$1 million, the contractor's profit would be \$100,000, making a total price to the Air Force of \$1,100,000. If the contractor could hold actual costs to \$900,000, his profit would be the original \$100,000 plus 15 percent of the saving, or \$15,000. On the other hand, if his actual costs mounted to \$1,100,000, his profit would be the original \$100,000 less \$15,000. The profit would disappear entirely if actual costs reached \$1,355,000, or 135.5 percent of the target.

A further innovation in the Charles plan is the "flexible incentive," an ingenious provision that, at specified times during the life of the contract, gives the company the opportunity to increase savings and profits dramatically (while risking equally dramatic losses). At these mileposts, when the contractor is pretty sure that the danger of failure is negligible, he can choose to gamble for an increased share of the cost savings, above the initial 15 percent and up to a maximum of 50 percent on the work still to be done. "The idea," says Charles, "is to instill in the contractor the cost-reduction motivation that comes with great risk, without, in fact, exposing him to great risk."

If the contractor in the hypothetical case, for example, saw the chance of great economies ahead, he could boost his share to 50 percent after half the work had been done. If he then completed the job at a total cost of \$900,000, his profit would come to \$132,500—the original \$100,000, plus 15 percent (\$7,500) of the savings on the first half of the job, plus 50 percent (\$25,000) of the savings on the second half. The catch is that if costs exceeded the target, 50 percent of the difference would come out of the contractor's profit.

In the actual case of General Electric's contract on the TF-39 C-5, the price is \$458,700,000—a target cost of \$417 million, plus 10 percent profit of \$41,700,000. The company stands initially to make an additional 15 cents on every dollar that its actual costs fall below \$417 million, and it can increase this up to 50 cents if it chooses to invoke the flexible incentive. On the other hand, the most that the Government can pay if GE runs into trouble is \$542 million, or 130 percent of the target cost. Any further expenses would be borne by the company.

Since the flexible incentive is experimental, the Air Force also asked the C-5 airframe competitors to submit bids on two other formulas, both of which offered a bonus for good performance but omitted the option to change the percentages. At this writing the Air Force had not yet decided which formula to use for the Lockheed contract.

(Secretary McNamara's comments, later supplied, appear below:)

THE SECRETARY OF DEFENSE,  
*Washington, February 18, 1966.*

HON. THOMAS B. CURTIS,  
*House of Representatives.*

DEAR MR. CURTIS: Thank you for your letter of January 25. As I promised in my appearance before the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee on January 24, 1966, I have read the article entitled, "The Ordeal of the Plane Makers," in the December 1965 issue of *Fortune* magazine. I am happy to offer the following comments.

The article rightly stresses the very desirable features of the "total package" contract. This approach to procurement contracting stimulates beneficial competition among potential contractors and ties profitability to efficiency in both development and production. The winning competitor must guarantee the performance of his product, as well as state his target cost. If actual cost is less than the contractor's target cost, an amount equal to 30 percent of the cost under-run will be added to the contractor's profit. On the other hand, if actual cost exceeds the target cost, an amount equal to 30 percent of the overrun will be subtracted from the contractor's profit with 70 percent of the cost overrun being borne by the Government. The Government will in no case pay more than 130 percent of the target cost. Hence, contractor profit falls to zero if actual cost exceeds 130 percent of the target cost.

The article is also correct in noting that the Navy has expressed considerable interest in applying the "total package" concept to its fast deployment logistic (FDL) ship program. The FDL ship, like the C-5A aircraft, is a major element in our programmed rapid deployment posture, and we anticipate benefits similar to those experienced in the C-5A competition to result from total package contracting for these ships.

However, I should like to reject the author's suggestion that the award of the C-5A contract to Lockheed was based on the desirability of continued military aircraft production at Lockheed's Georgia division. Long and arduous consideration of the contractor proposals revealed that the Lockheed airplane was the most economical in meeting the Department's military airlift requirements, all things considered. It was on this basis that the contract award went to Lockheed. DOD policy forbids the award of development and production contracts for reasons other than the cost and performance competitiveness of the winning contractor.

Though the concept formulation and contract definition experience was "memorably exhaustive" in the author's phrase, very considerable short-run and long-run benefits will accrue to the Department as a result of this ordeal. Moreover, the Air Force is thoroughly reviewing this experience to insure that we learn as many lessons as we possibly can from it.

Sincerely,

ROBERT S. McNAMARA.

# ECONOMIC IMPACT OF FEDERAL PROCUREMENT

WEDNESDAY, MARCH 23, 1966

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON FEDERAL PROCUREMENT AND  
REGULATION OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met at 10 a.m., pursuant to recess, in room S-407, the Capitol, Hon. Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senators Douglas and Jordan; Representatives Griffiths and Curtis.

Also present: Ray Ward, economic consultant; Douglas C. Frechtling, minority research assistant; and Hamilton D. Gewehr, administrative clerk.

Chairman DOUGLAS. We are resuming hearings today on a subject which may seem somewhat pedestrian and lacking in thrills, but which is extremely important, namely, report by the Department of Defense on its cost reduction programs.

Secretary McNamara reported on the 24th of January on this program and showed that in the last year, following out many of the suggestions of the subcommittee that savings of \$4.8 billion had been made without impairing in any degree the combat effectiveness of the armed services.

In fact, really, it increased the combat effectiveness by reducing deadwood.

We have repeatedly stressed that the magnitude of Federal procurement and even of segments of it vitally affect the whole economy, but what I want to stress in these hearings is that what we do not buy is also important.

Now is a good time to follow the old New England maxim of "use it up, wear it out, make it do." We have a military stores inventory of about \$40 billion, much of this may become obsolete, outdated and useless if not put to use, and civilian agencies of the Government have inventories of considerable size.

It was once said that the Government is like a pack rat, stores everything it ever buys, never lets go of it. When we have a real federal-wide system, we can maximize the use of this material.

We have spent some \$400 million for a catalog, a uniform catalog, for this very purpose and now is the time to use it.

Through our previous hearings we have developed that many of what in the bureaucratic language is called "short shelf life of items," or what I would call "perishable items" or items which depreciate over a short period of time, have become useless and have had to be given to schools or discarded.

We found this true with paint, photographic supplies, rubber goods, and so forth; some of those items are on display here on my right, and some will be brought up this afternoon.

We requested a study be made to identify the short-shelf-life items, or the perishable items, to use English rather than gobbledygook, and to work out a program for their use, and a Department of Defense and GSA study group has made an inventory of \$703 million which they found of these items.<sup>3</sup>

We want to learn today, among other things, what programs have been developed to insure the taxpayer will get his money's worth from this inventory. There are other important points which we may raise, but probably none more urgent.

I understand that there may be more medical supplies on hand than the Government can use before their effective life expires, and that some special authority may be needed to dispose of them in a timely way.

Our first witness today is Assistant Secretary of Defense Paul R. Ignatius, who is appearing for the second year. I have found Secretary Ignatius to be frank, honest, responsive, instructive, hard working, and a model public servant. Nothing I have said should be construed otherwise by anyone.

Mr. Secretary, you may proceed with your statement.

**STATEMENT OF HON. PAUL R. IGNATIUS, ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS); ACCOMPANIED BY J. M. MALLOY, DEPUTY ASSISTANT SECRETARY (PROCUREMENT); PAUL H. RILEY, DEPUTY ASSISTANT SECRETARY (MATERIEL REQUIREMENTS); R. C. MOOT, DEPUTY ASSISTANT SECRETARY (LOGISTICS SERVICES); AND MAJ. GEN. ALLEN T. STANWIX-HAY, SPECIAL ASSISTANT TO MR. IGNATIUS**

Mr. IGNATIUS. Thank you, Mr. Chairman.

Mr. Chairman, members of the committee, it is a pleasure for me to appear before the committee once again. I propose to review briefly some of the items of particular interest to the committee, as evidenced by your comments at last year's hearing and the committee's report.

As in past years, we have again this year benefited from your continued interest in our activities. We have accepted your suggestions in the same constructive manner in which they were given, and during the course of this statement I will discuss the actions we have taken.

#### SUPPLY SYSTEM INVENTORIES

During fiscal year 1965 our supply system inventories were reduced by \$1.8 billion (from \$38.8 to \$37.0 billion). Despite this reduction, active stocks increased \$700 million (from \$26.2 to \$26.9 billion). Assets stratified as Long Supply have been reduced by \$2.5 billion (from \$12.6 to \$10.1 billion), and "potential excess" stocks have been reduced by \$2 billion (from \$5.5 to \$3.5 billion).

Active stocks now represent 73 percent of the total inventory, or \$700 million more than in fiscal 1964. "Potential excess" on the other hand is lower than at any time in the last 10 years.

<sup>3</sup> Report, July 1965, pp. 4-5.

## INVENTORY ITEM REDUCTION

Conversion of the item identifications maintained by the separate military services to the Federal catalog system was completed in December 1958. At that time, 3.4 million Federal stock numbers were registered in the DOD portion of the Federal catalog. On January 1, 1961, the total had increased to more than 3.7 million items and had reached 3.9 million by June 30, 1962. In spite of our best efforts to reduce and delete nonessential items from the inventory, the number of item identifications continued to increase.

Finally, through persistent attack on the problem and the assignment of centralized responsibility and authority, the growth of cataloged items has been checked, and through the concerted efforts of the military services and the Defense Supply Agency, a substantial reduction has been made in the number of items which must be managed in the Defense supply system.

From December 1963 through June 30, 1965, more than 155,000 items were designated for deletion as inactive and unessential. During fiscal 1965, for the first time, we achieved a net reduction of 112,000 items in the DOD section of the Federal catalog, thus reducing the overall total, as of June 30, to 3.8 million items. This downward trend is expected to continue during fiscal 1966.

Although these programs resulted in substantial item reduction, it became quite evident that we must provide a parallel and equally concerted effort to control the number of items entering the supply system, if we were to reduce further our supply management costs.

To cope with this problem, the DOD Item Entry Control Office was established in DSA during fiscal 1964. The mission of this office is to "provide DOD-wide counsel and leadership in the development of programs and systems to control the entry of new items into the Defense supply system."

As a result of the test discussed with you last year, the refinement of systems and procedures has been accomplished. We expect the new item entry control techniques to produce significant results, both in number of items prevented from entering the system, and in dollar savings generated within the next 12 to 18 months.

## AVOIDING UNNECESSARY PROCUREMENTS

Phased provisioning involves the deferral of quantity procurement of selected high-cost items until reliable usage data are available to confirm our actual needs. This technique requires careful advance planning and coordination with the contractors producing the major end items.

During this past year, continued progress has been made. For example, we are now able to report an initial \$2 million procurement savings for C-141A aircraft spare parts, with additional procurement savings projected for calendar year 1966, ranging between \$4 and \$10 million.

Other major item procurement programs to which we have applied, or are now planning to apply phased provisioning, are the F-111 aircraft (both Air Force and Navy versions), the TF-30 and TF-33 jet engines for the FB-111 aircraft, the A-7A aircraft, and the C-5A aircraft.

Repair parts, component assemblies, and minor items comprise the bulk of the 3.8 million items in the military supply system. The inventory of these secondary items is valued at a little over \$17 billion, and annual procurement in fiscal 1965 amounted to \$2.4 billion.

We reduce unnecessary procurement in this area by continuing to maintain more realistic safety levels, reducing turnaround time in overhaul facilities, and shortening administrative and procurement leadtimes. As a result, we avoided procurement of \$1 billion in secondary items in fiscal year 1965.

#### UTILIZATION OF SUPPLY SYSTEM STOCKS

Substantial progress has continued in the utilization of existing inventories, thus obviating the need for additional procurements.

Over the years one of our continuing problems has been how best to achieve optimum utilization of the large quantities of materiel we hold in long supply. Until recently, the magnitude of the task of attempting to match, manually or by conventional card-punch equipment, the millions of procurement transactions with the stock position of over 3 million items, was almost insurmountable. The advent of computers and the rapid expansion of their capabilities have now provided us with the means of automating the task.

From fiscal year 1958 through fiscal year 1965 the amount of utilization has steadily risen from \$213 million to \$1.4 billion, and still greater improvement is expected in this activity in the future.

In reference to your recommendation of maximizing utilization of long supply assets between Government agencies, meetings have been held with the General Services Administration representatives. An agreement on policies and procedures is now in the final stages. The procedures will provide for direct DSA/GSA contact to accomplish the exchange of long supply assets.<sup>4</sup>

Requirements and inventories of items managed by the military departments, the Defense Supply Agency, and items managed by GSA and other Federal civil agencies, will be matched. This will give us the capability to screen requirements against assets in long supply on a Government-wide basis and thus reduce the Government's procurement cost.

The first phase of this procedure will include matching GSA and DSA assets. The second phase will bring all Federal civil agencies into the system. This subcommittee should realize that considerable time—probably 2 to 3 years—will be required to implement fully the second phase. The civil agencies must complete their catalogs, mechanize their procedures, acquire ADP equipment, program it, and phase into the system.

#### REDUCTION OF SURPLUS SALES OFFICES AND HOLDING ACTIVITIES

While we have been improving the utilization of excess property, we have also been tightening our surplus property disposal organization. We have reduced the number of Defense Surplus Sales Offices from 34 to 12. In addition, four regional offices have been eliminated.

<sup>4</sup> Report, July 1965, pp. 3-4.



As a result of these organizational reductions, 293 manpower spaces and approximately \$2.5 million a year have been saved.

A plan for the consolidation of military excess and surplus personal property holding activities was also initiated. As a result, 68 holding activities have been or are being eliminated. A reduction of 391 manpower spaces has been realized, and approximately \$2.7 million a year saved. When the entire plan is completed, additional manpower and monetary savings will be realized.

#### IDENTIFICATION, CONTROL, AND UTILIZATION OF SHELF-LIFE ITEMS

In response to the September 3, 1964, report of the Subcommittee on Defense Procurement, particularly that portion dealing with short-shelf-life items, we have, both in combination with GSA and separately, undertaken a number of actions which will be of interest to the committee. Our point of departure was a joint DOD/GSA study which you have already reviewed.<sup>5</sup>

This report and a later addendum contributed significantly to our understanding of the shelf-life problem. Based on this understanding, we are about to enter into an agreement with GSA governing the utilization of shelf-life items in the Federal Government.

This agreement will be implemented in DOD by the instruction which will have an effective date of July 1, 1966, to coincide with the final service implementation of milstrap, our military standard transaction reporting and accounting procedures, a necessary prerequisite to effective control.

Through this instruction, shelf-life items will be controlled within DOD by a uniform, all Service/DSA system up to the point where Federal utilization is required. By agreement, we will forego separate, prior DOD screening to give GSA the opportunity to screen Government-wide so that utilization of long supply materiel can be made while shelf-life remains.

We have already implemented that portion of the agreement concerning items which of necessity are managed both by DSA and GSA. Special utilization procedures involving direct contact between DSA and GSA managers have been worked out to insure that any long supply stocks in either agency will be utilized in lieu of new procurement.

The intent of the DOD instruction is to minimize losses by increased attention to the before-use considerations. Here we are talking particularly about requirements determination and procurement, with emphasis on controls to insure that quantities procured are never more than can reasonably be expected to be consumed during the shelf-life of the item in question.

Adherence to "first-in, first-out" principles is required and provided for in the instruction. While these principles have been in force previously, our new instruction will bring all controls on shelf-life under one document for the first time, and this will emphasize the attention we wish to have applied to these items.

The intent of the DOD/GSA agreement is to expedite the referral of DOD potential excess to GSA for utilization by civil agencies be-

<sup>5</sup> Report, September 1964, pp. 10-11.

fore the shelf life expires. The combination of our new instruction as well as the agreement should provide the necessary control.

In connection with improving the utilization of medical items before shelf life expires, we have asked DSA to represent us in the recently established Inter-Agency Committee, chaired by GSA, which has been organized to acquire a full understanding of the problems which now discourage cross-servicing on these items.

We believe that DOD can be of major assistance in utilizing medical items held in large quantities by other agencies. However, uniform item and packaging specifications must be developed before this program can be fully effective.

#### ITEM MANAGEMENT CODING

New criteria for coding items in DSA Federal supply classes were approved April 30, 1965, and coding of military service managed items began July 1, 1965, and will extend over a 2½-year period. The criteria are now applied to all new items within DSA classes entering the DOD supply system.

In addition, existing items in these classes, still under service management, are being reviewed for possible recording. Of the remaining 880,000 items in this category, it is anticipated that about 62 percent, or 545,600 items, will be assigned to DSA for integrated management. Experience so far with the program has proven this estimate to be valid.

#### DOD/GSA SUPPLY RELATIONSHIPS

Under terms of the DOD/GSA agreement, reached at the end of 1964, a joint DSA/GSA group has been reviewing the individual Federal supply classes (FSC's) managed by DSA to identify those classes susceptible to GSA management or DSA management.

The joint group has examined some 150 Federal supply classes and has identified 52 groups for which, with certain exceptions, the General Services Administration will be designated as the supply source.

In December, I forwarded to the Administrator, GSA, a plan of action developed by the DSA/GSA group. This plan of action identifies 52 Federal supply classes (FSC's) for primary assignment to the GSA Federal supply service, 98 Federal supply classes for primary assignment to DSA, and two classes for split management, with item selection and transfer to be completed by the end of the year.

I am informed, Mr. Chairman, just in the last day or so, the two classes for split management have been resolved, one going to GSA and one staying within DOD. (See p. 99.)

In concurring with the plan, the Administrator indicated his satisfaction with the recent progress and his feeling that the plan of action will accomplish the intended objectives.

With regard to the provision of the agreement dealing with DSA support of civil agencies, studies have indicated the feasibility of DSA providing Government-wide support in the areas of clothing and textiles, electronics and petroleum supplies. Plans are being developed, including the identification of economies that might be expected to result.

DSA support of civil agencies in the areas of medical and subsistence supplies is in process of examination. With respect to perishable subsistence, it has been determined that support can best be accomplished by individual cross-servicing arrangements between civil agency activities—mainly hospitals—and the nearest DSA Subsistence Regional Headquarters.

#### TECHNICAL DATA AND STANDARDIZATION MANAGEMENT

Although I will discuss technical data and standardization as two separate subjects, there is a continuous interface between these two programs.

Standardization actions begin with the generation of military requirements and continue through design, development, production, supply and final disposition of military items. The acquisition of technical data is also directly related to the life cycle of military hardware.

However, whether we talk about standardizing on a single weapon system design to fulfill military requirements, data packages for competitive procurement, standard parts in the inventory, or manuals to maintain and operate weapons, we consistently work toward increasing the capabilities of our military combat forces.

#### TECHNICAL DATA PROGRAM

The objectives that guide data management in the Department of Defense remain unchanged from last year. First, the requirements for data must be explicit; second, data delivered by our contractors must be adequate to meet our needs; and third, the information must be readily accessible to the user.

The early determination of data requirements in design is essential along with periodic refinement during subsequent phases based on changing needs, intended use, cost, quality, and timely availability where and when needed.

A Defense data manager's course is now in operation and the first three classes have been completed. During the next 5 years over 1,100 Defense personnel will receive this specialized training in the principles, policies, and procedures for improved management of data and documents associated with military material and systems. The need for qualified data managers has never been greater than it is today in both industry and the Government. We are encouraging the initiation of similar training courses with industry.

To improve the quality of engineering drawings, broader use of sampling techniques for their inspection is under consideration. Under such a procedure, sets of drawings will be accepted or rejected based on sampling evidence. Experience with this technique at some military installations has indicated a marked improvement in drawing quality after sampling plans were instituted.

The deferred ordering of technical data, under which the Government defers selection and delivery of all or any portion of the data specified in the contract until actual requirements are economically determined, has proved highly successful on the C-141 aircraft and J-79 engine programs.

This concept is now being applied to the F-111 and C-5A aircraft programs where the same degree of success is anticipated. We will monitor this concept for application to a broader range of programs in the other military departments.

Assistance has been provided to the Federal Aviation Agency by arranging the exchange of technological information on Defense supersonic aircraft developments between Defense contractors, FAA technical staff, and the supersonic transport (SST) contractors. Initial briefings have been followed by engineer-to-engineer discussions that should be of significant benefit to the SST development program. We will continue to assist FAA and its contractors in this vital national effort and thereby minimize what could otherwise have been a duplicating effort.

Our future plans for improving technical data management include:

- (1) Better identification of data costs.
- (2) Development of optimum systems for the collection, storage, retrieval, and distribution of data.
- (3) Determination of the feasibility of a DOD authorized data list.
- (4) Better quality of technical data delivered to the Government.
- (5) Exploration of wider application of the deferred ordering concept.

#### DEFENSE STANDARDIZATION PROGRAM

Standardization must be applied throughout the life cycle of military systems, equipment, and materiel to reduce the variety of items and to achieve uniformity in related technical documents.

During the past year the basic standardization policy statement was revised and now provides balanced guidance with respect to the role of research and development and logistics in the application of standardization disciplines.

The initial step has been taken to bring the standardization program under a 5-year programming cycle. Under the plan, for the first time, standardization projects will be identified, time phased, and resources programed over a 5-year period. In addition, automatic data processing methods are being applied to a reporting and management review system for the program.

Stage II of our program on review of overage specifications and standards has been completed. This review of 7- to 10-year-old specifications has resulted in identification of 1,605 for cancellation—some 31 percent; 1,423 for revision—27 percent; with 2,181—42 percent—of the total of 5,209 reviewed still being valid without change.

Review of 5- to 7-year-old specifications has been initiated. Following completion of the 5- to 7-year-old review, there will be a continuing review of specifications and standards to assure their current usefulness. You will recall that the stage I review covered specifications more than 10 years old, and resulted in cancellation of 4,900 documents, or 50 percent of the total.

The new specification for procurement of drawings, MIL-D-1000, is now in effect. It requires the acquisition of drawings based on specific intended uses and permits greater flexibility in accepting in-

dustry drawing practices. Also, military drafting practices previously covered in many different documents were combined into a single standard, MIL-Standard-100. Our objective is to control the proliferation of special drawing provisions by the individual services.

Future plans to improve standardization management include—

- (1) Better identification of resources and standardization costs.
- (2) Improved defense guidance on preferred parts lists, qualified products lists, part numbering and limited coordinated specifications.
- (3) Increased application of standardization as a design discipline during research and development.

#### INCREASED USE OF FORMAL ADVERTISING

The increase in competitive procurement by formal advertising continues—rising from 11.9 percent of total dollars awarded in fiscal year 1961 to 17.6 percent in fiscal year 1965. The fiscal year 1965 percentage for formal advertised procurements is the highest the Department of Defense has ever experienced.

During the same timespan, overall competitive procurements were increased from 32.9 percent of total dollars awarded in fiscal 1961 to 43.4 percent in fiscal 1965—an increase of 10 percentage points.

A substantial part of this achievement is attributed to two-step formal advertising. The percentage of formally advertised awards utilizing this method has increased from 2.4 percent in fiscal 1962 to 15.1 percent in fiscal 1965. In dollars, this represents an increase from \$85 million in 1962 to \$726 million in 1965.

Adopted in fiscal 1961, the two-step formal advertising procedure was designed to expand the use and obtain the benefits of formal advertising where available specifications preclude the use of conventional formal advertising. It is especially useful in procurements requiring technical proposals for complex items, and is employed only when there are enough qualified firms interested in bidding to assure adequate price competition.

Under the first step, unpriced technical proposals are reviewed in order to screen out those proposals which are technically unsuitable.

The second step is conducted on the basis of traditional advertising procedures, with public opening of bids and award to the lowest responsive and responsible bidder. As mentioned earlier, \$726 million was obligated under this procedure during fiscal year 1965. We hope to make greater use of this technique in the future.

Chairman DOUGLAS. Secretary Ignatius, I wonder if you could make estimates of the percentage of savings effected by these two methods.

Mr. IGNATIUS. Yes.

First, we run a sample each year of a representative number of our procurements to ascertain what the saving is when we shift from sole-source procurement to competitive procurement. We have used a factor of 25 cents on the dollar as being the savings achieved. Each year when we have run our actual sample we have validated this guideline of 25 percent.

I recall, last year's sample showed in excess of 30 percent, so we think our 25 percent figure is valid.

Chairman DOUGLAS. So, that is not a hypothetical figure?

Mr. IGNATIUS. No, sir; we do not believe so. Something happens when you bring competition to bear. We know that this is the strength of our own industrial economy and it serves us well in defense procurement when we can harness the same motivating force to do the job better.

Senator DOUGLAS. Now, your two-step form of advertising. Have you measured the percentage economies effected there?

Mr. IGNATIUS. Yes, sir; here if we shift from sole source to any form of competition, we generally get a saving of about that magnitude. The advantage of the two steps is that it lets us advertise in lieu of any negotiation; the law requires this.

To oversimplify the statement, the law requires us to procure by formal advertising except where we cannot, and the law lists some 16 exceptions that are permissive to us to procure by means of negotiation. We find that with standard type items, it is a relatively easy matter to procure by regular formal advertising.

This notebook, this glass, perhaps this table are items that could be easily described in a specification. This would be the basis for bids by interested qualified bidders and automatic award to the responsible bidder on public opening.

As you get into more complex items, on the other hand, that cannot be described so precisely or where there may be questions of tooling involved or interpretation, it has been our practice in the past always to resort to negotiated procurement. We developed the two-step method as a means of accommodating this more complex type of procurement.

During the first phase, as I noted, we do not get prices. We get technical proposals only, and we have an opportunity to sit down with the proposers to discuss their proposals, to clarify our intent, for them to clarify their intent, to screen out clearly unacceptable proposals at that stage, if this is the case. Thus having determined and clarified as a result of the discussions with the proposers, we then screen out unqualified companies and then go into the second step which follows the regular advertising method.

We call for bids to be submitted—prices to be submitted. The bids are opened publicly and award is made. The advantage of this, Mr. Chairman, is that it has allowed us to maintain what I would call the necessary flexibility of negotiation with the desirable objective of advertising and it has enabled us to bring more of our procurement under formal advertising which otherwise would have been done under negotiations.

Chairman DOUGLAS. One question: In these later procedures which do not involve initial advertising, how do you inform firms that they may make technical proposals?

Mr. IGNATIUS. We solicit all companies that we know to be qualified. Our buyers maintain active bidders' lists. We encourage companies to register their interest in Government procurement at our procurement offices.

Now, sometimes people learn about the procurement, which is publicized in various publications, and may submit a request to receive the bid documents and submit a proposal. Our effort is always di-

rected to obtain as broad a base of procurement as we can, and as I say, we have source files, bidders' files.

Chairman DOUGLAS. In the old days we used to get many bidder complaints that their firms were never invited to bid.

I want to say that we have been getting fewer complaints in recent years.

Mr. IGNATIUS. I am glad to hear that.

Chairman DOUGLAS. But once in a while this will show up. Will those be people who have been tried and found wanting, or will they be firms, new firms, or will they be firms that have not got the word, or what?

Mr. IGNATIUS. They can be a combination of all, Mr. Chairman.

We want any company that is qualified in the commodity area in which we are seeking procurement to participate. In some of the more technical procurements we may, based on our existing knowledge, send out to rather a small number of companies, because they are the only ones we happen to know about.

Now, we may learn of others and I might say we have quite an active program around the country where we hold procurement clinics to inform companies in various regional areas of our defense procurement program, and this is to increase knowledge of what we are buying, increase knowledge of our methods of buying, and for them to register interest in our procurements.

Chairman DOUGLAS. Thank you.

Senator JORDAN. Mr. Chairman, may I ask a question at this point?

Chairman DOUGLAS. Yes, Senator Jordan.

Senator JORDAN. To round out the record, Mr. Secretary what percent of procurement cannot be adopted either to formal advertising or to the two-step method on which you have elaborated?

Mr. IGNATIUS. The regular advertising, the traditional one-step, plus this two-step method that I have described, Senator Jordan, in fiscal year 1965 accounted for 17.6 percent of our total dollars. The remainder was procured on the basis of negotiation and much of that is highly competitive.

It does not mean that it was negotiated with only one company. We have a high degree of competition in many of our negotiated procurements and the overall competition figure which includes both advertising and competitive negotiation is 43.4 percent, so there are two comments I would make in answer to your question, Senator Jordan.

First, 43.4 percent of our procurement is on the basis of price competition; and secondly, 17.6 percent of our procurement was formally advertised and the balance was procured on the basis of negotiation.

Chairman DOUGLAS. By competitive negotiation?

Mr. IGNATIUS. Not all of it, but a good deal of it. In certain large systems, Mr. Chairman, Minuteman would be an example, it is simply not feasible to have competition. The investment in tooling and the leadtime precludes this.

Polaris would be another case. Theoretically I suppose it would be possible to have a competitive procurement of a Polaris missile, but there it would be prohibitive and a waste of resources.

Representative CURTIS. But has not a great amount resulted from breakout, because even there you would break out a good deal of the missile?

Mr. IGNATIUS. That is quite right, Mr. Curtis. We can and do break out from the prime and place that competitively. Additionally, there is the major innovation that was developed this last year by the Air Force which concerns the procurement plan that was followed in the case of the large new transport airplane, the C-5A.

Secretary Robert H. Charles of the Air Force and a number of people working with him evolved a procurement plan where, with a large system, we did get competition right from the beginning. They combined the research and development phase with a production phase and had an intense competition. We believe that this technique will enable us to increase the amount of competition in the major weapons system areas.

We think this is a very important development.

Representative CURTIS. Was this not the subject of a Fortune magazine article a couple of months ago?

Mr. IGNATIUS. I believe there was an article on it; yes, sir.

Representative CURTIS. I remember the article and I asked Secretary McNamara about it. I wanted to have his evaluation as to whether or not it was a good article. He had not read it at the time, but he supplied information for us later saying that he felt this was a fair presentation. It was commendatory, I will say. (See p. 56.)

Mr. IGNATIUS. It was. I believe, as I stated, that we have a very good opportunity here to increase competition and lower costs.

The thing that appeals to me, Mr. Chairman, is that we develop under one contract and the developer then receives the production contract. Under this arrangement he does his development and production under the same contract. His design engineers are highly motivated to design under least cost rules because the company has to manufacture, under the same contract, what its engineers design under the design phase.

We think there is very real opportunity here and the first time it has been tried was on the C-5A. We have several applications that we intend to use this technique and we are studying it intensively to see where we can use it in still other areas.

It will not work in all cases, but we think it has a good deal of application. Mr. Charles and his people did an excellent job in working this out.

We can improve as we go along too. We have learned a lot from our first procurement.

During the past year we have published a new regulation governing "Component Breakout." The committee has been interested in this subject in the past and with your permission we will provide a copy of our new regulation for the record.

Senator DOUGLAS. Without objection, it will be included.

(Document follows:)

#### GENERAL POLICIES

##### 1-326 COMPONENT BREAKOUT.

##### 1-326.1 *Scope of Paragraph.*

(a) This paragraph sets forth guidance for making decisions on whether or not components should be purchased by the Government directly and furnished to an end item contractor as Government-furnished material, for incorporation in the end item. This paragraph, however, does not pertain to all such decisions, but only to those which deal with whether components that have been included as contractor-furnished material in a previous procurement of the end item



should be "broken out" from a forthcoming end item procurement for direct Government purchase. Thus, this paragraph does not pertain to the initial Government-furnished equipment/contractor-furnished equipment decisions that must be made at the inception of a procurement program.

(b) Items procured as spare parts are governed by the "DOD High Dollar Spare Parts Breakout Program" described in DOD Joint Regulation AR 715-22, NAVMATINST P4200.33, AFR 57-6, MCO P4200.13, DSAM 4105.2, and are not covered by this paragraph.

(c) This paragraph applies to procurements of weapons systems or other items of major equipment involving components whose direct purchase by the Government may result in substantial net cost savings over the life of the procurement program. Accordingly, it will seldom be applicable to a procurement of such a system or item of less than \$1,000,000. The term "component", as used in this paragraph, includes subsystems, assemblies, subassemblies, and other major elements of an end item, but does not include elements of relatively small annual purchase value.

1-326.2 *Policy.* Whenever it is anticipated that the prime contract for a weapons system or other major end item will be awarded without adequate price competition, and the prime contractor is expected to acquire a component without such competition, it is Department of Defense policy to break out that component if:

- (i) substantial net cost savings will probably be achieved; and
- (ii) such action will not jeopardize the quality, reliability, performance or timely delivery of the end item.

The desirability of breakout should also be considered (regardless of whether the prime contract or the component being purchased by the prime contractor is on the basis of price competition) whenever substantial net cost savings will result (A) from greater quantity purchases or (B) from such factors as improved logistics support through reduction in varieties of spare parts and economies in operations and training through standardization of design. Primary breakout consideration shall be given to those components of the end item representing the highest annual procurement costs and offering the largest potential net savings through breakout.

1-326.3 *Responsibility for Component Breakout Selection, Review and Decision.* The project manager (or if there is no project manager such other official as may be designated by the Head of the Procuring Activity) supported by a project team (to include cognizant engineering, production, logistics, maintenance and other appropriate personnel, and the contracting officer or his designee) shall be responsible for:

- (i) earmarking as susceptible to breakout those components potentially conforming to the criteria and policy set forth herein;
- (ii) conducting the breakout review and evaluation described in 1-326.4;
- (iii) making the decision whether or not to breakout the component; and
- (iv) preparing records explaining such decisions in compliance with

1-326.5.

1-326.4 *Breakout Guidelines.*

(a) Each decision on whether or not to break out a component must embrace (i) assessment of the potential risks of degrading the end item through such contingencies as delayed delivery and reduced reliability of the component, (ii) calculation of estimated net cost savings (i.e., estimated purchase savings less any offsetting cost), and (iii) analysis of the technical, operational, logistic and administrative factors involved. As to each of these, the decision must be supported by adequate explanatory information, including an assessment by, and consultation with, the end item contractor where feasible.

(b) In deciding whether a component should be broken out, the guidelines set forth below (in the form of questions) should be considered. Answers will rarely be "positively yes" or "positively no" but usually "probably yes" or "probably no", with the degree of probability governed by the facts of the particular case. The decision will depend largely upon the degree and significance of the risks to quality performance, reliability and timely delivery of the end item which would be involved in breakout and upon the estimated overall cost savings. Where the risks, if any, are acceptable and breakout is expected to result in substantial overall cost savings, the component should be broken out. On the other hand, if such risks are unacceptable, the components should not be broken out.

(i) Are the design of the component (and the design of the end item insofar as it will affect the component) sufficiently stable that further design or engineering effort by the end item contractor in respect to the component is unlikely to be required?

(ii) Is a suitable data package available for Government procurement? (Note that breakout may be warranted even though competitive procurement is not possible.)

(iii) Can any problems of quality control and reliability of the component be resolved without requiring effort by the end item contractor?

(iv) Is it anticipated that requirements for technical support (*i.e.*, functions such as development of proposed detailed specifications; development of test requirements to prove design adequacy or compliance with design; monitoring tests to assure compliance with established requirements; definition of quality assurance requirements for production of articles; and analysis and correction of service-revealed deficiencies) heretofore performed by the end item contractor will be negligible? If not, does the Government have the resources (manpower, technical competence, facilities, etc.) to provide such support, or can such support be obtained from the end item contractor, even though the component is broken out) or other source?

(v) Can breakout be accomplished without causing unacceptable difficulties in logistics support (*e.g.*, by jeopardizing requisite standardization of components)?

(iv) Can break out be accomplished without causing over fragmentation, of the end item that might materially impede administration, management, and performance of the end item contract (*e.g.*, by unduly complicating production scheduling or identifying (and fixing responsibility for) end item failure that may be caused by a defective component)?

(vii) Can breakout be accomplished without jeopardizing delivery requirements of the end item?

(viii) If a decision is made to break out a component and to acquire it from a new source, can advance procurement funds be made available to provide that source any necessary additional lead time?

(ix) Is there a source other than the present manufacturer capable of supplying the component?

(x) Has the component been (or is it known that it is going to be) purchased directly by the Government as a support item in the supply system or as GFE in other end items?

(xi) Would the financial risks and other responsibilities being assumed by the prime contractor that will have to be assumed by the Government if the item is broken out be acceptable?

(xii) Will breakout result in substantial net cost savings? Estimates of probable savings in cost, should be developed for each case on its own facts, with consideration given to any estimated offsetting costs such as increases in the cost of requirements determination and control, contracting, contract administration, data package purchase, material inspection, qualification or pre-production testing, ground support and test equipment, transportation, security, storage, distribution, and technical support.

(c) If application of the guidelines in (b) above reveals conditions currently unfavorable to breakout, the feasibility of eliminating such conditions should be considered. For example, where adequate technical support is not available from Government resources, or similar assistance must be obtained in order to successfully accomplish breakout, consideration should be given to the procurement of the necessary services, such as product assurance suitability services, from the end item contractor or other qualified source.

1-326.5 *Records and Review Procedure.* The records of the purchasing activity shall contain documentation of:

(i) those components which have been reviewed and determined to have no potential for breakout;

(ii) those components which have been reviewed and earmarked as being susceptible to breakout pursuant to 1-326.3; and

(iii) those components for which a decision to break out has been made.

Documentation of these three categories, and for those components once earmarked but no longer considered susceptible to breakout, shall be signed by the cognizant project manager or other designated official and reflect the facts and conditions of the case, including any assessment by the contractor, and the

basis for the decision. Components that have been earmarked for potential breakout shall be reviewed well in advance of each successive procurement, with a decision made as to whether the component will be broken out for the ensuing procurement. Such reviews, made preferably in the course of requirements determination, but in any event before procurement of the requirement is initiated, shall be repeated until a final decision on whether or not to break out is reached, and shall be documented. When breakout is delayed or postponed, the documentation shall include a description of the actions required to accomplish breakout, identify the activities responsible for such actions, and indicate the fiscal year when breakout should be effected.

Mr. IGNATIUS. In this regulation we have provided the contracting officers with guidelines as to when to purchase components, subassemblies, and selected parts of major weapon systems directly from the actual manufacturer of those items as opposed to having the prime contractor procure them for us.

#### PROCUREMENT MANAGEMENT REVIEW

As you may recall, we described our procurement management review program to the committee last year. It is now in its fourth year of operation.<sup>6</sup>

Under this program we made periodic reviews of all major Department of Defense procurement offices to determine the effectiveness of procurement management to make recommendations for improvement, and to assure ourselves that our policies are properly carried out. These offices, which account for 75 percent of our procurement dollars, are reviewed every 2 years. In calendar year 1965 our first overseas review was completed, covering the European procurement headquarters of the Army, Navy, and Air Force.

As a direct result of the procurement management review program, procurement organizations have eliminated duplicatory efforts and streamlined their procedures, reduced administrative leadtime, reduced the frequency of use of cost-plus-fixed-fee contracts, improved the selection of contract types, broadened the use of competitive procurement, and have greatly improved their pricing methods.

Heretofore, our review activities have been directed toward the pre-award function. We now feel that it will be advantageous to review the contract management function; that is, the postaward actions. We have developed a tentative plan for review in this area, and will initiate a pilot study this month.

#### SUPPLY MANAGEMENT REVIEW PROGRAM

Encouraged by the success of the procurement management review program, we have developed a comparable program for the supply management area, so as to assure that we are effectively managing our inventories. A small unit within my office will coordinate the review effort.

#### PRODUCT QUALITY AND RELIABILITY

In order to prevent defects and minimize losses due to scrap and rework, Defense contractors are required to institute such quality controls and to conduct such inspections and tests as are necessary to

<sup>6</sup> Hearings, 1965, p. 51.

insure that their products conform to design and other contractual requirements.

Within the past year the Department of Defense has prepared and issued a quality and reliability assurance handbook entitled "Evaluation of a Contractor's Quality Program" to assist military quality assurance organizations in enforcing our requirements. (See appendix 9, p. 329.)

At the same time, intensive effort has been directed toward preventing product defects and failures due to human error. This effort is known as the Department of Defense zero defects program. Its aim is to insure that the job is done right the first time. The zero defects program is described in a DOD publication entitled "A Guide to Zero Defects." (See appendix 9, p. 369.)

The Departments of the Army, Navy, and Air Force, and the Defense Supply Agency have instituted in-house zero defects programs throughout the United States and at many overseas bases. Over 1.8 million civilian employees and military personnel have pledged their support to the zero defects program. Simultaneously, more than 1,200 Defense contractors and their subcontractors have instituted zero defects programs and are reporting favorable results.

To conclude, our overall management improvement efforts continue to be reflected in the Department of Defense cost reduction program which Secretary McNamara has reviewed with the committee.<sup>7</sup> The program provides for regularly scheduled reports of progress toward meeting specific goals. The savings that have been achieved have been of importance to the Department of Defense and, indeed, to the Nation as a whole. Equally important, they attest to our determination to conduct our affairs in a responsible and businesslike manner.

Mr. Chairman, as I said in opening this statement, we deeply appreciate the counsel we have received from your committee in the past and we solicit your continuing advice and support. We are prepared now to respond to questions or comments that you or the members of your committee may wish to direct to our attention.

With me are three of my deputies, Mr. Paul Riley, Mr. Robert Moot, and Mr. John Malloy; and Maj. Gen. Allen T. Stanwix-Hay, who has headed our Office of Technical Data and Standardization Policy.

#### DSA SAVINGS

Chairman DOUGLAS. That is a very fine statement, Secretary Ignatius. I want to compliment you and your associates in the Department on what you have done.

As you may know, some of us for 15 years have urged the development of a central Defense Supply Agency and have wanted such a supply corps.<sup>8</sup>

Now, can you give any estimate of the hard savings which are attributable to the DSA since its establishment?

Mr. IGNATIUS. Yes, sir; I can. We keep records of what we have achieved. I believe significant savings resulted from consolidations that took place and which this committee has urged upon us for so many years.

<sup>7</sup> See pp. 4, et seq., supra.

<sup>8</sup> Report, October 1960, pp. XI-XII.

First, we have been able to reduce our inventory as a result of consolidation. We have eliminated a lot of duplication that existed when there were separate service inventories and we estimate through fiscal year 1965 that this has resulted in an inventory reduction of \$506 million.

Secondly, by consolidation we have reduced our annual operating costs. It just costs less money to operate a consolidated activity.

Chairman DOUGLAS. If you take the supply services of the four military services plus DSA, what is the total personnel now compared to the total personnel in the four separate agencies before?

Mr. IGNATIUS. The personnel that DSA employs to do the job that was formerly done by the services before the establishment of DSA is some 8,439 less than what it was previously. In other words, as a result of consolidation we have saved about 8,500 people.

Chairman DOUGLAS. And that includes the employees in DSA itself?

Mr. IGNATIUS. Yes, sir, it does, and this is a comparison. We can furnish for the record the total DSA employees, military and civilian.

Chairman DOUGLAS. It was charged in the beginning that the creation of a Defense Supply Agency merely meant that you would put another echelon of supply on top of the previous echelons and the result would be an increase in personnel?

Mr. IGNATIUS. We do not believe this has been the case and as a result of a consolidated supply agency we can get the job done at less cost and with fewer people.

#### PAYROLL SAVING OF \$50 MILLION ANNUALLY

Chairman DOUGLAS. And those 8,500 jobs constitute a payroll saving of \$50 million a year?

Mr. IGNATIUS. Well, let's see, I suppose an average figure might be perhaps \$7,000 or so per individual, \$7,500.

Chairman DOUGLAS. \$50 million a year, conservatively.

Mr. IGNATIUS. Yes, sir; about that order of magnitude.

Chairman DOUGLAS. I wonder if you would say anything about the situation as far as medical and dental supplies are concerned?

Mr. IGNATIUS. Yes, sir. Medical and dental supplies, of course, are the responsibility of the Defense Supply Agency through its Defense Personnel Support Center in Philadelphia.

I believe from what I know about this, and Admiral Lyle who will follow me in testimony can expand on this if you wish, that this is an effective and professional organization and is doing a good job.

#### USE OF \$2.8 MILLION OF MEDICAL ITEMS

Recently in connection with the shelf-life problem that I discussed in my statement and which you referred to in your opening remarks. Mr. Chairman, DSA and the Public Health Service have had discussions with respect to exchange of information and exchange of assets. I am informed that so far some \$2.8 million of pharmaceuticals from the Public Health Service in long supply have been transferred to the Department of Defense for use.

I think this is progress in the general line that you called to our attention in your report last year.

Chairman DOUGLAS. Is there any tendency for the Defense Supply Agency to have excess stocks of short-life items?

Mr. IGNATIUS. Yes, there is that tendency and we need to improve our management to keep this to an absolute minimum.

Chairman DOUGLAS. Have you any estimate as to the value of medical items which—pharmaceutical items which have outlived their potency?

Mr. IGNATIUS. I do not. I have a figure for the amount of our inventory of perishable items or shelf-life items, but I do not have figures on the medical component. Perhaps Admiral Lyle will have that later; I do not have that, Mr. Chairman.

#### ALAMEDA MEDICAL TEST

Chairman DOUGLAS. There was an Alameda test in 1951–52 on medical and dental supplies and equipment. Are you familiar with that or any of your staff familiar with it?<sup>9</sup>

Mr. IGNATIUS. I am not, Mr. Chairman. Perhaps Mr. Riley is.

Chairman DOUGLAS. Are you, Mr. Riley?

Mr. RILEY. Yes, I am, Mr. Chairman. The Alameda test took place, I believe, in about 1951. It was proposed by the committee that was a forerunner of this one, the Bonner committee. The committee requested the Department of Defense to make a test of consolidated supply operations on medical items alone.

I think, from the point of view of the Bonner committee, that the test was not a complete success. However, it did provide basic objectives for the Department of Defense which this committee has urged upon us for a number of years.

The culmination of that test, I believe it is fair to say, is the Medical Supply Center of DSA, which has been a great success and has proved the achievements which the committee said should be accomplished.

#### LESSENING OF ECONOMIC IMPACT

Chairman DOUGLAS. What I am trying to get at is this: Suppose we now had the disorganized separate procurement of the four services. Would this in the present market result in a tremendous amount of duplicate and excessive buying?

Mr. RILEY. I do not think there is any question about that.

Senator DOUGLAS. But here you have been able to survey the needs as a whole and purchase as a whole. Is there any shortage of medical supplies in Vietnam?

Mr. IGNATIUS. I am not aware of any shortage of medical supplies in Vietnam, Mr. Chairman.

Chairman DOUGLAS. I have not heard of any.

So, what about clothing?

Mr. IGNATIUS. We have clothing procured by the Defense Supply Agency, again through the Defense Personnel Support Center in Philadelphia.

In respect to clothing, we have had, as you know, a rather significant increase in the size of our military forces in connection with our activity in Vietnam, and we have also had some new items that were as-

<sup>9</sup> Ibid., p. 68.

sociated with that activity, a new jungle boot, a lightweight tropical fatigue uniform.

We have also augmented our military strength by means of induction and enlistment, as opposed to a Reserve callup. This aggravates the clothing problem, because the Reserve personnel have a clothing bag, whereas you must clothe an enlistee or an inductee from the ground up, so to speak.

As a result of these many things, we find the situation as follows:

First, all of our requirements in Vietnam are being very well met with respect to all clothing items. In the case of one or two new items such as the jungle boot, we have to use substitutes yet, for a period of time, because the boot is brand new. When I last checked on the figure, we had shipped almost 400,000 pairs of the new combat boot, so we have a great many of them out there. We also use the regular leather in addition.

#### STANDARDIZATION OF BOOTS

Chairman DOUGLAS. Have you been able to standardize the boot?

Mr. IGNATIUS. Yes, the boot is standardized.

Chairman DOUGLAS. The Army boot, in my experience was always a better boot, the Marine Corps insisted on having a separate boot.

Mr. IGNATIUS. The jungle boot is standard sized and is used by the Marine Corps and the Army, and I believe also the leather boot has recently been standardized.

Chairman DOUGLAS. You have persuaded the Marine Corps to adopt the Army boot?

General STANWIX-HAY. We have compromised, sir. We have come up with the boot which we think combines the best features of all the boots.

Chairman DOUGLAS. What about blankets? Have you been able to standardize blankets or does each service now insist on its own blanket?

Mr. IGNATIUS. There was a GAO report several years ago, as I recall, on the question of blankets. My recollection, and I will need to check the record to be certain, Mr. Chairman, is that there were some differences, inherent differences, required in blanket size between a blanket that would fit a Navy bunk, for example, on a ship as opposed to a blanket that would be used by an Army man or a marine in the field.

I believe that was the substance of the Department's response. Perhaps Mr. Riley can add to this.

Mr. RILEY. I think that is correct.

Chairman DOUGLAS. Mr. Curtis?

Representative CURTIS. Thank you. I want to join with the chairman's remarks commending you for a good report.

Mr. IGNATIUS. Thank you.

Representative CURTIS. And then go into some questions of further details.

#### "BUY AMERICAN" ACT

One specific that has been bothering me a bit is the Buy American Act as it relates to some of our problems. I want to find out what the

Defense Department policy is by presenting a problem that has developed when we moved handtool procurement over to GSA. Apparently GSA has a different concept of, or maybe it is the law, of Buy American. The net result is that there are many procurements of material coming from abroad.

I think it is a 6 percent allowance that they give the domestic manufacturer or the domestic supplier. I have heard—this is what I wanted to find out—that the Defense Department has been using a differential as high as 50 percent.

Would you comment on that? (See appendix 2, p. 214.)

Mr. IGNATIUS. Yes, sir; your statement is substantially correct.

The Buy American Act provides for a differential. I believe it is 6 percent under the Executive order implementing the act. I do not think the act actually stipulates the percent. It is 6 percent except in certain instances it may be 12. Those certain instances, I believe, are in the case of a small business or a company in a distressed area.

But at any rate it is normally a 6-percent differential. You are quite right, Mr. Curtis. The Department of Defense, with respect to procurements where we would compare an oversea procurement versus one in this country has applied a 50-percent factor. In several instances we have even gone higher than 50 percent, but that requires the approval of the Secretary or the Deputy Secretary.

Representative CURTIS. Just so we get it out in the record, where does the authority for the 50 percent come from; is that under the Buy American Act, too?

Mr. IGNATIUS. This is Mr. Malloy, my deputy for procurement.

Mr. MALLOY. That was established by Secretary McNamara 2 or 3 years ago in an effort to reduce the impact of Defense expenditures on our flow of gold problems.

There is a Cabinet Committee on the International Balance of Payments problem and this figure of 50 percent was discussed some 2 or 3 years ago by the Cabinet Committee. That committee ratified the Defense policy of using the 50-percent rule.

Representative CURTIS. What authority, though, do they use? Is it from the Buy American Act that they get their basic authority to apply a 50-percent figure?

Mr. MALLOY. Mr. Curtis, the Buy American Act itself does not specify the percentage. That is left up to the executive department, as I understand it. The Executive order which implements the Buy American Act establishes for all Government agencies the 6- and 12-percent figures.

There is a provision in the Executive order for exceptions to the general figure and it was the exception procedure of the Executive order that Secretary McNamara invoked with the approval of the President's Cabinet Committee.

Representative CURTIS. Very good. In other words, it is the Buy American Act that is the basic authority. That is what I thought it was.

Then comes the question: Why by Executive order can we not correct this problem that exists in the procurement of handtools, at least as far as it relates to the procurement of handtools for which the ultimate user is the Defense Department?



We have a problem here, and yet this committee felt that this movement of handtools over into GSA was a very desirable thing. As you know, this committee is constantly watching the relationship of GSA and DSA. We urge, wherever possible and appropriate, that the Defense Department utilize the General Services Administration, but we run into this kind of impediment.

It would certainly render this movement ineffective and, as far as the domestic handtool producers are concerned, would create a real problem if you have a 50-percent rule applying to what the Defense Department procures, DSA or one of the military services, when only a 6-percent rule can apply to GSA.

Mr. IGNATIUS. You raise a good question, Mr. Curtis. There was, and it was in December of 1963 I believe, a Cabinet committee that addressed the question of these differentials and concluded that the disparities that existed between Defense, on the one hand, and some of the other agencies, on the other, should continue.

I will be glad to meet with Mr. Knott of GSA and pursue this further, also Mr. Malloy with his procurement people, will make further inquiries, particularly with respect to the handtool problem which you have brought to our attention.

(The following information was later supplied by the Department:)

#### GSA PROCUREMENT OF HANDTOOLS

The General Services Administration purchases all common handtools for the Department of Defense. In carrying out this responsibility, GSA applies the 6- and 12-percent Buy American differential required by Executive Order 10582. The Department of Defense, on the other hand uses a 50-percent differential in its buying program, although it should be noted that DOD does not buy common handtools. Any tools purchased by GSA are used by DOD regardless of the Buy American differential used during the purchasing phase. The differing Buy American rules have existed for some time and have been approved by the Cabinet Committee on the Balance of Payments as well as the Bureau of the Budget.

Representative CURTIS. I would appreciate that very much. I think we need to get this straightened out one way or another without even getting into other questions that might arise as to the wisdom of applying the Buy American Act to this extent. (See appendix 11, p. 406.)

#### BUY AMERICAN ACT AND BALANCE OF PAYMENTS

Mr. IGNATIUS. I think one of the things we were concerned about—that Secretary McNamara was concerned about—Mr. Curtis, was that the Department of Defense was responsible for a large part of our balance-of-payments deficit and he undertook in 1961 to deal very affirmatively with it with excellent results. In fiscal 1961 the gross defense expenditures entering the balance of payments were about \$3.1 billion. By the end of 1965, the figure had been reduced to \$1.4 billion.

Now, he did this by two means principally: One, to enter into a number of military sales agreements with companies abroad that had the effect of offsetting our gold flow expenditures; and secondly, by return of procurement under this 50-percent policy. I think I should add a third category, by looking very hard at a number of causes of

expenditures attributable to defense activities abroad and pruning them as far as prudence would allow.

Representative CURTIS. As you know, the Joint Economic Committee—the whole committee, of course—is deeply concerned about this balance-of-payments problem.

Mr. IGNATIUS. Yes, sir.

Representative CURTIS. And this is one that the full committee, both the Democrats and Republicans, have said is an area to look to. Of course, I personally commend the Defense Department for directing this attention.

I might worry about some of the specifics applied and I would like to ask this question: This has been at some additional cost to military procurement, hasn't it?<sup>10</sup>

Mr. IGNATIUS. Yes, sir.

#### COST OF BUY AMERICAN ACT POLICY

Representative CURTIS. Because in many instances we could have acquired these goods and were acquiring them at a cheaper price. Do you have any idea of what the additional cost has been, at least in that category that had to do with defense procurement?

You dropped from \$3.1 to \$1.4 billion, and one of the categories was this area. How much additional cost has it been in procurement, do you know?

Mr. IGNATIUS. Yes, sir.

Under the 50-percent rule that we have applied, through fiscal 1965, the average price differential or average premium that we paid was 27.6 percent, and the dollar equivalent of that was some \$67.5 million.

In short, we have spent \$67.5 million in order to reduce the gold dollars, so to speak, the gold outflow. You are right, it has cost more money to do it, but we have done it in the national interest.

Representative CURTIS. In the long run I would hope that military procurement would not have to be restricted by this kind of extraneous consideration—at least extraneous as far as getting the best quality at the cheapest price for our defense equipment.

But there is no question we have this overall problem of the balance of payments and this is one of the penalties we pay. I would argue for this.

I see my time has expired. I have a few other items that I will check when we come back.

#### ADEQUACY OF MACHINE TOOL MANAGEMENT

Chairman DOUGLAS. Mrs. Griffiths?

Representative GRIFFITHS. Thank you, Mr. Chairman.

I think, too, Mr. Secretary, you made an excellent statement. I would like to ask you, have you read this report from the GAO on Government-owned property in the possession of contractors?

Mr. IGNATIUS. That has just been issued, Mrs. Griffiths. The report is in the office; I have not personally read it, but the staff is going to work on it and I intend to read it.

<sup>10</sup> Hearings, 1963, p. 232 et seq.; hearings, 1964, pp. 13, 297 et seq.

Representative GRIFFITHS. It was made, if I recall, because I asked what control the Defense Department had over its property and supply in the hands of contractors.<sup>11</sup>

I notice in the report that it is the policy of the DOD to have its contractors maintain the official records of Government-owned property in their possession.

What records do you maintain?

Mr. IGNATIUS. I believe that our contract administration people maintain records of property that is in the hands of contractors so that we know what we have and where it is.

I believe that this is one of the functions of our Contract administration offices and that property officers are the ones within the offices who do this.

I would like Mr. Malloy to comment further on that, if he wishes.

Mr. MALLOY. Basically the records are kept by contractors in accordance with some rather detailed rules we have published which tells them how they are supposed to do this. As a matter of fact, we are coming out within the next month or two with an expansion of our rules in this area that we have been working on for some time.

Our own property administrators perform a surveillance function over the work done by the contractors and maintain overall figures showing the totals, relying on the detailed records in the contractors' hands.

Now the reason we do this is that the contractor himself has to maintain these types of records and if we maintain the exact same records, we would duplicate. So, in order to save administrative costs, we have for many years provided that the contractors fill out our forms in the way we want them and we then check on them and see that the records are accurate.

Representative GRIFFITHS. How do you check if you do not have a record of your own? How do you check?

Mr. MALLOY. We have records of property that the contractors acquire. We can tell from the contractors' accounting records what he has acquired and from our own records where we have furnished the property.

Representative GRIFFITHS. The report of the GAO points out that you do not require the contractor to pay for equipment that is missing or lost?

Mr. MALLOY. That is right.

Representative GRIFFITHS. Because it is assumed this would be charged back to the Government.

So that the real truth is, that the reporting system is very sketchy, to say the least, is that not really true?

Mr. MALLOY. I do not know as I could agree completely with that, Mrs. Griffiths.

I have had a chance to read the GAO report, rather fast, although I have not had time to study it. The GAO people have pointed out that there are some areas in which we can improve our administration of property records and I am sure this is true.

Part of the General Accounting Office observations had to do with the fact that they themselves were unable to track from our own

<sup>11</sup> Report, July 1965, p. 11.

records whether or not the property administrators were doing the job. This does not say that they were not doing the job.

But I think that the combination of the expanded regulations that we are in the process of putting out, plus the additional attention that we will devote as a result of this General Accounting Office study will undoubtedly prove beneficial.

As to the other basic question of whether we make contractors pay for missing articles, here, again, is a longstanding policy of ours which, as a result of the GAO study, we will investigate further. (See p. 240.)

The contractors can be held responsible, and they in turn will cover this responsibility by taking out insurance, and we will pay the premiums. For many years we have acted as a self-insurer in this area.

We do this in other areas and we have other instances in which we insist that the contractor take out insurance and we do not act as a self-insurer. It is a very complicated area, but we have not taken a look at this for a long time and I think that it will be quite beneficial to do so now.

#### DOD WILL REVIEW GAO REPORT

Mr. IGNATIUS. Let me add, I am glad you asked this report to be made. I am glad the GAO made it and we will undertake a review of what we are doing and how we are doing it. If it is evidence that we need to improve, we will do it. We appreciate your doing it.

The GAO and this committee have often brought matters to our attention. We will take a good, hard look at everything. If we agree with everything we will say so; if we disagree with some, we will certainly say so. (See p. 405.)

Representative GRIFFITHS. One thing it points out is there are billions of dollars worth of property now involved.

Mr. IGNATIUS. Yes.

#### POSSIBILITY OF DUPLICATION IN INVENTORIES

Representative GRIFFITHS. I have been running some hearings in here on tax increases and decreases. It seems to me that one of the problems that you have is that you have large amounts of equipment not known to a single agency, a single unifying agency that could make that equipment known throughout the country. Therefore you must be duplicating equipment that you have sitting in your own plants, in a contractor-run plant where he is not using the equipment, and it seems to me it would be one of the ways in which you could not only reduce the bill, but reduce the demand for machines upon other contractors.

If you actually knew whether or not you had equipment that you are now buying for somebody else, or that you are issuing to somebody else, how do you propose to take care of that?

#### ADEQUACY OF CONTROLS

Mr. IGNATIUS. We, I believe, have that under control, Mrs. Griffiths. Representative GRIFFITHS. The report says you do not have. This

report says you have hundreds of machines sitting around that you are not using and that you are duplicating elsewhere.

Mr. IGNATIUS. As I say, the report was issued on the 17th of March; I have not had a chance to read it yet, but I will and we will look at it carefully.

#### FUNCTIONS OF DIPEC

We did establish an organization called DIPEC (Defense Industrial Plant Equipment Center) that is part of the Defense Supply Agency that is responsible for looking at the machine tools of a general-purpose sort that are Government owned and used by contractors. We have, also, screening procedures and interdepartmental utilization procedures designed to avoid the kind of problem that you are mentioning here.

Certainly we do not want to buy quantities of tools if we have them, and we have procedures that are designed to prevent us from doing that. If there are problem areas in the report we will look at those particular areas.

#### WITHDRAWAL OF TOOLS FROM SUBCONTRACTORS

Representative GRIFFITHS. I would like to raise another question with you which I have raised with Secretary McNamara before. One of the things which you are doing is permitting your inspectors to direct machine tools out of a subcontractor's plant when the subcontractor was actually using them for your own work, and I happen to know of an instance where the machine tools were removed and put in storage and the prime took over the contract.

Now, I think this is just as bad as having equipment sitting in a contractor's plant while you order more.

Mr. IGNATIUS. I do not know the particular case that you mention, we will look into it if you will bring it to our attention.

Representative GRIFFITHS. You do not need to, because I have gone over it and I know what the facts are, and I know they were moved out of the plant. I think the Navy inspector moved them out, but I would assume that if you have equipment in plants that you do not know is there, you do not know that this happens either, and I would think that it would be a very good way to check up on what is happening with Government-owned equipment.

#### PAYMENT FOR CIVILIAN USE OF GOVERNMENT EQUIPMENT

Now, I think, also, that you ought to investigate how much Government-owned equipment is being used on civilian work and whether or not you are getting rent for it.

Mr. IGNATIUS. Well, we have procedures for that and use agreements that we enter into with companies and if the Government-owned equipment is used on nongovernmental work, the use of that equipment is covered by usage agreements. This is a matter of basic policy in the Armed Services Procurement Regulations.

Representative GRIFFITHS. Well, I would assume that you are not renting out equipment for private use when you need it elsewhere for Government use.

Mr. Chairman, may we make a copy of this report a part of this record?

Chairman DOUGLAS. Without objection, that will be done.

(See appendix 4, p. 240.)

Representative GRIFFITHS. Thank you very much. My time is up.

Chairman DOUGLAS. Senator Jordan?

#### STANDARDIZATION AND LIFE OF MILITARY HARDWARE

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Secretary, I also commend you for a very fine report. I want, first, to ask some general questions about standardization and the life cycle of military hardware.

I know that your job of procurement must be compounded tremendously by the fact that the life cycles of military hardware are very likely to be affected by obsolescence, by change in design, and by change in plans. I can see the tremendous burden this puts upon you.

Tell us for the record, if you will, are we using any of the military hardware, weapons, ammunition, or aircraft that were effective in World War II?

Mr. IGNATIUS. Are we using, today, any equipment that was effective in World War II, in Vietnam?

Senator JORDAN. That were standard in World War II.

Mr. IGNATIUS. Yes, sir; just quickly responding to your question, I do not think of too many things.

For instance, let's take some basic items: The rifles we are using are the M-14 and M-16; in World War II we used the M-1. We do not use many tanks in Vietnam; those that we do have are quite different.

The personnel carrier we use is the M-113, which is new, and was not available in World War II. We have, by and large, in the small-arms field, reequipped with the 7.62, including the M-14 that I mentioned, the M-16 machinegun, the .30 caliber equivalents, I mentioned the rifle and machinegun equivalents were used in World War II, so there is not much of that.

In terms of aircraft, we did not have helicopters, and we use many now. In terms of the fixed-wing, most of the fixed-wing are new. The only one I can think of that might be similar, it is not identical, but there might be similar equipment to the O-1 aircraft which is the single-engine observation plane. There are various commercial versions, the Piper Cub and Cessna. Here there would be similarities, but I am sure the performance would be different.

In short, I do not think of too many items, although I am sure there are some. Perhaps the bayonet is the same; I would guess it is the same. The uniform items have changed pretty much. There may be some in terms of support equipment, certain generators that go back to that time, but I do not right offhand think of too many, Senator Jordan.

Senator JORDAN. How rapidly do systems change? Will you give us the same rundown with respect to the Korean war?

Mr. IGNATIUS. Well, some of what we used in Korea we are using in a limited way. For example, Korea was the first, I believe, where we used helicopters to any extent and the Bell and Hiller observation

helicopters were introduced in the Korean war. This would be the OH-13 and the OH-23, and some of those are still being used in Vietnam and quite a few of them are being used in the United States. We also have a new light observation helicopter, the O-6, which replaces it and which is just coming into production. Of course, we have a whole family of new helicopters of the turbine variety, the UH-1 being the ones we use in the largest number, CH-53, 51, that we used in Korea. There has been quite a change there.

I would suspect some of the trucks of the standard variety, two-and-a-half ton. I know the three-and-a-quarter ton goes back 14 years, so that would go back to Korea.

Generally speaking, the military vehicles of the standard sizes probably go back to that period. There are new ones under development and limited procurement.

The tank has changed since then, I believe we had the M-48 tank in Korea. We have the M-60 now. We used the M-1 and .30 caliber arms systems then and we now have the .762 and .556, which is the M-16 rifle, so there has been quite a lot of change since Korea, but not as much as since World War II.

Senator JORDAN. That is a very uncertain procedure, then, trying to determine what the useful life of any system is.

Mr. IGNATIUS. Yes, sir; it varies. The .45 caliber sidearm, I believe, goes back to the Philippine Insurrection; that is a long time ago, and we still use it and it is a real good sidearm. The  $\frac{3}{4}$ -ton truck goes back 12 to 14 years, I believe. I do not think you want to replace for replacement sake. I think you want to replace if you have a real good reason. The real good reason ought to be a significant increase in combat effectiveness or a significant increase in doing the job less expensively. To change for the sake of changing simply costs money and complicates our supply system. As you bring in undue variety you have serious logistics problems.

#### VALUE OF STANDARDIZATION

I might mention, Senator Jordan and Mr. Chairman, that in some areas the value of standardization has been brought very directly to our attention as a result of Vietnam. For example, materials-handling equipment, the many makes and models complicate our spare parts supply.

The bulldozers—many makes and models make supply support difficult. Generators is another area. We have a major project going on generators to try to reduce the number of military standards in order to improve effectiveness; that is, we will not have as much dead-line because we will have not as many parts to keep in the supply system. You cannot guess right on all of these.

#### REDUCING DOWNTIME OF EQUIPMENT

Senator JORDAN. Mr. Secretary, the Comptroller General's report of November 29, 1965, on page 121,<sup>12</sup> said that Army reports disclose that for the 18-month period October 1, 1962, through March 31, 1964, a daily average of 318 helicopters and 119 fixed-wing aircraft, a total

<sup>12</sup> Staff study, 1966, p. 121.

of 437 Army aircraft were in a grounded status because repair parts were not available when needed.

The Comptroller's report suggests also that the publication and promulgation for standard rates for deadlining and reordering may be responsible by having relieved personnel on the site of responsibility.

We have had a tremendous stepup in the use of these aircraft in Vietnam. Have steps been taken to reduce the downtime of these very effective helicopters and fixed-wing aircraft?

Mr. IGNATIUS. Very substantially, Senator Jordan. The largest single unit in Vietnam that uses helicopters is the 1st Cavalry, Air Mobile Division. I get a weekly report on their deadline rate for helicopters and it has been quite satisfactory. The deadline rate is below what our norms would call for and this is true also of the fixed-wing aircraft in the 1st Cavalry as well as in other Army units in Vietnam.

With respect to aircraft operated by the Air Force, the Air Force for a number of years, I think, has had a very excellent system of control of the NOR system, as they call it, "not operationally ready" aircraft.

They maintain daily reports that come into Wright-Patterson Air Force Base, the headquarters of the Air Force Logistics Command where they know the aircraft that are down in all theaters in all parts of the world.

We are experiencing very satisfactory performance in our fixed-wing and rotary-wing aircraft in Vietnam. The only place where we are not satisfied in respect to deadline rates, Senator Jordan, is in materials-handling equipment and bulldozers, and we have taken action to deal with that. The action we have taken is to reduce the variety of makes and models to a smaller number of standardized items, so that we can, in fact, support them better.

Senator JORDAN. Thank you, Mr. Secretary.

Chairman DOUGLAS. Any other questions?

Representative CURTIS. Yes, Mr. Chairman.

Chairman DOUGLAS. Mr. Curtis.

Representative CURTIS. Mr. Secretary, some of these points that I will raise, I think, would best be answered in the record, if you would.

Mr. IGNATIUS. Yes, sir.

Representative CURTIS. We do read the record and it becomes a basis for further points.

I think I will skip this shelf-time item because Admiral Lyle will be here and you have gone into it to some degree.

#### USE OF RENEGOTIATION ACT

The Renegotiation Act is up again for renewal before my committee, the Ways and Means Committee, and the Senate Finance Committee.

I have felt for years that this should be eliminated, not that the process of renegotiation should be eliminated. I think you have to have it. At the same time, I think the military has been doing a very good job in putting what I called renegotiation clauses in their contracts. It is simply a question of whether the people who nego-



tiate the original contract are the ones best able to go over it in light of actual performance to determine where the renegotiation should apply rather than an independent board.

I can see in times of emergency procurement why we established the Renegotiation Board to do these things. I think for your response and maybe for the record would be this question:

In effect, I think you have bypassed the Renegotiation Board through the development of your clauses, the various clauses in your contracts, your incentive contracts, which I applaud. But they really go against the theory of the renegotiation. I guess this is the question to ask you directly here—has the Department of Defense thought this over as far as a basic recommendation to possibly handle this within-house, within the Defense Department rather than have an independent board?

Mr. IGNATIUS. If I understand the question, you are not suggesting the exclusion of, for example, incentive contracts from the renegotiation procedure—

Representative CURTIS. Oh, no.

Mr. IGNATIUS (continuing). But rather that it be done by the Department of Defense as opposed to the Renegotiation Board.

Representative CURTIS. That is right. I like to see the flexibility. I have often argued that the Board somewhat becomes a crutch. I would rather rely on what I think is true, the honesty, integrity and ability of our procurement officers. They are the ones who are best able to judge this in regard to new equipment, where no one can get the costs ahead of time to do the renegotiations. That is the theory.

Mr. IGNATIUS. Let's give you a response for the record, but just offhand I believe consideration has been given to the question of whether incentive contracts should be subject to renegotiation. I am not aware of any consideration having been given to us doing the job as opposed to the Renegotiation Board.

Mr. MALLOY. Not recently.

Mr. IGNATIUS. We will look into that and give you a fuller response for the record.

Representative CURTIS. This is coming before the Ways and Means Committee and I will be asking questions then, but I think it relates to our overall study in procurement practices. I would think we would have a much better system without this extraneous operation.

(Material which follows was subsequently submitted by the Department:)

#### RENEGOTIATION

The reason advanced for the transfer of the Renegotiation Board from the Department of Defense to an independent agency in 1951 was that only the creation of a separate agency would insure the objectivity of independent judgment and the uniformity of decision so essential to the fair and equitable administration of renegotiation. We consider this reasoning still valid.

Certain DOD contracts do provide for price redetermination by our contracting officers and this redetermination does give us a second look at costs. However, each redetermination may not be as effective as it should be. At the present time the Renegotiation Board determines whether, and the extent to which, the contractor's total profits from all its contracts in a fiscal year, are excessive in the light of the factors prescribed in the Renegotiation Act. There are present advantages to a contractor in that overall profit may be derived after losses

or subnormal profits on some contracts have been offset against high profits of others.

The Government has no direct contract relations with subcontractors and it is difficult to redetermine subcontract prices through the prime contractor. The profitability of defense business generated by all contracts negotiated with a contractor will not be known until the results of performance in his respective fiscal years have been recorded. The present Renegotiation Board provides the means for reviewing such profits on an overall basis.

The placing of the renegotiation responsibility within the Department of Defense would not take care of those contracts of other departments which are also subject to renegotiation. These other departments may want to establish boards of their own. However, it would be difficult to get all departments to work together to achieve uniform renegotiation results. The regulations would need to be as detailed as at present and more personnel would probably be required because of additional problems involving coordinations between departments.

It is our feeling that at the current high level of spending this overall and final look by an outside board operates as a means of assuring the public of effective procurement.

#### EXECUTIVE OFFICE POLICY ON PROCUREMENT OF COMMERCIAL-TYPE ITEMS

Representative CURTIS. Another subject for response to the record: The Bureau of the Budget has finally issued circular A-76 that this committee has been most anxious to have issued. I would like to have the Defense Department's comment on this. (See below.)

#### CONSIDERATION OF LOCAL TAXES

There are many aspects of it that I would like to comment on, but one in particular. I was disappointed in not having an item in here in lieu of local taxes. The fact is that our Government, with its Federal installations or operations, does not pay local taxes and yet it derives the benefit from States—sewers, police protection, and so forth. It would seem to me that this should be clearly spelled out as one of the items of cost. Would you supply for the record your comments in regard to this new guideline that has been published?<sup>13</sup>

#### GAO REPORT ON USE OF PROCEEDS FROM SURPLUS PROPERTY SALES

We have a March 18, 1966, report from the Comptroller General on cost of sale of surplus property and disposition of proceeds. The GAO will be testifying before us. Whether you have had an opportunity to go over this report of the Government Accounting Office or not, I do not know, but at any rate it would be better, I think, if you supplied your comments for the record.

Mr. IGNATIUS. We will do that. I have read a summary of the report. I have not read the full report, but my staff is reading it and we will comment on that for the record.

(The Department subsequently supplied the following:)

#### DOD COMMENTS ON BOB CIRCULAR A-76

The Department of Defense considers that Bureau of the Budget Circular A-76 contains comprehensive and sound guidance on the policies which all Government agencies must follow in determining whether products or services are to be provided by contract or by Government personnel. Department of

<sup>13</sup> See also, Report, September 1964, pp. 11-12.

Defense will comply fully with this circular, as a part of our efforts to achieve maximum economy and efficiency in the provisioning of all required products and services, with the reduction of unnecessary costs continuing to be one of our primary objectives.

As this circular was prepared by the Budget Bureau, any detailed response as to the reason why local taxes are not included as a cost consideration must, of course, come from that agency. However, it is our understanding that this element of cost involves various legal, economic, administrative, and budgetary problems which make its inclusion in any cost comparison formulas inadvisable. Moreover, it appears that the 10-percent differential, which the circular requires be added to all Government costs involving new starts of commercial or industrial activities, provides ample protection against any inequities in cost comparisons which might result from omission of local taxes.

Chairman DOUGLAS. We have made the GAO report on the adequacy of controls over Government-owned property a matter of record. (See appendix 4, p. 240.) Would you like to have this made a matter of record also?

Representative CURTIS. Yes, Mr. Chairman, I would.

(See appendix 5, p. 273.)

Chairman DOUGLAS. And there is still a third GAO report to be included on the use of high-priority requisitions.

(See appendix 6, p. 289.)

Representative CURTIS. We had, Mr. Secretary, an informal briefing on the newly established Defense Contract Administration Services, which I thought was quite good. Following that up, I had asked further questions. I think, in fact, that I have here a letter sent from Mr. Malloy, who is the Deputy Assistant Secretary of Defense, who sent the chairman a letter dated February 8, 1966, along with some data, including a summary listing of Department of Defense plant cognizance assignments of the installations and logistics.

One of the questions I raised is why various categories of contracts have been excluded from Defense Contract Administration Services, DSA, or are being considered for exclusion. There is a response to this question and also a memorandum for Deputy Director for Contract Administration Services of March 7, 1966, which Mr. Chairman, I would like to have in the record, too.

Chairman DOUGLAS. That will be done.

(See appendix 8, p. 305.)

#### EXCLUSION OF CONTRACTS WITH COLLEGES FROM DCAS

Representative CURTIS. Then I had this one additional comment. Perhaps we will supply some questions on this. I have not had a chance to go into this as fully as I would like. However, in attachment No. 3 there was a footnote stating that contracts to 300 colleges are now administered by military departments rather than the DCAS. (See p. 96.) I wonder whether you would agree that with regard to colleges, contracts should be centrally administered, not administered by individual departments, in order to lessen perhaps what some of the universities feel is interference in university affairs.

I am not sure that that would be the case, but if you have any comment on that specific now, I would be glad to receive it, otherwise just comment for the record, along with the other questions.

Mr. IGNATIUS. All right, sir, we will.

(Comment later supplied by Department follows:)

All DOD contracts which require on-site administration at colleges are being administered by a single DOD component, the Office of Naval Research. The Office of Naval Research was selected as the sole DOD contract administration representative at colleges because it had a field organization for this purpose in being, and had available the kind of scientific personnel best qualified to administer contracts with educational institutions, which are predominately for basic research.

#### POLICY ON MULTIPLE SUPPLY SOURCES

Representative CURTIS. I want to follow up on a question that I had asked Secretary McNamara concerning the theory of not relying on one supply source. I know your policy is to develop alternate sources. This problem occurred in East Alton with regard to the small arms ammunition, I believe, of Olin-Mathieson. The Secretary then said that you were in the process of developing other sources of supply. (See p. 43.)

Have you any up-to-date report on that?

Mr. IGNATIUS. In addition to Olin-Mathieson at East Alton, which produces this powder, we have opened the Government-owned standby plant at Baraboo, Wis., I believe it is, that makes the same kind of powder.

Secondly, there is more than one kind of powder for small arms. Olin-Mathieson made one in particular; Baraboo is making the same one, but there are other sources for the other types of powder that is used and we will give you a detailed report of this for the record, showing you the guns for which the different powders are used and the procurement sources that make the various powders.

Representative CURTIS. This question, of course, is directed only toward this as an example of the overall policy which the committee is concerned with.

Mr. IGNATIUS. Let me make just a quick overall comment and I will keep it very, very quick.

In this case of this particular powder, the Army at one point gave some consideration to having an alternate source, but the quantity was so small; in peacetime you do not use much of this, that it is not an economical operation, and so you maintain your insurance policy, so to speak, in the form of a stockpile of powder—

Representative CURTIS. You can stockpile it?

Mr. IGNATIUS. Yes, sir. You can, and we had large quantities on hand and we took approximately a 30-day strike at Olin and we had, as I say, large quantities on hand. It gets to be very costly to keep currently in operation alternate or duplicate sources on all of your items and I think that this is a case where you ought to confine it only as necessary and in the case of this particular powder, as I say, the Army looked into it, tried to interest some companies in it and they were so small.

Now, you get into war and you have, of course, the large consumption and your stockpiles carry you over until the new producers come in and we have standby plants that we bring into being to meet the increased consumption that inevitably occurs.

Representative CURTIS. The experience that you had overall with an emergency situation worked out?

Mr. IGNATIUS. As Mr. McNamara testified, we always could have invoked the Taft-Hartley act had the strike continued. We were hopeful that it might be settled and it was, in fact, settled, and the East Alton plant is in production and, as I say, we had made a decision—quite apart from the question of the strike—to open the Badger Ammunition Plant in Wisconsin, not as an alternate source for protection, not because of the strike, but because the consumption in Vietnam was increasing so tremendously.

Representative CURTIS. Thank you.

Chairman DOUGLAS. Thank you very much, Secretary Ignatius, for this report.

Mr. IGNATIUS. Thank you, Mr. Chairman.

Chairman DOUGLAS. I thank your associates, too.

We have kept Admiral Lyle waiting. I wonder if he would be willing to come forward.

Admiral Lyle, we are very happy to have you here. You are in a very difficult and important position and we appreciate your services therein.

#### STATEMENT OF VICE ADM. J. M. LYLE, U.S. NAVY, DIRECTOR, DEFENSE SUPPLY AGENCY

Admiral LYLE. Thank you, Mr. Chairman. Shall I proceed, Mr. Chairman?

Chairman DOUGLAS. Yes, if you would, please.

Admiral LYLE. Mr. Chairman and members of the committee, I am grateful for this opportunity to report to you again on the operations of the Defense Supply Agency in the performance of its assigned missions and on the status of its major programs.

Since I last appeared before you, we have experienced an extremely large increase in the demands for supply and service support of military forces deployed to southeast Asia and of related troop augmentations to reconstitute the strategic reserve. Primary management attention and first priority in the application of available resources have, of necessity, been assigned to satisfying these requirements. Activities directed toward system improvements and other longer range benefits have received less attention than might otherwise have been the case, but they have by no means been neglected.

The increased demands placed upon our system in support of southeast Asia operations have subjected it to the most prolonged, severe, and extensive test since DSA was established. The following comparisons will give you some appreciation of the impact on our supply system as a result of the military buildup and large-scale deployments:

In the first 7 months of this fiscal year, the dollar value of issues of stock fund supplies aggregated \$1.5 billion, approximately \$500 million—or 45 percent—above the peacetime level for which we had budgeted.

In the same period, we placed contracts aggregating \$2 billion to bring inventory levels in line with the continuing growth in military demands. This 7-month contract volume exceeded by almost \$300 million the previously planned volume for the entire fiscal year.

The volume of requisitions received and purchase requests generated by our supply centers for the first 7 months of fiscal year 1966 has exceeded the volume experienced in a comparable period in fiscal year 1965 by 2.5 million line items.

Tonnage received by and shipped from our depot system during the first 7 months of fiscal year 1966 has been approximately 55 percent higher than a year ago.

The response of our supply centers and depots to this surge in demand has been most gratifying. We have had to recruit and train additional personnel and to resort to high overtime usage to cope with the workload growth. We have also witnessed significant increases in productivity during the first 7 months of this fiscal year. As measured by work units per productive man-hour, these increases have exceeded 20 percent in each major supply operating area, when compared with the average productivity of fiscal year 1965.

While I do not wish to leave the impression that we have encountered no supply problems or that we are complacent about our capability to respond to emergencies, I am pleased to report that the DSA system has stood up well. Our supply effectiveness, as measured by the availability of stocks in being to satisfy requisitions received, had reached a highly satisfactory 93 percent prior to the Vietnam buildup last summer. Despite the impact of the great surge in demand, system effectiveness has held at or about 87 percent. We are giving first priority in the distribution of supplies to the forces in or deploying to Vietnam and to the outfitting of recruits, and have been able, with a few isolated exceptions, to support these elements adequately. As may be expected with an increase in demand of this magnitude across a supply system encompassing 1¼ million items, we will have support problems and some shortages from time to time, but I am confident that with the continued cooperation of the military services and the support of industry, we can cope with them.

Turning now to some of our major programs: Last December, with the activation of the Los Angeles and San Francisco Contract Administration regions, we completed the nationwide conversion of the contract administration services function from separate management by the three military departments to a consolidated operation under DSA management. Some 165 offices employing almost 20,000 personnel have been reduced to approximately 100 offices in 11 regions. Our basic program, exclusive of added requirements to support southeast Asia operations, envisions reductions in direct Government expenditures aggregating \$19 million per year, to be fully realized by fiscal year 1969.

#### EFFICIENCY OF DCAS

Chairman DOUGLAS. Admiral, is this a reduction in personnel expenditures only, or reduction, also, in material costs?

Admiral LYLE. It is primarily in reduction in personnel, Mr. Chairman, almost exclusively.

Representative CURTIS. Could I ask for your comment; would you agree that the quality is improved and also productivity of the services that you are rendering in contract administration?

Admiral LYLE. Mr. Curtis, I am not sure that we have enough experience to really state that conclusively yet, but we do have this indicator that relates to your question.

We anticipate that to support the increased workload stemming from the increase in procurement as a result of the Vietnam buildup we will be able to accomplish this with a disproportionately lower increase in staffing, so I think this does attest to an increase in efficiency and quality.

Representative CURTIS. I hope that you are doing it. Probably the wages or the salaries paid to this personnel group will be greater per individual, as it should be, because of the quality of people you are getting. That is the advantage of developing this esprit de corps that I see existing here and it is why I think your performance will be vastly improved. I am tremendously impressed with this operation.

Admiral LYLE. I share your feeling on the matter of esprit de corps and quality. The sense that I have from going around through the 11 regions, and I have now visited almost all of them, is that there is, following the natural disruption of the transition, now a significant and marked feeling of pride and esprit de corps and a sense of purpose and accomplishment in doing the job.

Representative CURTIS. Thank you, sir.

Admiral LYLE. As has been the case for most of our supply and service missions, the workload incident to this assignment has been significantly affected by the expanded requirements generated by the southeast Asia emergency. The increased volume of contracts placed by the military departments and by DSA itself, as well as requests to expedite deliveries against outstanding contracts, has already been reflected in increased workloads in all regions. We expect that the workload volume will increase by 40 percent above the level prevailing when we undertook the assignment. Our experience to date indicates that we shall be able to perform the added work with less than a 20-percent increase in the reduced work force which we are scheduled to employ. Accordingly, we can assure you that reduced costs per unit of work performed—one of the principal objectives of the consolidation—will certainly be achieved.

We are participating with the military departments, under the direction of the Office of the Secretary of Defense, in a joint review of the application of the new item management coding criteria, which Mr. Ignatius mentioned, to all items in Federal supply classes designated for integrated management. The review is scheduled for completion by the end of calendar year 1967. (See p. 70.)

We were most encouraged by your committee's endorsement of the agreement entered into last year by the Department of Defense and the General Services Administration. This agreement envisioned the fitting together of our respective supply management capabilities in a cooperative arrangement which would insure effective and efficient supply management for the Federal Government without impairing performance of our separate primary missions.<sup>14</sup>

Representatives of the Federal Supply Service and the Defense Supply Agency have proceeded, in the intervening months, to give effect to the principles and criteria set forth in the agreement. As

<sup>14</sup> Report, July 1965, p. 3; see also Staff Materials 1965, p. 214, et seq.

Secretary Ignatius has advised you, this has resulted in the identification of some 53 Federal supply classes as susceptible to primary assignment to the Federal Supply Service for support of both Department of Defense and Federal civil agencies.

I would like to amplify his remarks on plans for DSA support of other Federal agencies for selected commodity classes. While we do not seek these assignments as a means of building our responsibilities, we are ready to undertake them when significant Government-wide benefits are assured. The agreement recognizes that such benefits will accrue under the following conditions:

First, the supplies in question must qualify under agreed criteria for management by the Defense Supply Agency for Defense users.

Second, it must be demonstrated that separate management by the General Services Administration or another civil agency would result in significantly higher costs to the Government.

Third, assumption of the mission will not impair DSA performance of its primary military support mission.

We advised you a year ago that we had initiated a test of perishable subsistence support of certain Veterans' Administration and Public Health Service hospitals by our Chicago subsistence region. The test demonstrated that significant economies could be achieved for standard items which are used by civil agencies and are procured in quantity for military users, but that centralized supply of nonstandard items resulted in no significant benefits. Accordingly, we have agreed to make the procurement services of our subsistence regions available to these agencies and have suggested that local arrangements be made between the agencies and our regions to cover support by standard DSA-managed subsistence items.

Studies conducted jointly with the General Services Administration and principal civil agency users indicate that DSA support of all Federal agencies for fuel, electronics, and clothing and textile supplies promises significant Government-wide benefits. Accordingly, DSA support of all Federal agencies in these commodities has been approved in principle by both Defense and GSA, and detailed plans for the assumption of this responsibility, together with the identification of the savings to be achieved, are being developed.

Meanwhile, a number of separate interagency agreements between DSA and certain agencies have been negotiated. As a result, DSA is currently supporting the Coast Guard with a full range of our materiel. We have recently updated our agreements with the Veterans' Administration and the Public Health Service with regard to our support with selected medical items. We are also currently supporting the National Aeronautics and Space Administration and the Federal Aviation Agency with electronics materiel and the Office of Economic Opportunity with clothing and subsistence items.

We are continuing to pursue several separate but coordinated efforts to reduce the number of items used in the supply system of the Department of Defense. Our endeavors over the past year have encompassed the following:

- (1) Completion of a pilot test of an engineering data retrieval system, which seeks to inhibit the entry of unnecessary new items in the design process by making available to the design engineer information on items already in the system.



(2) Application to selected classes of a newly designed item entry control system involving the technical screening of proposed new items before assignment of a Federal stock number. The system will be extended to additional high growth classes in the near future.

(3) Vigorous pursuit of an item elimination program within DSA managed classes, resulting in the withdrawal of 143,000 items from the supply system and the Defense catalog in fiscal year 1965. Eliminations during fiscal year 1966 are expected to result in the withdrawal of an additional 140,000 items.

Representative CURTIS. Do you have this on computers?

Admiral LYLE. Well, the items, of course, are on the computer at the Defense Logistics Services Center, but the process for eliminating them or considering them for elimination is not in itself on the computers, Mr. Curtis.

Representative CURTIS. Thank you.

Admiral LYLE. And (4) continued progress in the development of improved Federal item identification Guides. These will make the cataloging system more responsive to a broad spectrum of logistic requirements, including standardization, substitution, materiel utilization, and procurement.

There is encouraging evidence that these and other efforts throughout the Department of Defense are paying off. After more than a decade of rapid growth, the number of items in the Defense section of the Federal Catalog registered its first significant decline in the latter half of 1964. This favorable trend was continued in 1965 with a net decrease of approximately 170,000 during that year.

#### UTILIZATION OF LONG SUPPLY

Efforts to increase utilization of long supply and excess assets within the Department of Defense continue to bear encouraging results. Central screening of releasable assets reported by military service inventory control points to the Defense Logistics Services Center resulted in the interchange of assets valued at more than \$1.4 billion last year. Assets valued at \$851 million which were declared excess by the military services were utilized in the same period. The utilization of excess and releasable assets has been significantly improved through provisions for special handling of high value items, those having a value in excess of \$10,000.<sup>15</sup>

This program centers around the publication of special bulletins containing full descriptive information and data on high value items, including photographs, and tailoring the description of the item to selected potential users; and making telephone contacts with potential users to inform them of substitute and interchangeable uses of high value items. Through the weapons system utilization program, materiel valued at \$1.7 billion was distributed to alternative users, of which almost \$300 million was transferred to other Federal agencies between 1961 and 1965.

The utilization of excess automatic data processing equipment is a more recent and specialized addition to our materiel utilization program. Under our system, a data processing equipment that becomes

<sup>15</sup> Report, July 1965, p. 3.

excess to a Defense agency's needs is reported to our Reutilization Screening Office. This office then circulates bulletins and takes other measures to advertise the availability of the excess equipment. This program is not confined to the Department of Defense, however, but through cooperative arrangements with the GSA, it extends to all Federal agencies—with provision for movement in both directions.

In fiscal year 1965, \$32 million worth of excess equipment was utilized within the Department of Defense. In the first 6 months of the current fiscal year, the Defense Supply Agency redistributed \$50 million worth of excess ADP equipment, of which \$38 million worth involved joint action with the General Services Administration. (See p. 115.)

#### OTHER COMMITTEE RECOMMENDATIONS

A significant recommendation in your last report centered around institution of a program by DOD and GSA to match agency needs against existing inventories of long supplies within the Federal Government.<sup>16</sup> DSA and GSA are currently working out the details of an agreement which will provide for direct contact between Defense supply centers and the Federal Supply Service to screen requirements against stocks in long supply. Interservicing of long supply stocks will be carried out for all items common to both DSA and the Federal Supply Service. Approximately 1,100 such dual managed items have been identified thus far. Direct contact at the inventory control point level will facilitate exchange of long supply assets, and the mutual use of Milstrip procedures will permit the exchange within the framework of current procedures and regulations to the maximum feasible degree.

Aside from the priorities imposed by the current military emergency, certain other practical impediments stand in the way of early effective action to employ full mechanized screening of Federal-wide long supply assets by the Defense Logistics Services Center. In the first place, the demands placed upon the Logistics Services Center over the past several years have outstripped its existing computer capabilities. We are now in the process of designing a long-range system for the center and of acquiring new and more sophisticated ADP hardware to support it. (See p. 118 and appendix 11, p. 408.)

This could well provide for the capability envisioned in your recommendation. In the second place, any agency desiring to participate in the program would need to develop a capability to tie in with a highly sophisticated mechanized system, and you may wish to secure the advice of civil agencies on this aspect of the problem.

Secretary Ignatius has advised you of the steps which have been taken to improve the management of short shelf life items throughout the Department of Defense. Action which we have taken within the DSA supply system is fully in accord with the newly developed policies and procedures. We have reviewed and strengthened our shelf life management system to insure that shelf life items are identified at the time of entry into the inventory, that shelf life items are stocked in limited quantities, that first-in items are the first issued, and that warehouse stocks are constantly under surveillance to report and force issue of materiel approaching the end of its shelf life.

In addition, we have instituted procedures which require laboratory testing of certain items such as food, medical, rubber, and photo-

<sup>16</sup> Ibid., p. 4.

graphic supplies to determine whether or not the shelf life can be extended. The new Defense instruction prescribes standard policies and procedures similar to those we employ. As part of the governmentwide attack on the problem, DSA represents the Department of Defense on an interagency committee established to coordinate the utilization of short shelf life items in the civil defense medical stockpile. (See appendix 11, p. 393.)

#### USE OF \$2.8 MILLION MEDICAL SUPPLIES

An interagency agreement between DSA and the Public Health Service was signed on February 17, 1966, which will facilitate the exchange of medical items between PHS and Defense. Over \$2.8 million worth of medical materiel has been transferred from PHS to Defense use. Additional materiel is under review by the Defense Personnel Support Center. Actions to transfer items to DSA have centered on items with matching stock numbers. The interagency committee is now working on methods of resolving differences in specifications, packaging, and funding procedures which stand in the way of fully effective interservicing.

Gentlemen, this concludes my statement. Dr. Garvin, our Comptroller, and I shall be happy to respond to your questions.

Chairman DOUGLAS. Senator Jordan, you sort of lost out on the first go-around. You may question now.

#### DEPOT SHIPMENTS BY DSA

Senator JORDAN. Thank you, Mr. Chairman. I think this is an excellent statement, Admiral. You state that tonnage received by and shipped from our depot system during the first 7 months of fiscal year 1966 has been approximately 55 percent higher than a year ago.

I am curious to know if you are able to utilize shipments by sea to meet most of your requirements in southeast Asia, or are you against a deadline, an emergency and have to fly a substantial percentage of supplies over by air?

Admiral LYLE. Well, Senator, the great majority of our tonnage goes by sea. This stems, naturally, from the nature of the commodities that we handle—large volume, high bulk, clothing, food, and so forth, and the tremendous volume required to support operations in Vietnam necessarily goes by sea.

This matter of differentiation between mode, between the sea mode and the air mode, is really governed by the standing Defense procedures, and under certain conditions of high priority where the materiel concerned is susceptible to airlift by virtue of the size and weight, why, then, it does go by air. For instance, medical supplies on occasion will go by air and certain essential repair parts will move by air; but the large bulk of our materiel goes by sea.

Senator JORDAN. We read a good deal in the press about the congestion at the docks in southeast Asia. Sometimes ships have to back away and go back to some place else to refuel and so on.

How prevalent is this?

Admiral LYLE. Well, Senator, I am not expert in this field, but I have general knowledge that this situation is vastly improved and

Secretary McNamara testified that as far as Defense-sponsored cargo itself, as opposed to AID and other materiel, we are about down to a normal backlog in the theater for unloading cargo ships, so that this port congestion at the other end has been largely resolved.

Senator JORDAN. And the system of inventorying at the other end has been improved so we are getting away from the piles on the docks that have lost their identity and so on?

Admiral LYLE. Yes, I am certain this is so, sir. I am not responsible for this operation, but I do know that certain Army logistics commands have been sent out there and established to cope with this problem and that they are setting up an organized and rational system of inventory control.

Senator JORDAN. Thank you. I have no further questions.

Chairman DOUGLAS. Congressman Curtis?

#### EFFICIENCY PERMITS BOTH GUNS AND BUTTER

Representative CURTIS. This is certainly a splendid report, Admiral, and it makes me feel very good to see this kind of progress.

I would make this general observation: If we can have guns and butter, and I happen to think we can, it is to a large degree because of the work the Defense Department has done over a period of years in bringing about this kind of efficiency and this kind of planning.

I would like to have made a list of the shortages of goods and materiel and of manpower skills. I am thinking of the overall picture of the economy which we must be concerned about. I can illustrate, of course, one place where we all know there is a shortage, and that is in medical skills; doctors, nurses, and so on.

I know specifically we have a shortage of copper. I would like to have the Military Establishment identify for this committee where you are experiencing shortages. I think this would be of value to us. I would like included not just shortages of goods and basic materials but also of skilled manpower where it has come to your attention. These are the things that will heat up the economy.

Of course, where there are these shortages, you may have had to move in and insist upon priorities or you may have recommended that there be imposed export controls. I do not know whether you had anything of this kind. I might ask you, do you have anything to do with the imposition of export controls on hides, which just happened about a week or 10 days ago? Was it a shortage of hides for shoes needed by the military that lay behind this?

(In response to the preceding line of testimony the Department subsequently supplied the following:)

There have been temporary supply shortages of maintenance parts and clothing items.

These temporary shortages of maintenance repair parts have related primarily to bulldozers, trucks, forklifts, and warehouse tractors. These equipments have experienced high deadline rates due to the lack of replacement parts. In large measure, these shortages were provoked by the rigorous combat operating and maintenance conditions in Vietnam and the long logistics pipeline involved, plus the fact that some of the equipment is obsolete and replacement parts are no longer in DOD inventory. We have acted strongly and directly to alleviate these shortages by establishing high priority requisitioning procedures, priority air transportation, expedited procurement, and rapid return of reparable components.

Measures to prevent or alleviate shortages have been given extremely close attention, including the monitoring of these efforts by the Office of the Secretary of Defense.

Prime examples of tight supply situations in the clothing area in support of Vietnam are the cases of the direct molded sole boot and the lightweight tropical combat uniform. Both of these are new items of supply which experienced extraordinary increases in demand over a short period of time. Nevertheless, adequate supplies of standard fatigues and combat boots have been and are available to meet replenishment requirements in Vietnam during the period in which we are building up production of the new items.

It is important to note that, while temporary shortages have occurred, none of any type have impeded combat operations in Vietnam. This fact has been attested to by General Westmoreland, our commander in South Vietnam; Admiral Sharp, our commander in the Pacific; General McConnell, Chief of Staff of the Air Force—and by General Wheeler, Chairman of the Joint Chiefs of Staff, General Johnson, Chief of Staff of the Army, and General Greene, Commandant of the Marine Corps, all three of whom recently visited Vietnam and talked with commanders down to the battalion level.

There are very few actual shortages in raw materials and basic manufacturing which are adversely affecting the Department of Defense today. The shortages which are heavily publicized are world or national shortages which, because of our defense priorities, do not impact on defense programs. Under the priorities system our needs take precedence over nonmilitary requirements.

Mr. Curtis cited copper as a commodity on which there is a shortage. The worldwide shortage of copper has posed a threat to general price stability and orderly marketing as well as continued prompt fulfillment of defense orders. Only limited amounts of copper are required by the Department of Defense compared with total U.S. consumption, about 5 percent, under the accelerated rates required by the Vietnam buildup. We cannot therefore say that defense programs have suffered because of this shortage. Of course, our problem has been eased by stockpile releases and future relief is expected from the predicted increase in domestic copper production over the next few years.

As to shortages of manpower, recruitment of civilian skilled manpower is difficult for most of the journeyman crafts in many locations where the DOD has facilities. In the shipyards, for example, active recruitment is underway for such skills as boilermakers, electricians, electronic technicians, machinists, pipefitters, radio and air-conditioning mechanics, ship fitters, and welders. The Air Force is recruiting several thousand civilian maintenance mechanic apprentices for such skills as welders, industrial electroplaters, turret-lathe operators, radio repairmen, grinding machine operators, aircraft mechanics, flight-line mechanics, aircraft sheet-metal template makers, general machinists, tool-makers, aircraft instrument and control systems mechanics, pressure instrument repairmen, optical instrument repairmen, and electromechanical instrument and control repairmen. Training programs have been expanded to train for these skilled craftsmen and their helpers.

There is also a shortage of nurses and medical technicians.

The buildup of military forces has required increased training programs for such skills as those needed for helicopter pilots, airplane and other maintenance mechanics, electronic technicians, and the construction crafts.

Admiral LYLE. Not to my knowledge; I have no knowledge that we were concerned with the imposition of these export controls.

Going back to your earlier point, Mr. Curtis, I believe it would be more appropriate, if I may suggest, that this question that you asked on shortages in manpower and basic materials and other goods be addressed to the Secretary.

Representative CURTIS. I think you are right. I do think, though, that in the Defense Supply Agency your attention has been directed and would be directed to see whether you might be in short supply in the future?

Admiral LYLE. Yes, sir, I can respond quickly to the major shortages that we have.

Representative CURTIS. All right, please do.

Admiral LYLE. Primarily in the clothing area, as Secretary Ignatius indicated, we have experienced some shortages. None of these affect Vietnam itself except the newly developed jungle boot and the recently developed lightweight combat fatigue uniforms, and we are getting substantial deliveries of these and have been for almost a year. But supply has not yet quite caught up with demand and we are having to make up the deficits out of the regular items of both combat boots and combat fatigues.

As far as the recruit support, we have experienced some shortages in almost all of the services, but by special measures of various sorts, by the services themselves and by us, we have been able to insure that all of the recruits have the essential items in at least minimum quantities.

We anticipate that the recruit support situation will clear up and improve around about July and August, and in the meantime, as I say, we are getting by on a minimum essential basis.

We have had trouble in the recruit area, for the Marines with the raincoat and the overcoat; with the Army with the raincoat and Army green coat and trousers. The situation in the Air Force and the Navy is much less acute and we have not had to reduce any bag allowances for their recruits so far, and I do not think we will have to.

Outside of the clothing area, we have had some difficulties with portable refrigeration boxes. This has been largely met now. In the area of fortification materials, we have had some shortages in barbed wire and concertina wire and sandbags. None of these affected actual immediate needs by the combat forces, but we were not able to respond fully to requisitions for establishment of pipeline stocks.

We will shortly be out of the woods in the area of these three.

I mentioned the jungle boots and the combat fatigues and, as Secretary Ignatius indicated, we have experienced difficulties in repair parts for the support of construction equipment and materials handling equipment, and vehicles; and the problem here stems from the fact that many of these were so-called orphan items of equipment, to a considerable degree old and now out of production, so that it was difficult to find sources for the parts.

Representative CURTIS. And the problem of a variety?

Admiral LYLE. And this is met by what Secretary Ignatius said about sending out new items of standardized equipment which will facilitate the parts support.

Representative CURTIS. Thank you.

#### EFFECTIVENESS OF GSA

You commented that the DSA had responded well. How about the experience with GSA as far as the military relies on them for certain supplies? Have they responded well, in your opinion?

Admiral LYLE. They are responding well. I am not aware of any problem of any significance. At the time they took over paint and handtools, there were some temporary transition problems in support of paint for the Navy, but this was cleared up in a matter of weeks and we have had no complaints or difficulties since then.

## ROLE OF DCAS

Representative CURTIS. You heard a number of the questions I will be submitting. Many of these probably will come to you, so I will let that rest. I have some further questions on the DCAS that I wanted to ask. Figures supplied to me by Deputy Assistant Secretary of Defense Malloy show that the services are handling \$75 billion worth of contracts while the DCAS is only handling about \$25 billion. I was wondering for that reason why we could not move into certain areas like basic research and other contracts at educational institutions; contracts for subsistence items; contracts even for items like headstones and grave markers; contracts for stevedoring; contracts for services of industry-technical representatives and consultant support services; and things like that. A fuller list of such items, including amounts, will be found in the material from Assistant Secretary Malloy that I asked to be included in the record earlier.

I would appreciate it if you would supply your reasons for the record. I would like this committee to have a continuing progress report in this area.

## EXCLUSIONS FROM DCAS

Admiral LYLE. We will coordinate with Mr. Ignatius' office in his response to your question in that same area, sir.

(The information furnished by the Department follows:)

Assignment of contracts falling within the categories enumerated above to either DCAS or one of the military departments is considered by individual category. A determination as to how best to handle each of these specialty areas is made on the basis of the special skills involved, the degree of direct control over the contractor which must be maintained by the buying office, the relative amount of field performance required, and the most efficient utilization of people. Also considered is the fact that the total dollar value of these types of contracts does not account for a significant percentage of the total contract administration services workload.

Basic research and all other contracts at educational institutions have been assigned to the Office of Naval Research for field contract administration services. The Office of Naval Research was selected because it had a field organization for this purpose in being and had available the kind of scientific people best qualified to administer the predominantly basic research-type contracts.

Contracts for subsistence items are awarded by the Defense Supply Agency (DSA). All contract administration services are retained for performance by the DSA buying offices except inspection which is requested, as required, from the Department of Agriculture, the veterinary services of the Army and Air Force, and from the DCAS. This procedure takes advantage of special skills available within the military departments as well as those which are available to DSA from the Department of Agriculture. General inspection services are provided by DCAS under this arrangement.

Contracts for headstones and grave markers are awarded by Army Support Services purchasing offices who retain responsibility for all contract administration services not requiring field performance. When required, field performance is accomplished by the DCAS office having responsibility for the geographic area. This permits the most efficient use of people and provides a single point of contact with the Government at the plant locations.

Contracts for stevedoring are usually by military departments at port activities operated by those departments. These same military departments have been authorized to perform contract administration services, using the same people who awarded the contract to maintain close control over contractor activities at the site. This eliminates the need for travel by those performing administration services. In those few cases where travel would be involved, field performance is accomplished by the nearest DCAS office.

Contracts for services of industry technical representatives and consultant support services usually require no field contract administration actions. Therefore, buying offices have been authorized to retain responsibility for administration of their own contracts. However, should field performance be required, DCAS has been designated to perform such services for the buying office.

In summary, each of these specialty areas has been considered for assignment to DCAS. Each case presented a different problem and was handled in a slightly different manner. But in each case, the best utilization of the skills and capabilities of available people was the predominant factor in deciding how the job would be done.

#### SHORT-SHELF-LIFE ITEMS

Representative CURTIS. Just a short question on the short-shelf-life situation. When you said that you are now laboratory testing so you can extend the shelf life, are you also looking at the possibility of improving packaging and storage techniques? I hope you are. That would be a very important aspect to examine.

Admiral LYLE. We did not mean that, but I think that you are quite right that this is something that should be looked at.

What we meant in my statement was that as an item approaches its prescribed or designated shelf life, we then give it an actual test to see if, in fact, its utility has been affected and if it has not been affected or not been impaired, then we will extend it so that we can continue to use it.

Representative CURTIS. The other thing I want to comment on is the experience we had with hamburgers many years ago—the emergency ration. It was a good example because this was a higher cost hamburger which you would not want to use in the general mess. But after the shelf time reached a certain point, it would have been cheaper to have used it in the general mess rather than just dump it, as was done. I wonder whether in the turnover of your short-shelf-life items you consider alternate uses such as the hamburger situation illustrated?

Admiral LYLE. We do, indeed. As a matter of fact, not long ago in the European theater the Army cooperated with us in using some of our combat rations that were approaching the end of their shelf life.

#### COST OF PRINTING

Representative CURTIS. One final thing and this is one that I am really interested in: We have talked about many areas to examine, but one of the big cost items that tends to be forgotten is printing. Any organization of large size does a great deal of printing. I wonder if you would give us a report—not now but for the record—on the cost of printing. Maybe it has to go out of your command. Maybe Secretary Ignatius will have to give us that.<sup>17</sup>

The Government Printing Office does the bulk of printing for the whole Federal Government and I daresay does some for the military. I do not know how much, but then there is a great deal of printing going on elsewhere. I think this is a subject that ought to be explored a bit, and I would appreciate your giving us a little light on this.

Admiral LYLE. The cost of Defense printing?

Representative CURTIS. Yes, in the Defense Establishment.

<sup>17</sup> See also, Report, July 1965, p. 7, and app. 11, pp. 401, 409, 413.



Admiral LYLE. I am sure I could get that. This comes under the jurisdiction of Secretary Horwitz, the Assistant Secretary for Administration, and I will arrange with him to supply this.

(Material later furnished by Department follows:)

Department of Defense (DOD) printing is obtained from four major sources:

- (a) Procurement through the Government Printing Office.
- (b) Procurement by DOD contract with private industry.
- (c) Production from inhouse DOD printing plants.
- (d) Procurement from DOD equipment contractors (essentially technical and maintenance manuals for hardware equipment).

The costs to DOD for obtaining this printing in fiscal year 1964, the latest date for which statistics are available, was as follows (figures are rounded out to the nearest million dollars):

- (a) Procurement through GPO, \$39 million.
- (b) Procurement by DOD contract with private industry, \$45 million.
- (c) Inhouse production, \$53 million.

Costs of procurement of technical and maintenance manuals from DOD equipment contractors are included as a part of the hardware system itself and have not in all cases been separately identified as printing costs. However, the military departments are currently undertaking accelerated programs for obtaining as much of this printing as possible through area contracts established by the GPO and for separately identifying the costs of those manuals, which for operational reasons, must be procured through equipment contractors.

(See also, app. 11, pp. 409, 413; see also p. 176.)

Chairman DOUGLAS. Thank you, gentlemen. We will meet at 2:30, not at 2 o'clock, this afternoon in this room, and Mr. Lawson B. Knott, Jr., Administrator of the General Services Administration, will be our witness.

(Whereupon, at 12:15 p.m., the hearing recessed to reconvene at 2:30 p.m. the same day.)

#### AFTER RECESS

(The subcommittee reconvened at 2:30 p.m., Senator Paul H. Douglas, chairman of the subcommittee, presiding.)

Chairman DOUGLAS. The committee will come to order.

We have with us this afternoon Mr. Lawson B. Knott, Jr., who has become Administrator of the General Services Administration since our last hearing, when he was Acting Administrator.

Mr. Knott, we know you have risen from the career service. We are glad to have you here this afternoon and you may proceed with your statement. My letter of January 26, 1966, to you concerning these hearings will be inserted at this point.

JANUARY 26, 1966.

Mr. LAWSON B. KNOTT, Jr.,  
Administrator,  
General Services Administration,  
Washington, D.C.

DEAR MR. KNOTT: The Subcommittee on Federal Procurement and Regulation plans to hold hearings again this year on the subject of "The Impact of Federal Procurement on the Economy."

It will be appreciated, therefore, if you and your staff will give the subcommittee the benefit of your views on the specific recommendations pertaining to your agency that were covered in our report of July 1965.

Of specific interest also will be a statement of progress on the procurement and management of automatic data processing equipment under present laws and regulations.

The subcommittee is also concerned with the scope and nature of the Government's real property holdings, both military and civilian worldwide, and trends in acquisitions and disposals. We would like to have copies of statistical data

you may have with respect thereto for inclusion in a staff report that will be issued shortly. Your views on real property management, the impact on the tax base of these holdings, and disposal procedures and practices will be of value to the subcommittee.

You will be advised as soon as a suitable date for the hearings can be arranged, which will be after March 1. As in former years, we will need 100 copies of your statement at least a day before the hearing date. If further information is needed by you, please contact our economic consultant, Mr. Ray Ward, phone No. 173-8169, study room 161, Library of Congress Annex.

Faithfully yours,

PAUL H. DOUGLAS,

*Chairman, Subcommittee on Federal Procurement and Regulation.*

**STATEMENT OF LAWSON B. KNOTT, JR., ADMINISTRATOR, GENERAL SERVICES ADMINISTRATION; ACCOMPANIED BY J. E. MOODY, DEPUTY ADMINISTRATOR; R. I. GRIFFIN, ASSISTANT ADMINISTRATOR; HEINZ ABERSFELLER, COMMISSIONER, FEDERAL SUPPLY SERVICE; HOWARD GREENBERG, COMMISSIONER, UTILIZATION AND DISPOSAL SERVICE; AND HARRY VanCLEVE, GENERAL COUNSEL**

Mr. KNOTT. Thank you, Mr. Chairman.

It is a pleasure, Mr. Chairman, as always, to appear before you and your subcommittee to discuss the relationship of GSA's programs to the work of this subcommittee in the field of Federal procurement and regulation.

I have with me several members of my staff to assist in presenting information about the varied GSA programs which are of interest to the subcommittee.

The stimulus provided by the subcommittee's annual review, which we have come to look forward to, of the progress in the field of property management has led to many improvements with attendant savings to the Government and the taxpayer.

Chairman DOUGLAS. Mr. Knott, do you really mean that or is that a statement intended to placate congressional Members?

**IMPACT OF SUBCOMMITTEE HEARINGS**

Mr. KNOTT. Mr. Chairman, I believe if we were to go back to the early stage of these hearings—I have known about them for about 5 years now—and we were to look at some of the things you were advocating and promoting, for example, in the field of supply, the integrated national supply system, I think is more directly attributable to the support and constant prodding of this committee than any other one single factor.

Chairman DOUGLAS. I thank you for this. Out of a fit of generosity, I want to say Congressman Curtis shares credit for this, too, because he has been crusading on this for some time. I hope he on the west bank of the Mississippi and I on the east bank of the Mississippi may use this handsome eulogy.

Mr. KNOTT. It is true that these phrases do have a way sometimes of sounding rather stereotyped, but I can say this with a great deal of conviction and I have said this to Congressman Curtis in private conversations and I know he knows we feel very strongly that this is so.

The Joint Economic Committee has been very helpful. Its interest has served as a catalyst that operates between authorizing and appropriation and funding activities that brings Government agencies together, and if there is one thing that GSA ought to stand for and ought to be able to lead the way on with the right kind of support, and that is the elimination of duplication of activities.

Chairman DOUGLAS. This handsome tribute pleases us very much. I hope you will not mind if upon occasion we refer to it. [Laughter.]

Mr. KNOTT. Thank you, sir.

#### DSA/GSA AGREEMENT

Last year we reported to the subcommittee that an agreement between GSA and DOD governing supply management relationships had been signed in late 1964. The agreement envisions the fitting together of supply management capabilities of DSA and GSA to form a coordinated national supply system for the Federal Government.

This will provide the Federal Government with an efficient and economical system for the procurement and supply of personal property and will eliminate avoidable duplication. For example, there are presently some 1,100 items stocked both by GSA and DSA. We believe that little, if any, of this duplication will continue to exist under this dual management when the joint studies now underway are completed.

During the past year, DSA and GSA have proceeded toward progressive implementation of this agreement. The DSA/FSS Material Management Review Committee (MMRC), established last year, completed its examination of 152 Federal supply classification (FSC) classes now managed by DSA to determine those which should continue to be managed by DSA and those which should be transferred to GSA. Fifty-three of these FSC classes studied were assigned to GSA and 99 remained with DSA. The 53 classes assigned to GSA will be transferred late this year.

#### PROGRESS TOWARD A NATIONAL SUPPLY SYSTEM

Integration of civilian agencies into the national supply system. Basic plans have been developed and actions taken to integrate the supply systems of several civilian agencies into the national supply system. The subcommittee was specifically interested in four agencies and selected commodity classes.

We have made good progress in these areas:

1. Analysis of cost and resource data on electronic, fuel and clothing and textiles indicates that it is feasible for DOD to support civil agencies for these items. We are now ascertaining what Government-wide savings would result from assignment of Government-wide supply support for these items to DOD.

Chairman DOUGLAS. You are willing to give up jurisdiction on these items?

Mr. KNOTT. Yes, sir; again, where they have the major capability, the major interest, it will avoid duplication and effect savings for the Government overall, then I think we should go in that direction.

Chairman DOUGLAS. You are to be commended. A most unusual type of Government official to surrender jurisdiction and cede power.

Representative CURTIS. But this is reciprocity, is it not?

Mr. KNOTT. Yes; it should work both ways. [Laughter.]

But you notice in the items we studied between GSA and DSA in a more narrow field that actually more items stayed with DSA than the ones that came to GSA, but it should be on the basis of the item itself rather than the numbers.

2. Further analysis of medical and nonperishable subsistence items is needed to identify the savings potential before a decision can be made on the assignment of these items. An indepth study is now underway to determine whether economies can be achieved through DSA supply support of these items to the Veterans' Administration and the Public Health Service. (See p. 393.)

3. Since we have already established that economies will accrue through arrangements for the Veterans' Administration and the Public Health Service to utilize Defense Supply Agency facilities in fulfilling their requirements for perishable subsistence, such arrangements are now being made on an installation-by-installation basis.

4. A joint GSA/VA review has been made of all other items now managed by VA to determine those which should be supplied by GSA and those which should be retained by VA.

5. Following a recently completed item-by-item review, agreement has been reached with the Post Office Department whereby GSA will provide direct support to major post offices on all items which the review established should be managed by GSA. This does not include items identified as peculiar to Post Office Department programs, such as lockboxes and mailbags, which will continue to be managed by the Post Office.

Chairman DOUGLAS. Now the mailbags can be, and I believe are, being made in the Federal prisons, are they not?

Mr. KNOTT. Many of them are; yes, sir.

Chairman DOUGLAS. Could they not all really be manufactured in the Federal prisons? Could this not be true of the mailboxes, too?

Mr. KNOTT. Whether they are made there or not, this is your question, not whether GSA or Post Office manages them?

Chairman DOUGLAS. Do you want to go into that question?

Mr. KNOTT. I would be glad to explore it. I frankly don't know at this point whether—

Chairman DOUGLAS. These two items, it seems to me, are peculiarly adapted to Federal prison production. We do not want to have the time of Federal prisoners lying idle. On the other hand, we do not want to have them assigned out to private contractors for profit; we do not want to have them swamping the private market with low prices because of labor, but production for Government use, it seems to me, is admirably adapted for the Federal prisons.

Mr. KNOTT. Certainly—

Chairman DOUGLAS. I am going to ask Mr. Ward to check on this and I want to say the Federal Bureau of Prisons, I think, is one of the most enlightened agencies in Government, beginning with the great Sanford Bates, to whom—he was a Republican, too.

[Laughter.]

Mr. CURTIS. This is my day.

Chairman DOUGLAS. Your time will come.

[Laughter.]

Chairman DOUGLAS. And going on to this splendid fellow who succeeded Bates, James Bennett, and now into the present executive, I would say the—

Mr. KNOTT. Myrl Alexander.

Chairman DOUGLAS (continuing). Efficiently and humanely administered agency of the Government. I have inspected a lot of prisons, not that I expect to be an inmate, but I wanted to see how the inmates were getting on and I have just been delighted with the work.

I think this is a real possibility.

Mr. KNOTT. Well, they, of course, have done a great job for GSA over the years in providing for our metal shelf needs in our record centers. This has been one of the standard items that we acquired through them.

Chairman DOUGLAS. I want Mr. Ward to go into this, because I think there are real possibilities with the Post Office Department.

Mr. KNOTT. The Post Office Department will redistribute to the smaller post offices the relatively few GSA-managed items used by them. GSA is currently performing all procurement, contract administration, and quality control for all Post Office Department motor vehicle requirements.

6. GSA regional depots are now supplying stores stock items directly to the Federal Aviation Agency. Such items are no longer stocked at the Federal Aviation Oklahoma City Depot. As you know, this is their largest depot facility.

Also, DSA presently supplies FAA electronic tube stock replenishment requirements and it is planned to extend this arrangement to other electronic items available from DSA.

7. DSA is now the principal direct supply source for National Aeronautics and Space Administration facilities for all electronic items available from DSA. NASA does not maintain redistribution facilities of its own.

In addition, we have been working, and will continue to work, with other civil agencies looking toward further implementation of the national supply system, including utilization of more effective requisitioning practices. For example:

1. An agreement is being finalized whereby the Maritime Administration of the Department of Commerce will obtain ships' parts, navigational aids, and other technical item support directly from the Defense Supply Agency.

2. Cooperative joint efforts between GSA and the Office of Economic Opportunity since its creation have been successful in avoiding the establishment of a duplicate supply system in OEO. Under these arrangements:

(a) The Job Corps uses certain excess or long-supply military clothing and textiles and other items of equipment and supply, and DSA supports the Corps for other recurring clothing requirements.

(b) Where it is economical to do so, Job Corps centers obtain both perishable and nonperishable subsistence support either from DSA or local military installations.

Chairman DOUGLAS. I have inspected some of the Job Corps camps. What you say is true, dungarees furnished from GSA, boots, blankets, excellent.

Mr. KNOTT. OEO, for a new agency, comes nearer utilizing the full spectrum of services that GSA has to offer than any agency that I know of in Government.

Chairman DOUGLAS. What we on the Hill are somewhat distrustful of are the empire builders. An agency wants to get everything under its wing. If each agency does this, you get great duplication.

Mr. KNOTT. Right. They have been willing and ready to use excess property, rehabilitated property, excess installations. They have been willing to use our services, in fact, have called upon us for rehabilitation of their buildings.

All of our services, in one way or another, have been contributing to their use.

(c) GSA is now furnishing or arranging to furnish complete supply support for all OEO programs, including the preparation of specifications, procurement and storage and distribution of training materials and other program type items.

In each instance, our negotiations with the civil agencies are guided by a single principle: Complete and effective supply support for Federal agencies at the lowest cost to the Government as a whole. Each arrangement we have concluded or have underway is designed to avoid duplication of effort in the management, procurement, storage and distribution of the Government's supply needs.

Since the last hearings, we have been working on additional aspects of the short shelf-life problem.

#### SHORT-SHELF-LIFE ITEMS

Chairman DOUGLAS. Mr. Knott, the late Maury Maverick had a phrase which he called "gobbledygook," and he said the Government was the great perverter of language and creator of gobbledygook. The phrase "short-shelf-life commodities" is gobbledygook, is it not?

Mr. KNOTT. I think that's right, sir.

Chairman DOUGLAS. Why not say it?

Mr. KNOTT. I think that is an excellent suggestion.

Chairman DOUGLAS. All right.

Representative CURTIS. I think you have to have a different term for this reason. I think every item has a shelf life and if you use perishables, you are relating to that which has, say a very short shelf life. I would like to get across the thought that everything, except possibly gold, has a shelf time. I think we could probably, as Senator Douglas says, improve on this.

Chairman DOUGLAS. Relatively perishable. [Laughter.] That is clearer than short-shelf-life.

Representative CURTIS. That may be.

Chairman DOUGLAS. We have to guard the language constantly against perversions, vulgarisms, archaisms, and so forth, and to my mind, the Government is the greatest perverter of the English language.

Mr. KNOTT. I would agree with that.

Chairman DOUGLAS. All right, go ahead.

Mr. KNOTT. We are about to enter into a cross-servicing agreement with the Department of Defense which is intended to assure that items subject to deterioration on the shelf will be offered for utilization by other Federal agencies, as soon as it becomes apparent that quantities of items are held which may exceed requirements during the period of remaining shelf life.<sup>18</sup> (See also p. 102.)

I guess that is another phrase—

Chairman DOUGLAS. You are struggling toward virtue. [Laughter.] We give you an A for effort.

Mr. KNOTT. Thank you, sir; at least I am conscious of it now.

Upon concluding this agreement, we will issue appropriate Government-wide implementing regulations.

The subcommittee will also be interested in our special efforts to rotate the civil defense medical stockpile. In October 1965, GSA, the Department of Defense, the Public Health Service, and the Veterans' Administration formed an interagency committee, chaired by GSA, to explore means by which utilization of limited shelf life items in the civil defense medical stockpile could be improved.

This has already resulted in a formal agreement between the Veterans' Administration and the Public Health Service under which stockpile items will be utilized by the Veterans' Administration in lieu of new procurement.

#### LIFE OF \$8 MILLION INVENTORY TO EXPIRE IN 18 MONTHS

A similar agreement has just been concluded by the Department of Defense and Public Health Service. During the last 3 months, the Department of Defense and Veterans' Administration utilized approximately \$5 million worth of medical supplies from the Public Health Service medical stockpile.

Just recently, we identified an additional \$8 million of inventory which will expire on the shelf in the next 18 months. Steps are being taken to utilize or enhance rotation of this material as rapidly as possible and to avoid recurrence of this undesirable situation.

For example: A special task force has been established to improve specifications and develop packaging standards. These actions are essential to future utilization of inventories which must be rotated. We are also exploring the transfer of these commodities to AID for use in its foreign aid program.

The subcommittee can be assured that this problem will receive the continuing attention of all agencies concerned.

#### SCOPE OF SURPLUS PERSONAL PROPERTY

The subcommittee's report noted that the Government generates upward of \$5 billion annually<sup>19</sup>—

Representative CURTIS. Mr. Chairman, is it at this point you had some samples you were prepared to show us?

Mr. KNOTT. Yes. Mr. Abersfeller, our Commissioner of Federal Supply, is with me and I want him to show you these samples.

<sup>18</sup> Report, July 1965, p. 4.

<sup>19</sup> Staff materials, 1966, p. 40.

## SAMPLES OF MEDICAL ITEMS WITH SHORT LIFE

Mr. ABERSFELLER. We have eight samples, Mr. Chairman, in the box, which represent an inventory of nearly \$3 million. These are all shelf life items. This is amobarbital sodium, of which we have \$26,000 worth of material which will expire.

Representative CURTIS. What would its shelf life be?

Mr. ABERSFELLER. That shelf life, Mr. Congressman, is 5 years, 60 months. Actually, this was packaged in 1957 or 1958, tested every 5 years, and expiration date extended.

Chairman DOUGLAS. Does each package have on it when it went into the stock?

Mr. ABERSFELLER. Most of them have on a code. Some of them have actual dates, Mr. Chairman; others have a code.

Chairman DOUGLAS. So you can tell when it went in?

Mr. ABERSFELLER. Yes, sir.

Representative CURTIS. Will this be indicated on the stock?

Mr. ABERSFELLER. Yes; as, for example, this one—tetanus toxoid—would show August 1, 1966—that is the expiration date.

Chairman DOUGLAS. When was it manufactured?

Mr. ABERSFELLER. This was manufactured in August 1964.

Chairman DOUGLAS. That is the expiration date. Do the others have expiration or entrance dates?

Mr. ABERSFELLER. Both dates. Another thing I would like to point out in shelf life is that these are all reexamined. We have a case of tetracycline, which was packed in 1952, has a computed 60-month or 5-year storage life and, in fact, has been extended now two times, and is still good.

Representative CURTIS. Based on your laboratory examination?

Mr. ABERSFELLER. Yes, sir. And this is important, there is no one we know that has a precise measure of shelf life for any item. We set up these safeguards, then at a point in time, we look at it again.

Representative CURTIS. Are these put on computers?

Mr. ABERSFELLER. Is the inventory on computers?

Representative CURTIS. And the shelf life.

Mr. ABERSFELLER. No.

Representative CURTIS. Can that be done?

Mr. ABERSFELLER. It could be done, Mr. Curtis, but I would not advise it. It is a most highly complicated proposition to use computers for shelf life control. It would mean, as an example, for the thousands of items we have in storage, there would be a transaction entry each time the item is procured; each time the item is issued; each time the item is retested; and all these entries would have to be related to the remaining shelf life of the item.

We have what we think is a more simple control and actually to a large extent most of it is done manually. In this particular case it is a little easier and less costly than by doing it on machines.

Representative CURTIS. All right.

## MANAGEMENT OF SHORT-SHELF-LIFE ITEMS

Mr. ABERSFELLER. As an example, a good inventory management system would not allow inventory to be bought in a quantity to exceed shelf life under any circumstances. It is only when demands unex-



pectedly rise or fall that cause this circumstance to exist. So many thousands of items in the system have a limited shelf life yet only a relative few give us any trouble. And under a machine system, you would have a difficult time of identifying those.

Under a manual system you could do it.

Representative CURTIS. Many years ago with the old Bonner subcommittee one of the things that we directed our attention to was dry cell batteries. I guess it was overprocurement that really created the problem. Rubber heels was another item.

Mr. ABERSFELLER. I think that is an interesting point. None of us buy from the point of view of buying more than we really need. Outside influences, over which the merchandiser has no control, if you will, is what causes items to be in an over-shelf-life condition, with the exception of stockpile materials.

Stockpile materials, such as these medical items, represent a different problem: you must have large stocks on hand; they are not consumed. In this case, they are for emergency use.

Representative CURTIS. Medical supplies are the kind of thing you need to stockpile because you have an unusual requirement there.

Mr. ABERSFELLER. Yes, sir; what we are hoping for, in the long haul, is that we not wait for the expiration date, but rather use the stockpile as a ready resource and draw down from it with regularity for issue to customers, and then replenish the stockpile.

#### DATING OF PACKAGES

Chairman DOUGLAS. On the shelf, do you have the packages arranged according to date of entries, so that you can always be taking the—

Mr. ABERSFELLER. Yes, taking the oldest stock first. First in, first out is the principle everyone follows here. In fact, every new shipment has a separate location in the warehouse, is stored there, nothing put in front of it. As issues are made, the oldest stock is issued first.

We do this through a mechanized system. This is a locator on computers. The people in the warehouse are instructed to select from a given location for a particular issue and that would be the older stock.

There are several other examples here of medical material. All of these happen to be drugs and pharmaceuticals. I should like to point out that there are other things in the medical stockpile which are not pharmaceuticals.

#### LIFE OF CANVAS COTS

As an example, canvas cots which we would also propose to rotate. They do have a longer shelf life, but they do have one. In fact, the Defense Supply Agency took over one and a half million dollars worth of canvas cots out of the stockpile.

Representative CURTIS. What would be their shelf life? Have you got it set up yet?

Mr. ABERSFELLER. We would expect it to be about 10 years. Strangely enough, the wood tends to deteriorate before the canvas because of certain larva that infest the wood, and this is one of the reasons we are concerned; canvas, under the right conditions, should

have a longer shelf life than 10 years, but again the efforts that we are concentrating on are to remove materials before their condition becomes critical.

Of the \$8 million of material which these samples represent, we do have some material for which there is no requirement during peacetime operations on the part of VA or on the part of the Defense Supply Agency.

An example would be the plague and cholera vaccines, which fortunately we do not need in this country; we are hopeful that we can work this matter out with the Agency for International Development, to arrange for their use in the emerging nations.

Representative CURTIS. The things you gave us tended to have a shelf of 5 years. Do you actually have items that are of a shelf-time as short as, say, a year or 18 months?

#### PAINT AND LACQUERS HAVE SHORT LIFE

Mr. ABERSFELLER. Yes; we do have. I do not think we have any in the medical stockpile with that short a shelf life, but we do have items in the system. Some items of paint and lacquers, as an example, have a shelf life of 6 months.

Representative CURTIS. So, those would be the perishables that Senator Douglas—

Chairman DOUGLAS. Relatively perishable.

Mr. ABERSFELLER. As you so aptly pointed out, Mr. Congressman, everything has a shelf life.

Chairman DOUGLAS. Nothing lasts forever.

(Laughter.)

Mr. ABERSFELLER. On this particular item of, Chloramphenicol, we have a million dollars of this in the stockpile, which was manufactured in 1952, expired first in 1955, and now extended through most of the remaining part of this year.

Chairman DOUGLAS. You better get rid of that pretty quick.

Mr. ABERSFELLER. Mr. Chairman, we are going to try to get rid of it very quickly, but if some should stay with us, we would again examine it, as we do regularly.

Chairman DOUGLAS. You have had luck now twice.

Mr. ABERSFELLER. Yes, sir.

Chairman DOUGLAS. You have had it extended twice. You better not try the third time.

Mr. ABERSFELLER. We are not going to push our luck; no, sir.

Chairman DOUGLAS. Excuse us, Mr. Knott. We are curious about these things and we like practical things to look at.

Mr. KNOTT. One picture is far better than many words in a case of this kind. That cover it very well.

Chairman DOUGLAS. Go ahead.

#### USE OF LONG STOCKS

Mr. KNOTT. Extending on into this same area, the subcommittee's report noted that the Government generates upward of \$5 billion annually in surplus personal property and recommended institution of a program to match agency needs against long stocks of the Government. Prior to its being declared excess, DOD personal property is

classified as "long supply" and current procedures within DOD require the screening of new procurement requests against long-supply inventories.

Secretary McNamara reported to you the substantial savings made under these procedures. We have been working closely with DOD on extending these procedures on a Government-wide basis. A number of actions are already underway:

1. Within the next 30 days we expect to enter into an agreement with DSA on cross-servicing of items which are presently stocked both by DSA and GSA. A special utilization procedure involving direct contact between DSA and GSA managers has been worked out to assure that any long-supply stocks in either agency will be used in lieu of new procurement. This procedure will avoid procurement by GSA for direct delivery to customer agencies of items not stocked by GSA, but which are in long supply in DSA inventories.

2. A Federal property management regulation will be issued shortly which will extend to other Government agencies the requirement for utilization of long supply to meet stock replenishment requirements. Since agencies' systems and their degree of mechanization vary, it is our intention to work with the agencies to adapt procedural details to individual agency's capabilities. This phase of the program will be implemented progressively.

The growing volume of utilization of existing inventories in lieu of new procurement by DOD and the civil agencies is due in large part to the cooperative efforts of DOD and GSA staffs. GSA has contributed materially to this effort through its screening of reportable and nonreportable excess property and filling requirements of defense, as well as civil agencies.

Chairman DOUGLAS. What is DLSC?

Mr. KNOTT. Defense Logistics Supply Center.

Chairman DOUGLAS. It used to be the old Civil Defense?

Mr. KNOTT. The same facility. It was the old Kellogg Hospital at one time.

GSA is working closely with DSA headquarters and the Defense Logistics Supply Center, Battle Creek, to improve the computer output reports on DOD excess so as to facilitate screening and matching against requirements. The introduction of automated techniques has caused some problems with item descriptions, which tends to delay or preclude effective screening for utilization. However, we are confident these will be resolved through our joint effort with DOD.

Over the years, GSA has continually improved its techniques for increasing the utilization of excess personal property within the Government in lieu of new procurement.

The results of our program have been gratifying. Property costing \$95 million was transferred in 1956. Transfers increased to \$310 million in 1961, and to \$677 million in 1965, which involved 577,524 line items of excess property.

To obtain this high rate, we screened reportable and nonreportable property which cost \$1.1 billion and \$2.4 billion, respectively. A large proportion of the excess currently being generated consists of missiles support equipment, electronic communication equipment, and similar items related to weapons systems. We are helping FAA, NASA,

AEC and the National Science Foundation in fulfilling their requirements for this type of technical equipment from available excess rather than by new procurement.

For the past 4 years, we have given special attention to the utilization of excess inventory in the hands of contractors. Transfers of contractor inventory for further Federal use increased from property costing \$34.8 million in 1962 to \$140.4 million in 1965.

Defense contractors were the largest source for contractor inventory and a large portion of the utilization was achieved by other defense activities. The success of this special program stems to a large degree from the speed with which the several screening steps can be achieved and the ability of Federal activities in the field to make selections at contractors' plants of needed items which frequently are of a non-standard nature, unidentifiable by Federal stock numbers.

The subcommittee report took note of the file cabinet moratorium announced by the President and recommended that similar steps be taken with respect to other items in excess supply.

Results achieved under the President's directive for the first full calendar year ending December 31, 1965, substantially exceeded the initial savings goal of \$5 million a year. Actual purchases of filing cabinets, typewriters and office furniture during calendar year 1965 were \$11.1 million less than procurements during the preceding year.

Of this total, \$3.6 million was in the file cabinet category and \$7.5 million in office furniture and typewriters. During the same period, excess office furniture, typewriters and file cabinets having an acquisition cost of \$7.6 million were transferred among Federal agencies for reuse.

One of the additional byproducts of this effort was the increase in the percentage of the total Federal records that moved from office space into our Federal record centers, and this is by far the greater savings. About 45 percent of the total Federal records are now in our record centers.

Chairman DOUGLAS. Is that St. Louis?

Mr. KNOTT. There are 13 record centers around the country. The two in St. Louis are specialized ones. One is military records and the other one is civilian personnel records. In Chicago, we have a record center and we have them at other locations around the country.

We are building a new one here in the Washington area, which is going to have a substantial impact on the movement of records out of offices here.

But this is one of the real benefits. We feel that moving up from 45 percent of the Government's records to 50 percent in the records center for example, will make a tremendous impact on the cost of office space.

In keeping with the subcommittee's recommendation, a review of long supply and excess stocks has been underway for several months to identify large volume common use items in serviceable condition and adequate quantities to warrant a buy freeze.

This review disclosed that relatively small quantities of the types of common use items normally stocked by the Federal Supply Service are being generated as excess property by DOD or other agencies. Thus far, we have found no additional items on which a buy freeze is warranted. However, we are still studying the situation and as-

sure the committee that buy freeze action will be taken if such items are uncovered.

At the present time GSA has prohibited, on a Government-wide basis, the purchase of mercury and is holding excess inventories to fill Federal needs.

GSA is pursuing a vigorous Government-wide property rehabilitation program to avoid new procurement. Agencies are making increased use of several thousand GSA repair, maintenance, and reconditioning contracts all over the United States and the results through fiscal year 1965 are most encouraging.

In that year property having an original cost to the Government of about \$73.6 million, consisting of 1.5 million pieces, was reconditioned or repaired as compared with \$53.4 million in 1964 and \$22.9 million in 1963. We now have 37 different classes of property covered by our contracts as compared with only 2 classes in 1962.

So, this is an expanding field that is proving to be quite beneficial.

Property costing \$407.8 million was donated for educational public health, civil defense, and public airport purposes in fiscal year 1965, an increase of \$15.3 million over fiscal year 1964.

During the last 5 years, surplus property costing more than \$1.8 billion has been donated for public purposes, primarily for educational use.

Representative CURTIS. I notice your headline says personal property. It is personal?

Mr. KNOTT. It is personal, yes, sir; and it should be emphasized that it is.

#### SALE OF USABLE PERSONAL PROPERTY

Excess property which is not transferred for further Federal utilization or donated for public purposes is sold as surplus. Usable property costing \$17 million was sold in 1960 and increased to \$40 million investment in 1963 and to \$70 million in 1965, an alltime record. The return on sales by GSA has averaged 15.3 percent of acquisition cost for the past 6 years.

Representative CURTIS. Could you supply for the record what you have done in the way of real property, too, just so we will have an idea?

Mr. KNOTT. Yes, sir; I would like to report right now that we are headed toward an alltime high in receipts from the sale of real property this year. Our program of donations to meet education, park, and recreational needs are standing at about the same, but the value and I believe the number of real properties that have been sold this year has reached an alltime high and we have receipts already in 8 months of this fiscal year which more than double the amount received all of last fiscal year. We are approaching \$100 million in returns and over the past 10 years have averaged about 108 percent of appraised fair market value.

Representative CURTIS. Some of that would be buildings, too, would it not?

Mr. KNOTT. That would be buildings; yes, sir.

Representative CURTIS. I wonder if you would supply for the record what the figures are for the past 2 or 3 years and if you could shown that which is buildings and that which is raw land?

Mr. KNOTT. Yes.

Representative CURTIS. I do not mean to separate, if it is land that contains buildings, but—

Mr. KNOTT. Unimproved land?

Representative CURTIS. Right, unimproved land and improved land.

Mr. KNOTT. Right.

Representative CURTIS. Thank you.

(The information subsequently submitted by the Department follows:)

*Disposals by sale*

[Dollar amounts in thousands]

	Number of properties	Acquisition cost	Appraised fair market value	Selling price
<b>Fiscal year 1964:</b>				
Land and improvements.....	126	\$309,877	\$70,606.8	\$75,187.0
Land without improvements.....	101	2,936	8,777.3	9,528.1
Improvements without land.....	41	27,445	5,251.2	5,337.0
Total.....	268	340,268	84,635.3	90,052.1
<b>Fiscal year 1965:</b>				
Land and improvements.....	160	246,112	32,419.0	36,626.9
Land without improvements.....	94	7,596	9,012.3	9,394.7
Improvements without land.....	38	6,189	213.6	300.9
Total.....	292	259,897	41,644.9	46,322.5
<b>Fiscal year 1966 (first half):</b>				
Land and improvements.....	79	123,334	23,993.7	55,954.5
Land without improvements.....	55	263	1,870.0	2,009.7
Improvements without land.....	19	17,185	3,019.2	3,093.7
Total.....	153	140,782	28,882.9	61,057.9
<b>Summary (fiscal year 1964 through first half fiscal year 1966):</b>				
Land and improvements.....	365	679,323	127,019.5	167,768.4
Land without improvements.....	250	10,795	19,659.6	20,932.5
Improvements without land.....	98	50,829	8,484.0	8,731.6
Grand total.....	713	740,947	155,163.1	197,432.5

Mr. KNOTT. Of course, that raises your percentage of return, although our percentage of return this year has increased. We are up this year on what we have sold, the roughly \$90 million that we have taken in so far this year, while it represents 106 percent of present value, it represents about 22 percent of the Government's investment, and this includes the buildings, ordnance installations, and so on.

Representative CURTIS. Very good.

Mr. KNOTT. In its last two reports, and I am turning now to automatic data processing activities, the subcommittee urged that action be taken to achieve the potential economies through centralization of the management of the Government-wide automatic data processing activities.<sup>20</sup>

The enactment last fall of Public Law 89-306, provided an expression of congressional intent and the authority and funding mechanism needed by the central management agencies to develop an aggressive ADP program. Since enactment of the legislation, we have been working closely with the Bureau of the Budget and the Bureau of Standards in developing an integrated master plan designed to capture

<sup>20</sup> Report, September 1964, p. 11; and Report, July 1965, p. 8.

the potential savings to the Government as rapidly as possible. Considerable progress has been made because we now have 13 ADP sharing exchanges operating in major cities with high concentrations of ADP facilities. This program will be progressively extended to a potential 30 locations. Sharing of resources totaled \$18 million in 1965, and this is expected to increase to about \$24 million in 1966.

Additional funds have been requested in the 1967 budget of GSA to cover hiring of experts and consultants to work on the numerous projects in the master plan in such fields as procurement, standardization, maintenance, and establishment and operation of service centers and equipment pools.

A management information system is being designed and will be installed this year to provide much-needed information on all aspects of the Government's ADP activities and expenditures.

A budget is being developed for the revolving fund authorized by the new legislation. Policies and procedures governing activities to be financed through the fund are also in the developmental stage.

Mr. Chairman, I believe again you would be interested to know that in establishing these centers we have assessed the situation in the local communities as to who had the major resources and we have been willing to work out with the agencies that had the predominant capability to operate these facilities.

The Navy, for example, is operating one of these exchanges for us, and right here in Washington GSA looks to an HEW computer facility to meet some of its overtime requirements at night.

Chairman DOUGLAS. You do this at night?

Mr. Knott. Well, some of our requirements—yes, this is often the case, where this will meet the need. This is true right here in Washington where our own supply requirements—the average—are met through open time, it is called, by HEW computers.

GSA's recently established special program for interagency redistribution of excess Government-owned and leased electronic data processing equipment showed substantial progress in 1965. During the year, equipment costing \$9.4 million, consisting of both main frame computers and components and accessories was transferred for secondary use in the Government, \$1.8 million was donated, and even greater activity is expected next year.

Each project which has been included in the master plan has been carefully thought out and scheduled for implementation on a progressive basis as the resources become available. A prudent step-by-step approach has been adopted to assure maximum participation by the individual Federal agencies and minimum disruption to current methods of doing business.

#### SAVING CLAUSE IN BROOKS-DOUGLAS ACT (PUBLIC LAW 89-306)

Chairman DOUGLAS. Now, Mr. Knott, you probably know in order to get the so-called Brooks-Douglas Act through, we had to put in section 111(g) which stated that:

Authority so conferred upon the Administrator shall not be so construed as to impair or interfere with the determination by agencies of their individual automatic data processing equipment requirements, including development of specifications for, selection of types and configurations of equipment. The Adminis-

trator shall not interfere with or attempt to control in any way the use made of automatic data processing equipment or components thereof for any agency. The Administrator shall provide adequate notice to all agencies and other users concerned with respect to each proposed determination specifically affecting them or the automatic data processing equipment or components used by them. In the absence of mutual agreement between the Administrator and the agency or user concerned, such proposed determination should be subject to review and decision by the Bureau of the Budget unless the President otherwise directs.

Now, I was opposed to this because I thought it hampered you very much and could lead to each agency getting its own computers and refusing to pool.

I also thought the Bureau of the Budget should not be an administrative agency.

I suspected, and I think my suspicions were well founded, they were out trying to run this computer system for the Government here in Washington at least, and to be a manager of the data processing rather than a research agency recommending policies for the Government, but in order to get this through, we had to agree to that. This was the price that the agencies required.

Now, I want to know whether you have had trouble with 111(g) since last October.

Mr. KNOTT. Well, of course, Mr. Chairman, we felt somewhat the same way, that the Congress dropped its voice in the last section after expressing a pretty clear intent in another direction.

Chairman DOUGLAS. That is right.

Mr. KNOTT. Nevertheless, we, as you, are reasonably well experienced in the art of compromise and we are perfectly willing to accept the challenge that is embodied in the first part of the act and to rest our case on what our investigations show can be accomplished in this area.

Chairman DOUGLAS. Well, what results are you having from this persuasion?

Mr. KNOTT. Well, of course, we have it called to our attention that the savings clause is there, but we have not pressed that point. What we are trying to do, and one of the greatest lacks, and it is not resolved yet, I would not for a moment suggest that it is—but we really do not have a complete inventory of the resources that the Government has. We are trying to identify those. If we can identify those and if we can point out where there are resources that can be used by other agencies, we can make it rather embarrassing to fail to use these resources rather than purchase new ones.

You know, despite the fact, Mr. Chairman, if I can use an analogy, that there is no such limitation on our authority to lease space, the directives and the Executive orders that have been issued implementing our authority to manage space make it very clear that we cannot impinge on the program responsibilities of an agency. We cannot tell an agency that it can or must operate out of Chicago when it decides it is going to operate out of Springfield.

So, that—

Chairman DOUGLAS. Let me say that if you have trouble with the agencies on the 111(g) I for one will favor removing 111(g) from the act.

Mr. KNOTT. I think, Mr. Chairman, that this committee is entitled to know, after we have had an experience of certainly no more than 2 years in operation under this act what our difficulties are.



Chairman DOUGLAS. Let representatives of the Bureau of the Budget hear or any other agency take notice.

Representative CURTIS. I would like to join the Chairman in that sentiment; yes, indeed.

Chairman DOUGLAS. Good. Without objection the text of Public Law 89-306 will be inserted at this point.

BROOKS-DOUGLAS ACT

Public Law 89-306

89th Congress, H.R. 4845

October 30, 1965

AN ACT To provide for the economic and efficient purchase, lease, maintenance, operation, and utilization of automatic data processing equipment by Federal departments and agencies

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That title I of the Federal Property and Administrative Services Act of 1949 (63 Stat. 377), as amended, is hereby amended by adding a new section to read as follows:

"AUTOMATIC DATA PROCESSING EQUIPMENT

"SEC. 111. (a) The Administrator is authorized and directed to coordinate and provide for the economic and efficient purchase, lease, and maintenance of automatic data processing equipment by Federal agencies.

"(b) (1) Automatic data processing equipment suitable for efficient and effective use by Federal agencies shall be provided by the Administrator through purchase, lease, transfer of equipment from other Federal agencies, or otherwise, and the Administrator is authorized and directed to provide by contract or otherwise for the maintenance and repair of such equipment. In carrying out his responsibilities under this section the Administrator is authorized to transfer automatic data processing equipment between Federal agencies, to provide for joint utilization of such equipment by two or more Federal agencies, and to establish and operate equipment pools and data processing centers for the use of two or more such agencies when necessary for its most efficient and effective utilization.

"(2) The Administrator may delegate to one or more Federal agencies authority to operate automatic data processing equipment pools and automatic data processing centers, and to lease, purchase, or maintain individual automatic data processing systems or specific units of equipment, including such equipment used in automatic data processing pools and automatic data processing centers, when such action is determined by the Administrator to be necessary for the economy and efficiency of operations, or when such action is essential to national defense or national security. The Administrator may delegate to one or more Federal agencies authority to lease, purchase, or maintain automatic data processing equipment to the extent to which he determines such action to be necessary and desirable to allow for the orderly implementation of a program for the utilization of such equipment.

"(c) There is hereby authorized to be established on the books of the Treasury an automatic data processing fund, which shall be available without fiscal year limitation for expenses, including personal services, other costs, and the procurement by lease, purchase, transfer, or otherwise of equipment, maintenance, and repair of such equipment by contract or otherwise, necessary for the efficient coordination, operation, utilization of such equipment by and for Federal agencies: *Provided*, That a report of equipment inventory, utilization, and acquisitions, together with an account of receipts, disbursements, and transfers to miscellaneous receipts, under this authorization shall be made annually in connection with the budget estimates to the Director of the Bureau of the Budget and to the Congress, and the inclusion in appropriation acts of provisions regulating the operation of the automatic data processing fund, or limiting the expenditures therefrom, is hereby authorized.

"(d) There are authorized to be appropriated to said fund such sums as may be required which, together with the value, as determined by the Administrator of supplies and equipment from time to time transferred to the Administrator, shall constitute the capital of the fund: *Provided*, That said fund shall be credited with (1) advances and reimbursements from available appropriations and funds of any agency (including the General Services Administration), organization, or contractor utilizing such equipment and services rendered them, at rates determined by the Administrator to approximate the costs thereof met by the fund (including depreciation of equipment, provision for accrued leave, and for amortization of installation costs, but excluding, in the determination of rates prior to the fiscal year 1967, such direct operating expenses as may be directly appropriated for, which expenses may be charged to the fund and covered by advances or reimbursements from such direct appropriations) and (2) refunds or recoveries resulting from operations of the fund, including the net proceeds of disposal of excess or surplus personal property and receipts from carriers and others for loss of or damage to property: *Provided further*, That following the close of each such fiscal year any net income, after making provisions for prior year losses, if any, shall be transferred to the Treasury of the United States as miscellaneous receipts.

"(e) The proviso following paragraph (4) in section 201(a) of this Act and the provisions of section 602(d) of this Act shall have no application in the administration of this section. No other provision of this Act or any other Act which is inconsistent with the provisions of this section shall be applicable in the administration of this section.

"(f) The Secretary of Commerce is authorized (1) to provide agencies, and the Administrator of General Services in the exercise of the authority delegated in this section, with scientific and technological advisory services relating to automatic data processing and related systems, and (2) to make appropriate recommendations to the President relating to the establishment of uniform Federal automatic data processing standards. The Secretary of Commerce is authorized to undertake the necessary research in the sciences and technologies of automatic data processing computer and related systems, as may be required under provisions of this subsection.

"(g) The authority conferred upon the Administrator and the Secretary of Commerce by this section shall be exercised subject to direction by the President and to fiscal and policy control exercised by the Bureau of the Budget. Authority so conferred upon the Administrator shall not be so construed as to impair or interfere with the determination by agencies of their individual automatic data processing equipment requirements, including the development of specifications for and the selection of the types and configurations of equipment needed. The Administrator shall not interfere with, or attempt to control in any way, the use made of automatic data processing equipment or components thereof by any agency. The Administrator shall provide adequate notice to all agencies and other users concerned with respect to each proposed determination specifically affecting them or the automatic data processing equipment or components used by them. In the absence of mutual agreement between the Administrator and the agency or user concerned, such proposed determinations shall be subject to review and decision by the Bureau of the Budget unless the President otherwise directs."

Approved October 30, 1965.

Mr. KNOTT. We certainly appreciate that, Mr. Chairman. And we think, however, by persuasion we may get there. We are going to try that first.

Now, on the disposition of excess strategic and critical materials, Mr. Chairman, if I could just have a brief word. The subcommittee will be interested, I believe, to learn of our progress in the utilization and disposal of excess strategic materials. For the past 2 years the Government has planned for the orderly disposal of these excesses on a commodity-by-commodity basis. Disposal plans have been formulated in close coordination with concerned Federal agencies and industry. Excess materials are released into the market in a manner carefully calculated to conform to the ability of the markets to absorb them without adverse economic impact.

Representative CURTIS. Could I ask a question there?

Mr. KNOTT. Yes.

Representative CURTIS. In some of these, you coordinate with the Department of Commerce?

Mr. KNOTT. Yes, sir, we have an interagency coordinating committee that consists of Commerce, State, Interior, and OEP, of course.

Our disposal efforts to date have been successful in this regard and we have been able to accelerate sales, at rates consistent with the needs of the expanding domestic economy which normal sources of supply have been unable to fulfill.

Zinc, molybdenum, vanadium, columbium, mercury, and tungsten are examples of the excess commodities disposed of which has relieved severely strained normal supply sources. Our disposal of excess strategic and critical materials has, in many instances, been the factor which enabled continued full-scale domestic industrial operations instead of curtailment.

The volume of excess materials sales increased from \$167 million in fiscal year 1964 to \$432.5 million in 1965. In the current fiscal year, total disposal volume reached \$602 million through mid-March 1966. This new high in the disposal of materials in less than three-quarters of the fiscal year was accomplished without any perceptible adverse impact on the normal channels of trade.

#### ANTI-INFLATIONARY ASPECTS OF SALES PROGRAM

Chairman DOUGLAS. And it has helped to keep down inflation, has it not?

Mr. KNOTT. It certainly has had that byproduct; yes, sir.

Representative CURTIS. The chairman said he would stir me up a bit. I am very happy about that aspect but there are some that you did not mention, like copper and aluminum.

Chairman DOUGLAS. Copper is coming.

Mr. KNOTT. Well, aluminum, Mr. Curtis, I think, is one of the most successful of all of the things that we worked out. Now, I think it is unfortunate that at the time the agreements were being worked out, and this was a continuation of an effort that started a few years earlier, that the price rise got into the picture, but actually we have an agreement that is very satisfactory to industry, and industry since those contracts were signed in late December has purchased 130,000 tons of aluminum, and has told us clearly that this has exceeded their expectations and has made it possible for them to expand.

Representative CURTIS. Of course, here is the point. I will not get into it any further, but as long as you use what is really your need for military purposes and keep your stockpile at that level and do not use it just to help along the industry, then you are not outside the law.

Mr. KNOTT. Exactly.

Representative CURTIS. I have raised this question. I do not do it here other than to bring it into context. I think we have gone beyond that in copper, for example, where we are in real short supply. Frankly, the testimony before the Ways and Means Committee indicated that they were trying to do what Senator Douglas said: take care

of a price problem. I would say, and these are my words, that this is being done at the neglect of future military needs.

Chairman DOUGLAS. Congressman Curtis and I have been getting along so well that the afternoon is not really characteristic. In order to make it more characteristic, let me say we largely purchased these raw materials to keep prices from falling. I do not see why we cannot use the same stockpiles to keep prices from rising. This is not merely a bailout, this is also a stabilizing factor and my dear friends from the other side of the aisle and across the river, weep about inflation, but every time we try to do something about it in the field of raw materials then they say, "You should not do it."

Representative CURTIS. Let me respond by saying I do agree with Senator Douglas to some degree. There was, I would say, a misuse of procurement of stockpiles in order to keep prices up. But I emphasize "misuse." I hope I was critical then, because the law did not provide for using stockpiles for that purpose. I think I am consistent in pointing out a misuse, if it is the other way of getting rid of them. I would still say that if stockpiles were too high for Defense needs, then you are doing the right thing to get rid of them.

Chairman DOUGLAS. As a practical measure a lot of this stuff was bought to keep prices up. We all know the raw materials lobbies that operate through both Houses of Congress. If I may beat my breast I will say I voted against nearly all of these purchases.

Representative CURTIS. So did I. [Laughter.]

Chairman DOUGLAS. But, nevertheless, they went through. Having gone through, then I think it is proper to seek to keep prices from going up.

Representative CURTIS. No; two wrongs do not make a right. [Laughter.]

Senator DOUGLAS. A compensatory action to avoid evils which otherwise would occur. This was a compensatory action.

All right, Mr. Knott. Mr. Curtis and I have to have these byplays in order that the afternoon may be complete. [Laughter.]

Mr. KNOTT. Establishing Government policy to use excess strategic and critical materials to avoid cash outlays for new procurement has resulted not only in the avoidance of substantial Federal expenditures, but also has reduced the Federal drain on materials currently in short commercial supply. The volume of Government use of excess strategic and critical materials has increased to \$142.9 million for the first 6 months of this fiscal year. This includes approximately \$78 million in copper transferred to the Bureau of the Mint.

That is where a lot of it went.

Representative CURTIS (presiding). Yes, that is where a great deal of it went.

#### UTILIZATION OF REAL PROPERTY

Mr. KNOTT. One of the subcommittee's recommendations dealt with the Government's utilization of real property.<sup>21</sup> Government-owned real property holdings in the United States on June 30, 1965, consisted of properties which cost \$59.8 billion. This is an increase of \$27 billion since June 30, 1955, an average of \$2.7 billion per year for the 10-year period. The bulk of this increase, \$19 billion, was

<sup>21</sup> Report, July 1965, p. 6.

in the Department of Defense of which \$9.7 billion was for Air Force installations, \$4 billion for the Corps of Engineers, and \$4.3 billion for Navy and Army. From the civilian agencies, the major portion of the \$8 billion increase was for AEC, NASA, Interior, Agriculture, and GSA. During this same 10-year period, the Government has, through an aggressive program using GSA facilities, improved utilization or disposed of considerable amounts of real property as indicated by the following statistics:

*Transfers, sales, donations, and other disposals of Government property*

[In millions of dollars]

	Number of properties	Acquisition cost
Utilization transfers within the Government.....	1,391	865
Sales of surplus property.....	2,637	2,410
Donations and other disposal actions.....	2,209	1,084
Total.....	6,237	4,359

In addition, we had on hand on June 30, 1965, property which originally cost the Government \$1.2 billion of which \$313 million was in the excess category and available for further utilization within the Government, and \$855 million was surplus and available for disposal. Thus, in the 10-year period, real property which cost \$5.5 billion was reported to GSA by Federal agencies as excess to their needs.

Representative CURTIS. Could I ask—in your computation, these costs would include buildings?

Mr. KNOTT. Yes, sir.

Representative CURTIS. So, it would be raw land, cost of acquiring raw land and then if they build the buildings on it that would go in there in the cost?

Mr. KNOTT. That is right, and that is why while terminology again is a problem here, I think acquisition cost is not really representative, and in the text in most cases we tried to indicate this is the Government's investment.

Representative CURTIS. That was what was confusing me. Perhaps in your accounting system, where the Government has raw land, for example, you would have the acquisition cost and then when you put an improvement on it, you would add to it so that your total figure is the full amount of the investment.

Mr. KNOTT. Right, sir.

Representative CURTIS. Very good.

Mr. KNOTT. In the past decade, we have seen the scope of Government activities change to keep pace with changes in technology and the social and economic needs of the Nation. New requirements for airpower, missile power, space exploration, water and recreational resources, dams, electric power, and the Great Society programs for education, training, health, and other things, all have required new Federal facilities.

Therefore, it is possible that the real property holdings of the Government will continue to grow in the aggregate to meet similar changes in requirements which will undoubtedly occur in future years.

We are acutely aware of the need for holding new acquisitions by the Government to an absolute minimum and for getting unneeded

properties back onto the local tax rolls as rapidly as possible. To this end, we have been working closely with the Bureau of the Budget on a program designed to intensify the review of real property holdings by the individual agencies to increase excess declarations to GSA and to accelerate the disposal of property which has been determined surplus to the Government's needs. This effort is expected to result in the issuance of regulations and detailed procedures to assure that these objectives are achieved.

Representative CURTIS. May I interrupt?

Mr. KNOTT. Yes, sir.

#### FEDERAL GOVERNMENT PAYMENTS IN LIEU OF TAXES

Representative CURTIS. Here is an area where I have been trying to encourage, for accounting reasons as well as others, that the Federal Government pay in lieu of local taxes.

Mr. KNOTT. Yes, sir.

Representative CURTIS. Now, we have got some Federal Government land holdings that are, in effect, subject to payment in lieu of local taxes.

Mr. KNOTT. Right.

You have one in Missouri. Those RFC properties.

Representative CURTIS. The RFC properties. I have always felt it was good cost accounting for two reasons: One, local real estate taxes largely cover community services, sewers, streets, police, fire and so forth, from which the Federal Government's holdings benefit. The other reason, and probably an equally important one, is that it makes the Federal Government realize what the actual cost of its holdings is in this respect and, therefore, encourages it not to hold highly valuable land when some cheaper land would serve its purposes equally well.

Mr. KNOTT. Right.

Representative CURTIS. Would you comment on that briefly.

Mr. KNOTT. Certainly, there is a great deal of merit to that and those RFC properties have gradually been depleted. I think GSA has only about three left.

Representative CURTIS. Yes.

Mr. KNOTT. Defense may have two or three.

Representative CURTIS. This is one of the advantages of the lease-purchase program of post offices, I would say. It keeps that land and the facility in the local tax base.

Mr. KNOTT. Yes.

Representative CURTIS. And I know in other areas there are arrangements for payment in lieu of local taxes. I think in relation to some of the housing—public housing programs—they pay a certain amount but it usually is at the raw land value rather than at the value of the improvement on the land.

Mr. KNOTT. Well, you know one of the things that the Corps of Engineers did to lessen the impact of its acquisitions for recreational purposes around the reservoirs that it has built is this sharing of the revenues that it receives from the leasing of lands for agricultural purposes.

Representative CURTIS. Yes.

Mr. KNOTT. That started out at 25 percent and then increased to 75 percent of the proceeds, and this, in some instances, amounts to more than the taxes that the land was producing before it was acquired.

Representative CURTIS. I do not want to put an undue burden on your office, but could you supply for the record a résumé of how we handle these Federal estates in relation to this problem of local taxes? I suspect we have a variety of ways of doing it—I know the RFC situation, but I suspect there is quite a number of different arrangements. Perhaps I should ask the Budget Bureau this question.

Mr. KNOTT. There was a very fine report by one of the Hoover Commission task forces: It was an intergovernmental relations study that identified some 27 programs of shared revenues and payments in lieu of taxes.

Representative CURTIS. That is what I am getting at.

Mr. KNOTT. And I became familiar with that back in the late 1930's. You know the Congress, for a period beginning about 1950 through about 1960, I think, averaged no less than 30 or 40 bills every year on payments in lieu of taxes, and they fell into patterns of about a half dozen different varieties.

Representative CURTIS. Mr. Ward just sent me a note that 25 percent of U.S. Forest Service receipts go to States.

Mr. KNOTT. Actually, it was the pattern for the Corps of Engineers provision. That is the Weeks' law.

Representative CURTIS. On the handling of the Government properties, perhaps I should ask the Bureau of the Budget to report on the various techniques you use there.

Mr. KNOTT. Yes, sir.

Representative CURTIS. Thank you. I will follow up on that with the Bureau of the Budget. (See p. 198.)

Mr. KNOTT. In the 10-year period ending in 1965, GSA was able to transfer within the Government, excess property originally acquired at a cost of \$865 million, thus avoiding new acquisitions. In 1965, these actions reached the record high of \$242 million. A few recent examples are the former military property at the port of Whittier, Alaska, was transferred to the Alaska Railroad for emergency use following the disastrous earthquakes; 10 facilities originally costing \$57 million were made available to the Office of Economic Opportunity for use as Job Corps centers; and in the last 3 years GSA has, in its construction program, been able to use existing Government-owned sites which, if purchased on the open market, would have cost \$31 million.

Additionally, rental of sites held by GSA pending construction and arrangements for interim use of excess and surplus property produce income of about \$2 million each year.

Of course, one of the things we have to guard against in this time of increasing values in property is that merely because the Government owns it and it is no longer required by one agency we ought not to allow it to be used by another agency for an uneconomic use.

Representative CURTIS. That is very good.

Mr. KNOTT. I think it is much better to deny that use and require that agency to buy more suitable land from private ownership and to get this property back into its highest and best use.

Representative CURTIS. I could not agree more. Incidentally, if we actually did have an amount in lieu of taxes that went with that land, the agency would not be so anxious, perhaps, to acquire it if they knew that the amount to be paid in lieu of taxes had to come out of their annual budgets.

## OPTIMUM USE OF REAL PROPERTY

Mr. KNOTT. This is very true. We have a proposal right now to use a piece of property in Hawaii for a fruitfly laboratory and while it may be that there is no other land that can be used for this purpose I want to be convinced that this is so before we use that kind of property that is worth far in excess of \$100,000 an acre. (See appendix 7, p. 302.)

Representative CURTIS. I am tremendously impressed with that. It is so important to get that land back in the tax base of the community to take care of the cost of schools, et cetera. Let the Federal Government utilize land which is not as valuable and would not mean as much if it were taken out of the tax base.

Mr. KNOTT. That is true.

## REAL PROPERTY DISPOSAL PROGRAM OF GSA

GSA is continuing to convey surplus real property for public use purposes, in accordance with existing statutes, at discounts ranging up to 100 percent. Qualifying uses include education, health, airports, historic monuments, wildlife conservation, and parks and recreation. The investment in properties donated during the 10-year period ending June 30, 1965, totaled \$577 million.

We believe, however, that disposal by sale is most beneficial to the public local communities, and the Federal Government. Sales put the property back into the civilian economy, as you have pointed out, Mr. Curtis, thereby adding property to local tax rolls, reduce the cost to the Government for protection and maintenance, and return sales proceeds to the U.S. Treasury.

Equally important is that many of these sales are to user-buyers thus bringing needed payrolls into the communities where the properties are located. In the past 4 years, sales by GSA of 92 industrial facilities to user-buyers furnished employment for more than 56,000 employees with an annual payroll of over \$390 million. As Secretary McNamara indicated in his testimony of January 24, efforts of GSA have resulted in the timely and effective sale of large facilities no longer needed by the Federal Government. (See p. 31.) The following are several examples of the sale of such properties:

*Examples of property disposal sales*

[Dollars in millions]

Name and location	Sale price	End-use/employment
Naval Ordnance Plant, Macon, Ga.....	\$6.8	Production of ordnance material; 800 employees.
Seattle Army Terminal.....	4.0	Commercial maritime facility in port of Seattle.
Naval Ordnance Plant, York, Pa.....	9.6	Production of ordnance material; 1,100 employees.
Naval Industrial Weapons Plant, Southington, Conn.	22.0	Powerplant and engine production for aircraft.
High Energy Fuel Plant, Muskogee, Okla.....	1.7	Industrial development.
San Jacinto Ordnance Works, Houston, Tex.....	11.0	Do.

With the exception of the latter one, all of these were effected promptly so that there was, for example, in the case of Macon, Ga., a direct transfer of most of the work force.



## ECONOMIC ADJUSTMENT PROGRAM

Representative CURTIS. That leads me to ask you: The committee has been tremendously impressed with Secretary McNamara's reports of what they tried to do in the way of economic adjustment when you close down a military facility. (See p. 33.)

I judge from your testimony here that GSA participates in this economic adjustment operation, or do you?

Mr. KNOTT. Yes.

Representative CURTIS. Have you developed something along this line?

Mr. KNOTT. As a matter of fact, in the early days when this program was first inaugurated, we made trips from the Washington level around to a number of these installations with Defense. I believe that it is pretty well standardized and is done at the local level where our local people meet with their people at the time the announcement is made to discuss general procedures.

One thing that is helpful, certainly for the Department of Defense but to some extent is disadvantageous to us, is that there is a fairly long stretch-out period for the deactivation of some of these installations and it is very difficult for us to know what we can do with a prospective purchaser.

Representative CURTIS. Yes.

Mr. KNOTT. It has both an advantage and a disadvantage. Sometimes, if there is a contract operator in the plant, why, then we have a readymade customer, but if it is Defense operated and it is going to take some time to clear it out, that makes it difficult.

Representative CURTIS. You might review, if you have not already, the actual setup that Secretary McNamara seems to have. I remember the testimony related to what happened in Decatur, Ill. There, through anticipation of the closing down, they were able to make the transition so there was no unemployment. I am thinking to a large degree of the employment of the people there.

Mr. KNOTT. Yes, sir. I recall that transaction very well, and our great problem there was to get the local people to stand still long enough for us to get what was a good transaction for them in terms of a company that could produce for them as well as a return for the Government.

Representative CURTIS. Yes; very good.

Mr. KNOTT. The success of our disposal program is due in part to our efforts to stimulate public interest through streamlining of procedures and modification of regulations relating to the terms of sales, interest rates, and the methods of offerings for disposal. In some cases, bidders may submit bids on an entire property or on any combinations of parcels of real estate and packages of equipment which may be needed by bidders in their proposed operation of the facility.

Turning now to our advertised and negotiated procurements, in fiscal year 1965, 77 percent of GSA's total procurement dollars were expended under publicly advertised, competitive bidding procedures. This includes awards made to small business firms under restricted advertising procedures but does not include orders placed with commercial suppliers under indefinite contracts by other agencies. Our

experience thus far indicates that this level will be maintained in fiscal year 1966. In GSA, negotiated procurements consists primarily of contracts for professional services such as architects and engineers, small purchases under \$2,500, military priority requirements, and specialized procurements for oversea use by AID and State Department.

This is a purified figure in that this relates only to the advertised competitive bidding, but it does not take into account the rather extensive competitive bidding that we have on negotiated procurement.

Representative CURTIS. Right.

Mr. KNOTT. Which would increase the picture.

Representative CURTIS. Could I ask on that: do you get assistance in extending your advertised bidding through the breakout techniques like the—

Mr. KNOTT. The second step?

Representative CURTIS. No, where you have a prime contractor. I do not imagine you have so many of these as the military, but cases where you ask the prime contractor to break out of the contracts, so that when he lets to the subcontractors, advertised bidding might come in at that level.

Mr. KNOTT. Yes.

Representative CURTIS. Have you developed—

Mr. KNOTT. No, but they do use our term contracts. (See p. 139.)

Representative CURTIS. For instance, in an item like a missile or a Polaris submarine, maybe 80 percent of the components are what might be called common use items. You can, through the breakout procedure, ask that the prime contractor, although there has to be a negotiated bid with him, use the "advertised bid" technique in his breakout of contracting of the subs.

Mr. KNOTT. Now, we did that in the case of the building that we built for Commerce at the World's Fair, because that had to be a negotiated contract or, cost plus, and the only way we could handle that was to select a general contractor and then to require him to do the bidding.

Representative CURTIS. That is the technique, but you have not developed this to any great extent?

Mr. KNOTT. No, and the only time it will occur on our advertised construction contracts, because they are advertised to the prime, the only time it will occur at the lower level is when there is a change in a material, for example, and two or three alternates will be offered and we will require that the general require the sub to get bids and that is a part of the basis for our decision.

Representative CURTIS. Yes, very good.

Mr. KNOTT. Orders placed with small business firms in 1965 totaled \$527.8 million or 56.8 percent of all prime contracts awarded by GSA. This was an increase of \$200 million over the 1963 level. In the first 6 months of this fiscal year, \$301 million was placed with small business firms and if this rate continues, dollar awards in 1966 will exceed those in recent years.

Mr. Curtis, this is about the wrapup of the things looking over our discussions last year and the things the committee indicated their prime interest in that we felt we wanted to report affirmatively with

you, but we have our staff here. We would be happy to go into these areas more fully or into any collateral areas that you see fit.

Representative CURTIS. On behalf of Chairman Douglas and myself, I want to thank you for an excellent presentation and a very responsive one to the very points the committee has raised.

I think that we will use the technique of supplying to you a number of written questions, which we have done in the past and which seems to be one way of moving this dialogue forward. (See appendix 11, p. 393.)

#### ADVERTISED BIDS AT LOWER COSTS

I have a couple of points I noted here. Does your experience ting your goods and services at a lower cost through the advertised technique?

Mr. KNOTT. Yes, sir; and one of the most refreshing things in that connection has been the work that we have done through our business service centers with new businesses.

We have kept in the last year or so a tab just to see how well this was paying off as a GSA activity. We kept tabs on some of those that we have counseled with, came in and bid, and we found that actually we reduced our procurement, as I recall, about 10 percent, by the participation of these new bidders in the field. This was a new departure.

#### ADVERTISED BIDS HELP SMALL BUSINESS

Representative CURTIS. We have also found, and I want to be sure that your correlation would be the same, that as advertised bids go up as a percentage of all bids, that small business tends to increase its participation.

Mr. KNOTT. Yes, sir.

Representative CURTIS. Do you find that to be true?

Mr. KNOTT. I think that is true.

Mr. GRIFFIN. I think that is very true, Mr. Curtis.

#### AREAS OF POTENTIAL SUPPLY SHORTAGES

Representative CURTIS. Let me direct a question I asked Secretary Ignatius this morning in respect to the GSA.

The full Joint Economic Committee is concerned with the overheating of the economy. We are looking, of course, for areas where there might be a shortage of materials and, equally important, skills.

Could you supply a list for us of what areas you might have seen in your procurement where we might be getting shortages in either raw materials or skills?

Mr. KNOTT. Yes, sir; I would be happy to. We have been doing some reviews in that area recently, but I would like to be precise and furnish you with a list.

Representative CURTIS. It is a sort of early warning. I know you have seen it and this committee, I think, would benefit by having whatever information you might have there.

(General Services Administration later supplied the following information:)

LIST OF ITEMS REPORTED BY BUYING ACTIVITIES AS PRESENTING PROBLEMS OF PROCUREMENT DUE TO SHORTAGES OF MATERIALS OR PRODUCTIVE CAPACITY

*Material shortages*

<i>Item</i>	<i>Raw materials</i>
Copper products:	Copper
Copper wire	
Tubing	
Brass valves	
Neoprene-covered electrical items	Neoprene
Leather-faced gloves	Leather

*Productive capacity*

Antimalarial drugs (critical)	Surgical dressings
Bandages	Textile items:
Paper products:	Heavy canvas
Kraft papers	Denim and duck
Fiberboard	Tarpaulin
Cartons	Sheeting
Toilet paper	Mattress covers
Paper towels	Blankets
Colored writing paper	Cushioning material
Lumber and plywood	Selected handtools
Twist drills	

Representative CURTIS. The Comptroller General gave us a report in March 1966 of the cost of sale of surplus property and disposition of proceeds in the Department of Defense. (See p. 273.)

I would like to have you review it, not from the standpoint of commenting on the Department of Defense, but from your standpoint of whether or not these were common problem areas in this very difficult area of disposing of surplus properties.

Mr. KNOTT. Yes, sir.

Representative CURTIS. I would add another personal comment. I am most anxious to try to get GSA more in the area of disposal of properties and get the Military Establishment out of it. I appreciate the reasons why they think they can dispose of their own material better than could an agency like GSA. But let me ask this general question: Are there any continuing discussions between you and DSA or the Defense Department, because I am not sure DSA could handle this. This would be the Defense Department.

Mr. KNOTT. DSA is handling it.

Representative CURTIS. DSA does handle it?

Mr. KNOTT. Yes.

Representative CURTIS. Well, I think some of the services handle some of their surplus disposals themselves, do they not? Is it all now under DSA?

Mr. KNOTT. Yes.

Representative CURTIS. That is one achievement anyway. Then, the question is: What are your negotiations, or your understanding, with DSA in respect to taking over more of this disposal?

Mr. KNOTT. Well, we had reached a fairly high plateau of discussions with them about the time we had the hearings last year, but frankly, Mr. Curtis, as we moved along and we became more familiar with the way in which their utilization program was entwined with their sales program and we became aware of their own efforts to cut

back on the number of sales depots which they actively did, they have pursued this, and I think from what I can understand, have done a splendid job of consolidating those within the last year, we felt it was inopportune for us to move in, that actually we would simply slow down their operation and probably could not make a case that GSA could do it more efficiently.

Representative CURTIS. I am not going to ask you to get into the position of competition here. I think the committee has to do it. Frankly, the "punkin fund" technique is actually a colloquialism used in the Defense Department. They get the use of funds or some of it that they derive from sales. That is a very unhappy basis for having the Defense Department remain in this business of disposal of surplus properties. I do not want to draw you into this because this would be wrong. We will pursue this—

Mr. KNOTT. That is the crux of the thing.

The other things were factors, but the financing was the heart of it, and we discussed it with the Bureau of the Budget and simply decided that at this point the timing was bad.

#### EXECUTIVE OFFICE POLICY ON PROCUREMENT OF COMMERCIAL-TYPE ITEMS

Representative CURTIS. Now, also I would like to have your comments for the record on the recent Bureau of the Budget promulgation, I think A-76, on Government in Business, for the record? (See below.)

Mr. KNOTT. Yes, sir.

Representative CURTIS. And then I also wanted to thank you for the charts on this real property.<sup>22</sup> This has been very helpful to the committee; in fact, as I again say, this whole presentation here has been most fruitful.

(The comments on BOB Circular A-76 referred to above was later furnished by GSA.)

#### BOB CIRCULAR A-76

The President, in a memorandum of March 3, 1966, to the heads of departments and agencies said in part—"Decisions which involve the question of whether the Government provides directly products or services for its own use must be exercised under uniform guidelines and principles." Under the direction of the President the Director of the Bureau of the Budget issued Circular A-76, also dated March 3, 1966, setting forth policies governing the Government's procedures in this area.

In addition to those activities specifically required by law the circular lists circumstances under which the Government may provide a commercial or industrial product or service for its own use as follows:

(a) Procurement of a product or service from a commercial source would disrupt or materially delay an agency's program.

(b) It is necessary for the Government to conduct a commercial or industrial activity for purposes of combat support or for individual and unit retraining of military personnel or to maintain or strengthen mobilization readiness.

(c) A satisfactory commercial source is not available and cannot be developed in time to provide a product or service when it is needed.

(d) The product or service is available from another Federal agency.

(e) Procurement of the product or service from a commercial source will result in higher cost to the Government.

<sup>22</sup> Staff Materials, 1966, pp. 8-15.

Each agency is directed to establish an inventory of its commercial or industrial activities having an annual output of products or services costing \$50,000 or more or a capital investment of \$25,000 or more by June 30, 1966.

A requirement for certain cost comparisons is also included in the circular along with selected periodic reviews of existing commercial or industrial activities at least once before June 30, 1968, and every 3 years thereafter.

A Government commercial or industrial activity is one which is operated and managed by an executive agency and which provides for the Government's own use a product or service that is obtainable from a private source.

We anticipate no significant impact on GSA from the new circular in view of the fact that we have been acting under the provisions of Bureau of the Budget Bulletin No. 60-2, since 1959. The bulletin included basically the same policy. The circular restates and expands substantially the elements which were contained in the previous issuance.

However, the General Services Administration is now undertaking to inventory and review as required all activities meeting the definitions contained in the circular.

Selected examples of activities which will quite probably be included in GSA's inventory:

- Printing and duplicating facilities.
- Office machine and furniture repair shops.
- Cleaning of public buildings.
- Operating equipment servicing.
- Supply system laboratories.

Representative CURTIS. Mr. Ward, do you have any specific questions you would like to direct?

Mr. WARD. No, but there was a gentleman here who wanted to say something about A-76 for the record but it seems he has gone.

#### BUY AMERICAN ACT

Representative CURTIS. One other thing: Were you in the room when I asked Secretary Ignatius—or perhaps it was Admiral Lyle—about the problem of handtools as the "Buy American Act" affects GSA? I am most anxious that that be resolved so that the different treatment of "Buy American Act" does not foul us up in this technique of procurement. (See pp. 83, 188, 214, 408.)

#### DIFFERENT POLICIES AMONG AGENCIES

Mr. KNOTT. Right. Obviously, we are pursuing different policies here. We have taken this up with the Bureau of the Budget several times. The Bureau is well aware of this. I understand they are coming before the committee.

Representative CURTIS. Yes, we will be sure and ask them about that.

Mr. KNOTT. And we have talked with them about it very recently.

I think that even so—and I am not trying to pass this to the Bureau of the Budget—I think that even so, to the extent that we have within the last 2 or 3 years more and more taken on the procurement of things such as handtools and paint that we might have urged with the Bureau that even though there may be other reasons why in our normal procurements there should be a difference between our procedure and Defense, that in those defense related items we might well have been allowed to follow that.

Representative CURTIS. That is right. That is one way of going, but in my judgment we have to resolve this.

Mr. KNOTT. I agree with you.

Representative CURTIS. I was very happy. I think it was Secretary Ignatius who volunteered, as a matter of fact, that we would get into this and—

BOB MUST RESOLVE PROBLEM

Mr. KNOTT. We have talked several times, but this decision rests with the Bureau of the Budget. There is no misunderstanding between us and Defense. We recognized the difference, but the difference, the policy rests with the Bureau. (See p. 408.)

Representative CURTIS. Apparently the Executive has the power to resolve this.

Mr. KNOTT. I think so.

Representative CURTIS. At least we cleared that up. We do not have to amend the law. The Executive has the power to correct this through policy determination.

Mr. KNOTT. Exactly.

Representative CURTIS. Very good. Thank you very much.

The committee will stand adjourned and will meet tomorrow at 10 a.m. when we will hear testimony from Mr. Staats, the Comptroller of the United States. In the afternoon, Mr. Schultze, Director of the Bureau of the Budget.

(Whereupon, at 4 p.m. the hearing recessed to reconvene Thursday, March 24, 1966.)

USE OF GOVERNMENT SUPPLY CONTRACTS BY CERTAIN CONTRACTORS

(This item is submitted in accordance with Mr. Ward's request of Mr. Abersfeller.)

The Federal procurement regulations provide for the use of GSA supply sources by prime contractors in performing cost-reimbursement type contracts when authorized to do so by the Federal agency awarding the contract. The appropriate subpart of the Federal procurement regulations is attached.

In addition to the specific provisions of the Federal procurement regulations, the Administrator, General Services Administration, has authorized the use of GSA supply sources by State and local instrumentalities operating under the Office of Economic Opportunity programs. Also, the community action program and the Job Corps center contractors of the OEO use GSA supply sources.

When authorized to do so, these contractors may procure any items in GSA stores stock or contained on Federal supply schedule contracts, provided they comply with the policy and procedures set forth in the Federal procurement regulations.

SUBPART 1-5.9—USE OF GSA SUPPLY SOURCES BY PRIME CONTRACTORS IN PERFORMING COST-REIMBURSEMENT TYPE CONTRACTS

§ 1-5.930 Scope of subpart.

This subpart prescribes policies and procedures for the guidance of Federal agencies in authorizing the use of General Services Administration (GSA) supply sources (Federal Supply Schedule contracts and GSA stores stock) by their prime contractors in performing cost-reimbursement type contracts (see § 1-3.404).

§ 1-5.901 Policy.

(a) When a Federal agency deems that it is in the best interest of the Government to do so, the agency shall authorize its prime contractors to utilize GSA supply sources in performing cost-reimbursement type contracts. Before issuing such an authorization the agency should determine the advantage to be

obtained therefrom in the performance of such contracts in terms of price, delivery, contract administration, and any other significant factors, and shall take into account any recommendations of the prime contractor.

(b) Except as otherwise specifically authorized by the Administrator of General Services, Government prime contractors and their subcontractors shall not be authorized to utilize GSA supply sources in connection with the performance of any fixed-price type contract, or any subcontract thereunder, or any subcontract under a cost-type contract, whether or not such contract provides for price adjustment, escalation, redetermination or modification, or cost-reduction incentive.

#### § 1-5.902 Authorization to prime contractors.

(a) Authorization to prime contractors to utilize GSA supply sources shall be given only if title to property ordered on a purchase basis under Federal Supply Schedule contracts will pass to and vest in the Government directly from the Federal Supply Schedule contractor (rather than through the prime contractor), and title to Government-owned property ordered from GSA stores stock will remain in the Government.

(b) Authorizations to cost reimbursement type prime contractors to order equipment on a lease or rental basis under Federal Supply Schedule contracts shall be given only on the condition that such leased or rented equipment will be used solely in the performance of cost reimbursement type Government contracts.

(c) Authorizations shall be in writing and shall cite the number of the cost-reimbursement type contract; specify any applicable limitations on the authority, including the period of eligibility; and contain any other pertinent information (e.g., requirements relative to ordering, receiving, inspection, and payment).

(d) Copies of each authorization shall be forwarded to the General Services Administration, Federal Supply Service, Office of Supply Management, General Services Building, Washington, D.C., 20405, and to the GSA regional office serving the geographical area in which the facilities of the authorized prime contractor are located.

#### § 5.903 Procedure for placing orders.

##### § 1-5.903-1 Orders under Federal Supply Schedule contracts.

Orders placed by cost-reimbursement type prime contractors under Federal Supply Schedule contracts shall be placed in accordance with the provisions of the applicable Federal Supply Schedule and the authorization. They shall be accompanied by a copy of the authorization (unless a copy was previously furnished to the Federal Supply Schedule contractor) and shall contain a statement as follows:

"This order is placed in behalf of the ----- (insert name of authorizing Federal agency) -----, in furtherance of U.S. Government contract No. ----- (insert number of cost-reimbursement type contract) -----, pursuant to written authorization dated -----, [ <sup>1</sup>----- ]. In the event of any inconsistency between the terms and conditions of this order and those of your Federal Supply Schedule contract, the latter will govern."

##### § 1-5.903-2 Orders for GSA stores stock.

Orders placed by cost-reimbursement type prime contractors for GSA stores stock shall be placed in accordance with the authorization. They shall show the address to which billings are to be sent and shall contain a statement as follows:

"This order is placed in behalf of the ----- (insert name of authorizing Federal agency) -----, in furtherance of U.S. Government contract No. ----- (insert number of cost-reimbursement type contract) -----, pursuant to written authorization dated -----."

##### § 1-5.904 Furnishing information to contractors.

Federal agencies shall assist their prime contractors authorized to use GSA supply sources in obtaining pertinent Federal Supply Schedules and the GSA Stores Stock Catalog and appropriate supplements thereto, and shall furnish them with any other helpful information.

<sup>1</sup> Insert "a copy of which is attached," or "a copy of which you have on file," or other suitable language, as appropriate.



**§ 1-5.905 Payment for GSA stores stock.**

Bills for GSA stores stock will not be rendered by GSA until after shipment has been made. Agencies should direct their cost-reimbursement type prime contractors to make prompt payment. Contractors should be given permission to pay any such bills upon receipt. Necessary adjustments will be made by GSA subsequent to payment.

**§ 1-5.906 Control of property acquired under authorizations.**

Cost-reimbursement type contracts under which prime contractors are authorized to utilize GSA supply sources should contain specific provisions covering the control, use, and accountability of property acquired from those sources.

# ECONOMIC IMPACT OF FEDERAL PROCUREMENT

THURSDAY, MARCH 24, 1966

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON FEDERAL PROCUREMENT  
AND REGULATION OF THE  
JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met at 10 a.m., pursuant to recess, in room S-407, the Capitol, Hon. Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senator Douglas; Representatives Griffiths and Curtis.

Also present: Ray Ward, economic consultant; Douglas C. Frechtling, minority research assistant; and Hamilton D. Gewehr, administrative clerk.

Senator DOUGLAS. The hearings will continue this morning with testimony from the Comptroller General of the United States, an old friend, Mr. Elmer Staats, who has recently assumed the duties of that high and important office.

Mr. Staats, you have been a very able servant of the executive branch. I hope you realize that you are now a servant of the legislative branch.

Will you come forward, please?

I think you are accompanied by Mr. Frank Weitzel, the Deputy Comptroller, and by others.

The Hoover Committee tried to have the General Accounting Office transferred to the executive branch, which would have meant that the executive branch would have been reviewing its own actions. This I always believed was a great mistake and Congress rightly kept jurisdiction in this, although it made some of the bureaucrats downtown angry. You have always been a good servant of the public, but you are now responsible to the legislative branch. You will find the pressure a little different.

May I say that we have relied on the General Accounting Office very much in the past, and we have found the staff to be devoted and competent. They have been of great help to us going into the question of waste in the Defense agencies, and they have been very useful and I am delighted that you are surrounded by such able colleagues. My letter of January 26, 1966, about these hearings will be inserted at this point.

JANUARY 26, 1966.

HON. FRANK H. WEITZEL,  
*Acting Comptroller General of the United States,*  
*Washington, D.C.*

DEAR MR. WEITZEL: The Subcommittee on Federal Procurement and Regulation plans to hold hearings again this year on the general subject of the impact of Federal procurement on the economy and we will review the recommendations in previous reports, especially those of July 1965.

It will be appreciated, therefore, if you and such staff as you may select will be prepared to give the subcommittee your views and recommendations on the following:

1. General findings and trends in the Federal procurement area as revealed by GAO studies and reports for calendar year 1965. This will include competitive and negotiated bidding, utilization of existing materials, management of short-shelf-life items, sales and disposal policies and procedures, utilization of receipts, and other related matters.

2. A review of the program initially suggested by the GAO for the procurement and management of ADPE under existing law, regulations and procedures. Parenthetically, the persistent and informed efforts of the GAO in this field deserve the highest praise.

3. The adequacy of the controls and regulations pertaining to Government-owned inventory in the possession of contractors. This point is stated on page 11 of our report of July 1965.

4. The requisitioning procedures and practices of users of the facilities of the central supply agencies, DSA and GSA. See page 6 of the July 1965 report.

As in previous years, the subcommittee solicits your views as to those areas of procurement administration which should be given the highest priority of attention during the current year. We also desire a statement of the accomplishments and savings of the GAO during 1965, and will need 100 copies of your statement at least 1 day prior to the hearing date.

It will be appreciated if you will again furnish the subcommittee with an index and the synopses of reports pertaining to the subjects we have had under discussion. If further information is needed, please contact our economic consultant, Mr. Ray Ward, phone No. 173-8169, study room 161, Library of Congress Annex.

You will be advised of the hearing date as soon as details can be developed, but we will commence as soon after March 1 as may be practicable.

Faithfully yours,

PAUL H. DOUGLAS,

*Chairman, Subcommittee on Federal Procurement and Regulation.*

You may proceed, Mr. Staats.

**STATEMENT OF ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES; ACCOMPANIED BY FRANK H. WEITZEL, ASSISTANT COMPTROLLER GENERAL; ROBERT F. KELLER, GENERAL COUNSEL; WILLIAM A. NEWMAN, JR., DIRECTOR; HAROLD H. RUBIN, ASSOCIATE DIRECTOR; JAMES H. HAMMOND, ASSOCIATE DIRECTOR; RICHARD GUTMANN, ASSOCIATE DIRECTOR; J. K. FASICK, ASSOCIATE DIRECTOR, DEFENSE ACCOUNTING AND AUDITING DIVISION; EDWARD H. MAHONEY, ASSOCIATE DIRECTOR, ACCOUNTING AND AUDITING POLICY STAFF; AND ARTHUR J. SCHOENHAUT, DEPUTY DIRECTOR; GREGORY AHART, ASSISTANT DIRECTOR; AND IRVINE CRAWFORD, ASSISTANT DIRECTOR, CIVIL ACCOUNTING AND AUDITING DIVISION**

Mr. STAATS. Mr. Chairman, as you have indicated, I have appeared before this subcommittee on several occasions in behalf of the Bureau of the Budget and I am here today in my new capacity as Comptroller General, a post which I assumed only last week.

I would like to make three general points before I read my prepared statement.

I have said on many occasions that I have had a very high regard for the work and the staff of the General Accounting Office. Secondly, I want to stress the importance which I personally hold to the work of this subcommittee. I think I made this statement last year. It has

been constructive in supplying a discipline for all of us who carry some responsibility in this field. This subject covers approximately one-half of the total budget of the Defense Department and it covers a very significant part of the budgets for the other agencies. I for one would hope that the subcommittee would continue its interest in this field and it is my intention that this subject receive a very important part of the attention of the General Accounting Office.

Senator DOUGLAS. Thank you very much, Mr. Staats.

Mr. STAATS. It will be my desire to be cooperative with this committee and other committees of the Congress and we will pledge our best efforts to that end.

Senator DOUGLAS. You always did that when you were in the Budget Bureau and I am sure this will continue.

Mr. STAATS. From March 1 through December 31, 1965, we have issued more than 180 reports to the Congress relating to reviews of Government activities. Many of these reports continue to demonstrate the need for improved management of Government operations in order to reduce costs.

This continuing need for improvement does not mean that the Government departments and agencies involved are not considering our reports and making progress toward the correction of these problems. We believe that they are giving close attention to most of the matters reported by us and they have taken a number of actions intended to correct the particular situations our audit reports have disclosed.

Cash collections and other measurable realized or potential savings in Government operations directly attributable to action taken or planned on findings developed by the General Accounting Office totaled an estimated \$186.8 million during fiscal year 1965.

Senator DOUGLAS. I understand these [pointing] are some of the 180 reports here?

Mr. STAATS. This is, I am told, just 80 of them, Mr. Chairman. [Laughter.]

Representative CURTIS. These are just the part that apply to our studies?

Senator DOUGLAS. Yes.

Mr. STAATS. But it is an impressive total, nevertheless.

Corrective actions of this magnitude indicate the degree of interest of Government departments and agencies in improving management policies and practices and in avoiding the incurrence of unnecessary costs. However, the fact that our audits continue to disclose the need for further improvements indicates that the management processes require continual attention.

In view of the significant impact of Department of Defense procurement on the national economy, our comments today will be concerned primarily with activities of the Department of Defense or with other governmental activities closely related to Department of Defense operations. We also have with us additional analogous information on civilian agencies which we are prepared to discuss if you so desire.

In this statement we will discuss our findings relative to the (1) requisitioning procedures and practices of military installations utiliz-

ing Defense Supply Agency activities, (2) adequacy of controls pertaining to Government-owned inventory in the possession of contractors, (3) use of proceeds from the disposal of surplus personal property, (4) procurement and management of automatic data processing equipment, (5) management of short shelf life items—that is, items which deteriorate after a specified period of time—and (6) consolidation of common military supply and service activities.

In addition, we will comment on four areas of defense activities which we believe merit particular attention; namely, (1) the need for more effective inventory controls, (2) potential savings through greater utilization of excess material to avoid procurement, (3) the need for adequate technical data to permit competitive procurement, and (4) the effectiveness of supply systems in meeting operational needs.

Your staff has been furnished copies of more than 80 reports relating to our reviews of Department of Defense activities. Background material prepared for your use by your staff contains brief digests of these reports. (See "Staff Materials," 1966, pp. 62-123.)

The subcommittee requested that we inquire into the requisitioning procedures of military users of supplies managed by the Defense Supply Agency and the General Services Administration. Our survey in this area has disclosed a large number of unnecessary or incorrect high-priority requisitions as well as repetitive requisitions for small quantities of material. Our report on the use of high-priority requisitions was submitted to your subcommittee and the Secretary of Defense on March 18. (See appendix 6, p. 289.) Our review of frequent requisitioning of small quantities is in progress.

In our report on high-priority requisitions, we state that the deficiencies in supply management and the lack of effective controls, in our opinion, have led to the degradation of the high-priority system and the incurrence of significantly increased costs.

We reviewed selected high-priority requisitions issued by five military installations and filled during a 2-week period ending September 3, 1964, by the Defense Supply Agency Depot at Tracy, Calif. We found that approximately 70 to 80 percent of the requisitions in our sample had been designated high priorities unnecessarily or incorrectly.

In many instances the urgency of need could have been avoided by utilizing materials already in stock, timely requisitioning of known requirements, and maintaining stocks and levels sufficient to meet programmed or recurring requirements.

For example, an Air Force base issued a high-priority requisition for 100 units of a splice to replenish bench stock in the base aircraft maintenance unit. The Defense Supply Agency filled the requisition by expediting shipment of 100 units of a substitute splice. However, at the requisition date, the base had over 350,000 units of the substitute splice on hand.

We have an example of that, Mr. Chairman, if the committee would be interested. I have it here with us today.

Representative CURTIS. Is that a visual example?

Mr. STAATS. Yes.

Representative CURTIS. Yes, let's see it.

Mr. STAATS. Mr. Rubin, could you show that to the members of the committee.

Mr. RUBIN. Mr. Chairman, this is the splice that was requisitioned; this was the splice substituted.

Senator DOUGLAS. Identical?

Mr. RUBIN. No, they are not identical, but this is an acceptable substitute.

Representative CURTIS. Was the stock number the same or what brought about the confusion? Or why did they not know they had it?

Mr. RUBIN. Well, the stock catalog indicated this was an acceptable substitute. Nevertheless, they requisitioned the other one.

Representative CURTIS. In other words, this was not an error in the cataloging?

Mr. RUBIN. No, it was in the catalog as an acceptable substitute.

Representative CURTIS. Could we spell that out for the record: the two stock numbers?

Mr. RUBIN. Yes, the one that was requisitioned, the stock number on that is FSN-5940-232-5209. The substitute item is FSN-5940-840-0139.

Mr. STAATS. In other instances, requisitioners failed to conform to the Department of Defense criteria on the relative urgency of need and assigned high priorities to fill relatively unimportant and routine requirements, such as stock replenishment, predetermined allowances, and administrative purposes.

The use of high priorities was subject to certain controls, which included local administrative and military audit agency reviews and challenges by the supply and transportation agencies. In fact, substantial savings resulted from the challenging by transportation personnel of the requisitioners' need for high-speed transportation of large volume shipments. In our opinion, however, the existing controls were not fully effective because they did not identify the basic causes of requisitions being unnecessarily or incorrectly designated high priorities.

A Defense Department study group has recently completed a study of the priority system and has recommended changes to strengthen the system. However, we believe that correction of these problems requires the establishment of a management control system which would measure the extent and financial effect of the use of high priorities by requisitioning activities in order to preclude unnecessary, as well as incorrect, use of high-priority requisitions.

Our examination into the ordering of small quantities of material has not been completed. On the basis of our work to date, however, we are of the opinion that the Government's cost to distribute common supplies from the central inventory points, such as the Defense Supply Agency and the General Services Administration, is being significantly increased as a result of the repeated ordering by military activities and their direct supply support points of small quantities of low-cost material rather than the less frequent requisitioning of larger quantities on a more economic basis.

In pursuing the reasons for this condition at selected installations of the Air Force Logistics Command and the Army Supply and Main-

tenance Command, we found that the installations were not stocking adequate quantities of low-cost material needed for their recurring requirements. As a result, these stocks were frequently depleted and replenished in small quantities.

Representative CURTIS. Is it true they assume they have insufficient warehouse or storage space?

Mr. STAATS. Could I ask Mr. Newman or Mr. Rubin?

Mr. RUBIN. The items we are talking about are relatively small and would take relatively little space. I do not think space is a factor.

Representative CURTIS. That is what I wanted to discover.

Mr. STAATS. This occurred at the Air Force installations visited, because in the interest of conserving operating funds, the command limited stock levels to 60 days, thereby precluding the requisitioning of quantities on an economic basis.

For example, at an Air Force base the anticipated demand for the current year for spools of wire was 12 spools, representing a total value of \$24. However, the base supply office established the stock level at two spools pursuant to the command's instructions, which directed deviation from the established Air Force requirement for maintaining a 390-day stock level when annual demand was \$25 or less. Had the 390-day stock level been retained, 1 routine requisition for 13 spools could have been issued, thus avoiding the issuance of 4 high-priority requisitions as well as 4 routine requisitions.

Mr. Rubin has an additional example here, I believe, if the committee would be interested.

Mr. RUBIN. This example is a plastic sleeve, which was requisitioned. We have a requisition for \$1.04. Thirteen feet of this was requisitioned. We have a record of six requisitions during the period of about 9 months for a total of \$22.32 worth of materiel. We estimate it cost over \$36 to process the requisitions; a cost of over \$6 apiece.

If they had used their normal criteria for base stock control, they would have only required two requisitions instead of the six.

Representative CURTIS. For the sake of the record, it looks like a tubular plastic object about an inch wide and about a quarter of an inch thick.

Mr. RUBIN. The price is 8 cents a foot.

Representative CURTIS. 8 cents a foot.

Mr. RUBIN. It is a protective cover for flexible electrical insulation.

Representative CURTIS. For the record, give us the stock number.

Mr. RUBIN. The stock number is FSN 5970-284-8619.

Mr. STAATS. Army instructions generally provide for a 420-day stock level when annual demand is \$100 or less. Nevertheless, at the Army installations visited, we found that repetitive, small quantity requisitions were being issued because of the maintenance of 45-day stock levels. During our review the command revised its instructions to correct this condition by authorizing the economic ordering of material when annual demand was \$300 or less.

The Department of Defense has developed a quick reaction system based on minimal stock at using activities. Our preliminary examination at other commands of the Air Force, Army, and Navy indicated that stock replenishment practices vary from periodic ordering of economic quantities to repetitive ordering of small quantities.

The varying practices of the military activities preclude an estimate at this time of the total increased cost to the Government. The magnitude of the condition is indicated, however, by the fact that in fiscal year 1965, military activities issued to four Defense Supply Centers about 11.1 million requisitions, and 6.6 million of these, or about 60 percent, involved material costing \$10 or less per requisition, averaging about \$3 each.

On the basis of cost information at the military and Defense Supply Agency installations, we computed that the average cost to issue and handle a requisition was more than \$6.

Turning to the question of controls over Government-owned property in possession of contractors:

In accordance with recommendations contained in your subcommittee's 1965 report and discussions with a member of your subcommittee, we have performed a limited survey of the adequacy of controls over Government-owned property in the possession of Defense contractors. Our report was released to you and the Secretary of Defense on March 17. (See appendix 4, p. 240. See also, p. 88.)

Our survey indicates that there is a need for the Department of Defense to improve the quality of the work being performed by Government property administrators. Under the prevailing practices at the four contractor plants we visited, the required surveillance of contractor controls over Government-owned property is only partially performed or is poorly documented.

For example, we found that there was insufficient review as to whether there was an actual need for the contractor to retain Government-owned equipment. At one plant where the property administrator had not made an assessment of the use of production equipment, we noted that the capacity of turret lathes and grinders on hand far exceeded the machine capacity needed for projected business, as computed by the contractor. In addition, the number of machines was greater than the number of available operators.

We found that the Department of Defense had drafted new regulations relating to the activities of the property administrator. These proposed regulations, now under review within the Department of Defense, appear to require greater effort on the part of the property administrator in surveillance over Government-owned property than is generally being devoted to this area at the present time.

Before the Department's new regulations can be fully effective, we believe that further study needs to be given to the problem of how much responsibility contractors should have for reasonable care of Government property in their possession. The effect of the Department's current policy for noncompetitive contracts is that contractors are generally not held liable for the loss, damage, destruction, or disappearance of Government property while it is in their possession unless it can be proven that the loss resulted from willful misconduct or lack of good faith on the part of the contractor's managerial personnel.

This policy was adopted many years ago when it was believed that further liability on the part of the contractor would lead to increases in contract prices not commensurate with the benefits received. Since there have been significant changes in Department of Defense procurement practices in recent years, we believe that reevaluation of the policy is warranted.



We are therefore suggesting that the subcommittee consider recommending to the Department of Defense that it undertake a thorough study to determine, under current and foreseeable conditions, the most effective and economical method of obtaining adequate control over Government-owned property in the possession of Defense contractors.

#### CHECK OF RECORDS AND INVENTORIES

Senator DOUGLAS. Mr. Staats, may I ask this: Were you able to reconcile the inventories, or did you find actual loss of machine tools and equipment?

Mr. STAATS. With respect to machine tools as such?

Senator DOUGLAS. Or any type of equipment? Did you find that some of the equipment owned by the Government used by the private contractors had disappeared?

Mr. STAATS. Again, Mr. Chairman, I would like Mr. Rubin, who made this study, to comment.

Mr. RUBIN. Mr. Chairman, we were unable to obtain total information on the amount of losses. There is no central record maintained. However, we do have some examples in the report submitted to the subcommittee.

On page 15 of the report, for example, we give two situations that we did note in our review at four plants. In one case there was a fire in a building in which \$8 million worth of Government-owned property was destroyed. The property involved includes some equipment and also material. (See appendix 4, p. 246.)

In another example which we also have on the same page, we have some Government property missing, plant equipment which was missing, and again, for which the contractor was not held responsible for. This property included such items as fire extinguishers, workbenches, vises, storage cabinets, racks, and tables.

Senator DOUGLAS. Did you find any cases of where certain tools were being used by the private manufacturer, yet no payment being made for them?

#### INADEQUATE USE RECORDS

Mr. RUBIN. We have found such examples. We might say that the basic problem was the fact that the records were not clear as to the extent of use. In other words, there was inadequate record-keeping as to the utilization of equipment, whether it was being used on Government work or commercial work or not being used at all. The records were very unclear in this respect.

Senator DOUGLAS. Did you find evidence that Government-owned equipment might be used on private business without being paid for?

Mr. RUBIN. We have found some evidence of this. We have some previous reports several years ago which went into this to some extent. As I say, our main finding was the lack of records as to what controls did exist.

Senator DOUGLAS. Mrs. Griffiths, who initiated this query, has just come in.

Mr. Rubin is testifying on the care of property owned by the Government by private contractors. I was questioning him as to

whether there is evidence of property having been lost or evidence of property used but not being paid for. Perhaps you would like to continue.

Representative GRIFFITHS. Go right ahead.

Representative CURTIS. I would like to ask this: This is the military; is there any indication that we have a similar situation with the space agency and AEC? I am thinking of those where there might be this kind of property, possibly the National Institutes of Health. These are other governmental agencies that might have contracts out where Government property is used.

I was wondering if their standards were better or much different from the Defense Department as far as this problem is concerned?

Mr. STAATS. Mr. Curtis, I do not believe we have gone into this particular aspect of it in depth; this would be a good area to explore, I would think.

Representative CURTIS. We would like to see what is done elsewhere in the Government to determine if another agency will show a better record which might indicate to us how this can be improved.

Mr. STAATS. Mr. Weitzel tells me we have made some studies in this, but not in depth.

Mr. WEITZEL. Mr. Chairman, we have done some work with the Intergovernmental Operations Subcommittee of the House Government Operations Committee for better inventory controls of Government property that was in use under research or grant contracts.

Representative CURTIS. I know a study that you did for me concerning the use of surplus property that was given to educational institutions. This is a little different matter, but your study revealed there was such lack of control that some of this equipment had gone into private hands and was not used for educational purposes at all.

Mr. WEITZEL. This is correct, Mr. Curtis, and we do feel that through your interest and through the issuance of this report, the Health, Education, and Welfare officials as well as the State officials in that particular State and in other States were alerted to the necessity of tightening up their controls, including audits, requiring better reports and seeing that the property was used for the purpose for which it was donated.

Mr. STAATS. You also have, Mr. Curtis, the situation where you have a mixed plant, a plant which has contracts with several different Government agencies, representing a different kind of problem, and there it is largely a question of designating the agency that is to have the responsibility for control.

Representative CURTIS. This gets into the same problem that involved McDonnell Aircraft and others on whether they should buy a computer themselves, which is mainly used for Government work, or whether the Government should buy and then, under an accounting system, charge them for it.

This is all part of this same problem.

Mr. STAATS. It is the same issue exactly.

If there are no further questions on this point, the next part of my statement relates—

## TENURE OF PROPERTY OFFICERS

Representative GRIFFITHS. Let me ask some.

I think that one of the interesting things to know is how long a property officer remains in a certain plant. That is part of this problem of the loss of equipment which, I am sure, is in part due to the fact that a contract may be taken from a plant, but not the equipment. By the time a new contract is put into that plant, the property officer is different for the Government.

Mr. STAATS. It is a matter of turnover of personnel.

## RECORDS OF PROPERTY OFFICERS

Representative GRIFFITHS. A turnover of personnel. He walks in and for the first time I discovered yesterday and from your reports, without any record of his own of what property there is there. So that he has to ask the plant itself: "What kind of Government-owned property do you now have?"

## RESPONSIBILITY FOR PROPERTY

Now, they are not going to have to pay in case some of the property is missing, so that I think you have really a very difficult problem. There is nobody who really cares, nothing has ever happened to anybody in case property has been missing, has there?

Mr. STAATS. The review which is underway in the Defense Department at the present time, I am told, will try to fix this responsibility more clearly than it has in the past, and I think the situation does prevail that you indicate; if you have the contractor responsible, then you have to more or less take his word for it.

Representative GRIFFITHS. That is right, and I do not share Secretary Ignatius' theory at all that in plants where there is Government-owned property that it is being used; if it is being used for private contracts, that the Government is collecting a fee. I do not believe that.

Mr. STAATS. Mrs. Griffiths—

Representative GRIFFITHS. There may be some instances, but they certainly are not competent to say that it is true in every instance, because they do not have that good a record.

## FURTHER STUDY REQUIRED

Mr. STAATS. We think this is an area for further study. Mr. Newman has given a lot of thought to this problem.

Mr. NEWMAN. What you say is the truth. This area has been neglected by the Department of Defense. We have issued a few reports showing instances where adequate rent has not been collected from contractors.

Representative GRIFFITHS. Of course it has been neglected.

Mr. NEWMAN. And as for the records that are being kept, I know during World War II they had quite elaborate records that had to be kept for the Government itself. However, with improvements in the contractor's internal controls basic accounting systems, and today we

more or less use the contractors' records in the same manner as his cost records are used for reimbursing him under the supply contract.

As for our control in the Government we have an agreement and a list of the supplied pieces of equipment with serial numbers. This is the basic document that we have with the contractor, so this equipment should not get lost. As a matter of fact, we need to emphasize, as the Department of Defense is now planning to do, who is responsible for the accountability of this equipment.

Representative GRIFFITHS. Of course, not every tool, jig, die, or fixture has a serial number.

Mr. NEWMAN. I am particularly talking about lathes—

Representative GRIFFITHS. You are talking about large equipment, a \$100,000 piece of equipment or \$20,000, but not parts.

Mr. NEWMAN. Not necessarily that high. In the production line you may have a particular lathe needed that the contractor could not buy, so the Government will furnish it. In a battery of lathes where we have a production line, that lathe may be right in the center of the processing line mixed with his own lathes. We do not have detail property records in the Government of all the equipment the contractor has. The point about continuity of property administrators, is a problem. They are having problems retaining property administrators, because the salaries, I understand are not commensurate with the responsibilities.

#### SHOULD CHECK FOR UNNEEDED PROCUREMENTS

Representative GRIFFITHS. I think one of the other things that really should be checked closely is, are you ordering equipment, buying new equipment when in reality you have many duplications of that equipment in contractors' plants?

Mr. NEWMAN. This is a big area. This is something we should get into.

Representative GRIFFITHS. Because it would be a great saving today if you could stop this from happening.

I think another thing that has happened, as I pointed out yesterday, is that some of this is being removed from the contractors' plants when it should not be removed. It is being moved into storage when it in reality is needed; all you are doing is taking the contracts away from subcontractors.

#### HOARDING EQUIPMENT BY CONTRACTORS

Mr. WEITZEL. Mrs. Griffiths, our report pointed out and showed concern on the part of the Defense Department that in some plants contractors were making minimum use of this equipment, so it would not be declared surplus to their needs. They could keep it for possible later use and did not declare it.

#### DOD DIRECTIVES DISREGARDED

One of the biggest problems we found was the Department of Defense's own existent directives were not being observed at the four plants we visited, as we mentioned on page 11 of our report. (See p.

244.) They had not been observed with regard to the requirement of periodic assessment of actual use of production equipment.

Representative GRIFFITHS. Nobody ever checked up?

Mr. WELTZEL. Exactly. We were glad to note Mr. Malloy, the Assistant Deputy Secretary of Defense, yesterday told the committee that this report had been helpful and these regulations had been adopted years ago, as we said, and they are reconsidering them in the light of present conditions.

#### ROLE OF DCAS IN PROPERTY MANAGEMENT

Representative CURTIS. Mr. Chairman, could I mention here, too, one development in the Defense Department of the Contract Administrative Service? I have been tremendously impressed with the development of this and the elimination of duplication. In the same plant there would be a Navy-contract administrator, one for the Army, and so on. Each had different jobs, and did not even know what the others were doing.

As I understand this picture, the Defense Department has now created a new service, Contract Administration. I am curious and I wish I had asked this question yesterday, as to whether the DCAS looks out after this kind of Government property.

Does anyone know? Is that supposed to be under it?

Mr. NEWMAN. Yes, sir.

Representative CURTIS. It is.

I do not know whether you people can report on the development of a service like this, but to the extent that you could report on it this possibly is one area where this reform will come about.

Mr. NEWMAN. As a matter of fact, Mr. Curtis, we are planning to get in and evaluate what has been done.

For example, the first project that was set up in the Defense Contract Administration Services was in Philadelphia. I visited the office about a year ago.

Also, the internal auditors have issued three reports on the DCAS property administration. We are working closely with them to find out their evaluation. But I was amazed to find out just how deeply the service is going into the contract administration. They are covering areas that have not been touched in years.

Representative CURTIS. I think this is a great innovation.

Mr. NEWMAN. You must realize that in the past at a contractor's plant like Douglas, the plant representative was responsible for practically the whole administration of the contract activities at that particular plant.

Representative CURTIS. And there has never been any real training—

Mr. NEWMAN. Correct, specialists.

Representative CURTIS. And this now should develop an esprit de corps. There should be real, not just on-the-job training, but training that takes them out into the field for special training. And I think all of this is being contemplated.

Mr. NEWMAN. Along the line that Mrs. Griffiths spoke about, the internal auditors—the Defense Contract Audit Agency up in Secre-

tary McNamara's office can get into contractors' plants to check on the property. It should be part of their job to see that this equipment is there.

Representative CURTIS. We had an informal briefing on the development of the Contract Administration Services about 3 or 4 weeks ago. I would appreciate very much if you have not looked over it, if you would do so. (See appendix 8, p. 305.)

Mr. NEWMAN. I have not seen it.

Representative CURTIS. Any comments you care to make on it would be helpful.

Mr. STAATS. We would be glad to do that and supply comments to the committee, either as part of the record or separately.

Mr. RUBIN. Mr. Curtis, if I might add, our study did not cover the property they are administering. However, internal auditors of the Defense Supply Agency did cover them. We have furnished to the committee copies of three internal audit reports they have prepared on this very subject in view of the committee's interest. (See pp. 249-272.)

Representative CURTIS. Very good.

Mr. STAATS. Turning next to the use of proceeds from disposal of surplus property:

At the request of Congressman Curtis of this subcommittee, we have examined into the expenses incurred by the Department of Defense in the disposal of surplus property and the use of proceeds from such sales. A report on our findings was submitted to Congressman Curtis, the Secretary of Defense, and the subcommittee on March 18. (See appendix 5, p. 273.)

Our selective review of 1965 disposal transactions showed a number of instances where sales proceeds of approximately \$1 million were retained by military installations or were used to reimburse operating expenses contrary to Defense criteria.

For example, proceeds from scrap sales were utilized by an industrial fund activity principally to defray major maintenance costs at the installation, even though the scrap material was obtained from vessels undergoing overhaul or modification. According to Defense criteria, such proceeds should be deposited in the Defense surplus proceeds account rather than be retained by the industrial fund activity.

Also, contrary to Department of Defense-established criteria, costs were reimbursed from sales proceeds for (1) performing reclamation work in connection with the disposal process; (2) handling unneeded material before it entered disposal channels; and (3) processing industrial fund scrap material, the proceeds of which were retained by the industrial fund activity.

We found during the course of our survey that there is need for improvement in the identification of disposal costs and the reporting thereon and for more intensive reviews of disposal activities by internal auditors of the Department of Defense.

We believe that this condition developed primarily because the Defense Supply Agency, the organization responsible for managing the Defense-wide disposal program, did not provide adequate guidance, require the implementation of uniform accounting methods, or

exercise positive control over the disposal operations of the military services.

As a result of the lack of effective direction and control of the disposal program and the accounting therefore, we believe that management officials have not been provided with adequate information to properly appraise the various disposal functions so as to identify adverse conditions warranting corrective action. The availability of reliable management data is particularly important in the case of this program where there is no limitation on the amount of disposal sales proceeds that can be used to finance operations.

Defense Supply Agency officials advised us recently that they had proposed, for the consideration of the Department of Defense and the military services, a uniform cost accounting structure for disposal operations. This proposal had not progressed sufficiently to permit our review and appraisal prior to the completion of our work.

We believe that more effective accounting and reporting of transactions involving the use of surplus sales proceeds and more intensive internal reviews are necessary to provide that only those expenses which are related to disposal operations, and are not provided for in other appropriations, are reimbursed from surplus sales proceeds.

Senator DOUGLAS. Mr. Staats, I wonder if you could give, for the record, the total amount that the Defense Department realized from the sale of surplus. In the background material on page 40,<sup>23</sup> I find that in 1965 acquisition cost of surplus personal property amounted to \$3,958 million, or virtually \$4 billion; that the amount realized was \$108 million, or that the percentage of gross proceeds relative to total acquisition cost was less than 3 percent.

Does that not seem to you a rather low figure? This is a gross acquisition cost.

Now, if you will read the next table, the return of \$108 million realized cost them \$78 million to sell, so that the net proceeds were \$20 million out of \$4 billion, or one-half of 1 percent, and sales costs were 72 percent of gross sales proceeds.

Mr. NEWMAN. You will notice, Mr. Chairman, how that keeps going up, too. From 1958 it was 23 percent and it was up to 72 in 1964. This is an area that needs attention.

Mr. STAATS. Mr. Chairman, I agree that the percentage is very low, but one of the factors here, as you realize, is that included in this category are military weapons items.

This would include ships and military weapons, so that the realization on those items would necessarily be very low.

Senator DOUGLAS. Did you inspect any of the auction places where Government surplus was put up, such as clothing, shoes, equipment of one type or another?

Mr. STAATS. You are referring to auctions, Mr. Chairman, did I understand correctly?

Mr. RUBIN?

Mr. RUBIN. Our study was directed basically to how they disposed of the proceeds rather than going into the efficiency of the sales them-

<sup>23</sup> Staff materials, 1966, p. 40.

selves. Consequently, we may have observed an auction very briefly, but this was not the objective of our review—what disposition was made of the proceeds received.

I might also mention in connection with your previous question as to the reason for the rather large ratio of expenses to proceeds, rather the low net return, we discussed that to some extent in our report.

On page 5 (see appendix 5, p. 276) we have a schedule which outlines the proceeds and expenses incurred or charged against the proceeds from 1958 to 1965, and we also bring out the fact that there was a rather substantial increase in the ratio of expenses to proceeds beginning in 1958. We also point out on page 6 that in 1960 the House Appropriations Committee, in its reports on the appropriations bills, pointed out that it wanted to encourage the disposition of excesses and consequently it encouraged that they charge expenses to the proceeds from sales.

'And this may account for some of the increase.

Representative CURTIS. I would observe that it does. In fact, there is a colloquialism used among the military called the "punkin fund." This is called the "punkin fund" because this money is loose, and this is the real reason, I would argue, why the efforts of this committee to have surplus property disposal handled by GSA has been resisted bitterly by the Defense Department.

Of course, if they have a "punkin fund" here, they do not want to let go of these free funds that not only show up in the increased cost of disposing, but also in the surplus over that which does not go to the individual installation, but does remain under the power of the Defense Department to spend.

Am I correct in that latter assumption? I want to be sure.

Mr. RUBIN. Well, there are several categories. In some cases it would go to the defense fund; in other cases it might remain at the installation level.

Representative CURTIS. Even that over and above what they try to account for in disposal costs?

Mr. RUBIN. I am thinking in terms of expenses they charge against the proceeds at an installation.

Representative CURTIS. I was trying to separate the two. I know that is the one where they get the "punkin fund" up by trying to charge to the disposal cost. But then after they have done all that, there is still a net. I did not think they had control over spending the net.

Does not that net go to general funds—

Mr. RUBIN. The net goes to the defense supply fund.

Representative CURTIS. But it does not come back to the General Treasury?

Mr. RUBIN. Yes; the residue in that fund would. We explain that also in the report in our background section.

Representative CURTIS. Well, this, of course, is one of the big areas. Madam Chairman, I think, for the sake of the record, we should have page 40 of this staff report of March 1966 reprinted in the record at this point.

Mrs. GRIFFITHS (presiding). Without objection, it will be printed.



(Page 40 of report follows:)

TABLE 16.—*Proceeds from disposal sales of surplus personal property by the military departments, fiscal years 1958-65*

[In millions]

Proceeds from disposal	Fiscal year—							
	1958	1959	1960	1961	1962	1963	1964	1965
From sale (other than scrap and salvage).....	\$128	\$140	\$124	\$106	\$87	\$59	\$61	\$55
From sale of other property.....	55	72	70	61	48	40	42	53
Total.....	183	212	194	167	135	99	103	108
Acquisition cost (total).....	5,460	7,366	5,983	6,123	3,482	3,446	4,815	3,958
Percent of total gross proceeds to total acquisition cost.....	3.38	2.88	3.24	2.71	3.87	2.87	2.14	2.72
Percent of proceeds to acquisition cost (other than scrap and salvage).....	5.18	5.2	5.25	5.98	7.02	6.66	6.22	5.64

TABLE 17.—*Costs of disposal sales of surplus property by the military departments, fiscal years 1958-65*

[In millions]

Costs of disposal sales of surplus property	Fiscal year—							
	1958	1959	1960	1961	1962	1963	1964	1965
Cost for demilitarization.....	\$24.0	\$20.5	\$26.6	\$19.1	\$9.1	\$9.5	\$12.7	\$13.2
Costs for preparation and selling.....	18.5	37.8	51.8	65.5	69.0	62.6	64.6	65.1
Total.....	42.5	58.3	78.4	84.6	78.1	72.1	77.3	78.3
Gross proceeds.....	183.0	212.0	194.0	167.0	135.0	90.0	103.0	108.0
Percent of sales costs to gross proceeds.....	23.0	27.5	40.4	50.6	58.0	75.2	75.0	72.5

Representative CURTIS. Acquisition costs of disposal property in 1958 were \$5.4 billion, \$7.3 in 1959, then in successive years it was \$5.9, \$6.1, \$6.1, \$3.4, \$3.4, \$4.8, \$3.9. This reveals the size of disposal operations and then the increased costs of disposing and, of course, the net figures that Senator Douglas has pointed out show the total picture.

I think I would have a tendency to defend the low figure somewhat along the lines, Mr. Staats, that you have mentioned. A lot of this is only usable for scrap, so you are not going to get a very big return on your acquisition dollars.

On the other hand, as I have observed for years, the garbage pail techniques of checking your original procurement become very important. In other words, you look at what has come out in waste as a method of checking back on your original procurement system to see whether there was overprocurement, et cetera. So this is a very, very important area.

Mr. NEWMAN. If I may, Mr. Curtis, during a recent trip last year to Europe Mr. Gutman and I visited a number of these disposal activities, because we were vitally concerned about getting into this area.

Now at one installation in particular that I visited there was a big gasoline truck, just like you see on the streets of Washington, and that gasoline truck could not be sold "as is" on the economy in that nation; it had to be reduced to scrap. With many military items there is the problem of demilitarizing as well as cutting them down to size for scrap.

Now, what we recover is "scrap value" which is much less than what we could recover, if we could sell the equipment "as is" to the people in the country.

Representative CURTIS. You have a demilitarizing problem; you also have the problem that you occasionally run into in the Department of Commerce. I remember an instance where they had a lot of cook stoves. Then the stove industry came in and raised Cain about their selling all this surplus on the market, pointing out what it would do to their normal trade channels. This is a legitimate concern. But it also indicates that possibly the stove people were probably pretty happy about this overbuying when it was occurring.

This is a very difficult area, as you point out. I think it is a very important area to give us some insight into the whole range of procurement practices. I now am expressing a personal view here. I feel very deeply that we ought to get this disposal of surplus out of the military establishment. They have to be in it to do the demilitarization; that can be done by an accounting process where they can be reimbursed for their costs. They do not have to actually handle the sale of the scrap or of the unit if it is going to be sold as a unit. The GSA could be set up to handle this whole area of disposal. This is frankly what I would like to see unless your studies or others came up to show that my preconceived notions are in error.

Mr. STAATS. Mr. Curtis, perhaps the Budget Bureau will comment more on this point this afternoon, but there needs to be a more definitive study than has been made to date as to the relative cost of the shift of this disposal operation, in my opinion, than we have had to date.

There has been a good deal of discussion about it. I think it is a perfectly valid question, but there needs to be more definitive study than we have had to date as to whether or not this would be feasible and more particularly, in my mind, the question of whether there would be real economies.

Representative CURTIS. Yes, but you can see how impatient I become after 16 years of going after this and having the Defense Department still not come up with a study. Then I run into a situation like the development of the "punkin fund," which makes it very clear to me that it is not studies the Defense Department is concerned about, but it is frankly hanging on to control of considerable sums of money.

I am not begrudging them the money if we have knowledge of how they are spending it, but we do not have. And I am impatient about this.

Mr. STAATS. I personally would welcome a study which I do not think is impossible to carry out.

I think also on this point it would be more meaningful if we could break down this figure so that we could exclude or at least classify these items so that we could get a better idea as to what the return is.

I think this might then indicate to us the areas where we need to give our attention. These figures are very difficult to understand.

Representative CURTIS. I could not agree more with the need for knowing what we are doing, but when the people who have the knowledge that we need do not come forth over a period of years forthrightly to give us the information, I begin to think that they have no very good arguments for retaining that activity under their control. Obviously, if they had good arguments, they would have been coming forward with them. I want to get the military uniform off of it, frankly, because I also feel this is a further way of hiding away from some of these economies.

Yes, I, indeed, am impatient. Here it is 1966, and we still do not have the studies. Many of the recommendations—and praise be to Secretary McNamara—of this committee and the old Bonner subcommittee, have been implemented after great struggles. I think the figures show—in fact, Secretary McNamara says—savings of \$4 to \$5 billion a year from carrying out some of these suggestions that have been made by this committee, the second Hoover Commission, the first Hoover Commission and others. But here we are in an area where resistance is all over the place.

The checks of you people reveal and the details show that there is not a good system. It comes very close in some of these instances to a question of legality of expenditures. I hate to even get into this area, because I go on the assumption that by and large we are dealing with honest people, and fine people. But we have to get a system set up where those who have the better instincts have an opportunity to exhibit them, rather than the other way around.

Mr. WEITZEL. Mr. Curtis, your mention of legality reminds me of a case similar to the stove case you mentioned that we ran into in the General Accounting Office, where a surplus property dealer bought some used anchors from the Navy Department and then protested to us the requirement in his contract that he had to scrap the anchors. We followed this up with the Navy Department and found this provision had been put in at the request or with the concurrence of the Commerce Department to help the new anchor industry and prevent competition of these good used anchors with new anchors.

We ended up with a decision which held that this requirement was illegal, because Congress had not provided in the surplus property disposal laws for this kind of exemption from competition, resulting in surplus property sales at less than fair market value, and our decision held that this was an illegal requirement.

Representative CURTIS. That is the point on this so-called demilitarization and it illustrates it. You can hide behind the military cloak, saying that this is something that must be demilitarized, like a tank. Of course, you have to demilitarize that, or a machinegun, something like that. That kind of thing cannot be sold in the market and should not be. But when you talk about the military aspect of an anchor, it is clearly a phony argument to say that has to be demilitarized.

Mr. WEITZEL. As a result of our decision, the Navy did revise its regulations on disposal of surplus anchors and I believe has substantially increased the proceeds from them.

Representative CURTIS. Thank you very much.

Chairman DOUGLAS. Mrs. Griffiths?

## FEASIBILITY OF COMBINING DSA AND GSA EQUIPMENT RESERVES

Representative GRIFFITHS. The DOD has a large equipment reserve, about \$3.4 billion, I understand. Is that right?

Mr. STAATS. I believe that is right.

Representative GRIFFITHS. So has the GSA a large reserve. Why can they not be combined—the GSA's large equipment reserve and the DOD's, why can they not be combined?

Mr. STAATS. The GSA reserve, if I understand it correctly, is the industrial mobilization reserve. Is that not correct? It is held, of course, in standby and serves a somewhat different purpose. Some of this has been used since the buildup in Vietnam; a great deal of it was used at the time of the Korean war.

## GAO WILL CHECK

As to whether or not they could be combined, what the problems would be, I frankly have not given the subject any study. Perhaps others here have, but I have not personally given it any study. I will be glad to look into it.

Representative GRIFFITHS. Thank you.

Mr. STAATS. To summarize this section of our report, we believe that (1) the Secretary of Defense should strengthen the central management role of the Defense Supply Agency to provide more positive and effective direction and control over disposal operations of the military services, (2) a uniform cost accounting system should be implemented that would provide more definitive cost identification, (3) an improved reporting system should be established to provide management with necessary data for appraising program operations, and (4) periodic internal audits should be performed to validate reimbursed disposal expenses.

The next section of our statement related to automatic data processing.

Because of its extent and significance, the high costs involved, and the impact on Government activities, we have from time to time reported to the Congress on Government-wide developments in automatic data processing. (See also p. 122, et seq.)

Our most recent report of this nature was submitted to the Congress on August 31, 1965. This report, entitled "Management of Automatic Data Processing Facilities in the Federal Government," contained our views on the report on management of automatic data processing in the Federal Government prepared by the Bureau of the Budget and transmitted to the Congress on March 2, 1965.

Because of the importance of the Bureau's report, our office reviewed it in light of the findings and recommendations which have resulted from our work in this field in recent years.

In our report we stated that:

We consider the Bureau's report to be a useful document for highlighting many of the automatic data processing management problems requiring attention in the interests of achieving greater efficiency, economy, and effectiveness in the application of public funds.

The report emphasized the need for the Government to make decisions on the procurement and utilization of automatic data processing

equipment on the basis of Government-wide factors rather than on the basis of individual installation needs. It also stressed the need for the Government to adopt a program under which equipment for use by Government contractors would be purchased and furnished on a selective basis in lieu of the present arrangement whereby contractors make individual decisions regarding the purchase or lease of this equipment.

In our statement before this subcommittee last year, we pointed out that significant economies were being achieved by the Government because of the increased emphasis being placed on purchasing rather than leasing of automatic data processing equipment in Government agencies.<sup>24</sup>

The Bureau of the Budget has estimated that about 50 percent of the currently installed equipment is owned by the Government, compared with about 15 percent owned in 1962. The Bureau has also estimated that the net savings resulting from equipment purchases made during the past 3 years will amount to about \$200 million within the first 5 years of use. Our studies indicate that savings of this magnitude should be achieved and that annual recurring savings will amount to over \$100 million for each year of use of this equipment beyond the 5-year period.

As we pointed out during the hearings before this subcommittee last year, we believe also that substantial savings can be achieved through purchasing rather than leasing of automatic data processing equipment by Government contractors. The Bureau of the Budget has informed us that it considers that the criteria set forth in its Circular No. A-54 of October 14, 1961, prescribing conditions under which determinations are to be made by Government agencies as to whether to buy or rent automatic data processing equipment also should be applied to cost-reimbursement-type contracts.

In addition, the Bureau of the Budget recommends that an amendment to the Armed Services Procurement Regulation, proposed by the Department of Defense in July 1964, be made effective at the earliest practicable date and that it also be adopted by the National Aeronautics and Space Administration. The proposed amendment would allow a cost-reimbursement contractor to buy or rent computer equipment, but would limit the cost to be passed on to the Government to the equivalent of ownership costs if, under specified criteria, purchasing is determined to be the most appropriate method of procurement. Inasmuch as the Department of Defense has not adopted this amendment to date, we have recently requested information as to the status of this matter.

And I have been advised, Madam Chairman, that the Department of Defense will issue this regulation August 1.

Representative CURTIS. Of 1966?

Mr. STAATS. 1966; yes.

Last year the Congress enacted Public Law 89-306 (H.R. 4845, approved October 30, 1965), which made provision for the economic and efficient purchase, lease, maintenance, operation, and utilization of automatic data processing equipment by Federal departments and agencies. (For text, see p. 125.)

<sup>24</sup> Hearings, 1965, p. 112, et seq.

On November 29, 1965, we advised the heads of the executive departments and agencies that we were undertaking a Government-wide study of present and planned uses of automatic data processing systems in the Federal Government with particular emphasis on compatibility and standardization of such systems and equipment, including related communication facilities.

This study will include further inquiry into the trend of development, use, and cost of automatic data processing systems in relation to the flow of data and information within Government systems and between Government and private industry systems.

#### §3 BILLION ANNUAL COMPUTER BILL

Representative CURTIS. Mr. Comptroller General, in order to get this in context, I understand that the Federal Government bill on data processing equipment now is approaching about \$2 billion a year; is that about it?

Mr. STAATS. It is about \$2 billion a year if you exclude cost reimbursement for use of ADP by contractors. That figure is not a very well-established figure, but it approximates a billion dollars, so if you want to include total cost to the Government for all ADP costs, then the figure of about \$3 billion would be correct.

Representative CURTIS. I wanted that in context to demonstrate for the record the size of what we are talking about.

Mr. STAATS. It is a very major item, yes. And I must say we plan to give more emphasis in the GAO to this area than we have been in the past with our staff.

Representative CURTIS. Yes.

Mr. STAATS. Last year, when we discussed our report on supply management of paint and other short-shelf-life items, we stated that existing control procedures were inadequate and there was a need for closer supervision of the implementation of existing procedures. We suggested that procedures be established to provide a basis for effective inventory controls and warehouse procedures, adequate identification and use of interchangeable items, and effective rotation of stock-piled items in meeting current requirements on a Government-wide basis.

During the past year the joint General Services Administration/Department of Defense study group initiated action to strengthen its proposed procedures for controlling short-shelf-life items.

We understand that review and revision of a proposed Department of Defense instruction has not been completed and that the Department of Defense has not yet reached final agreement with the General Services Administration on cross-servicing procedures for maximizing government-wide utilization of short-shelf-life assets. However, the proposed procedural revisions appear to cover the problem areas which we reported to this subcommittee last year.

With respect to the implementation of the cross-servicing agreement in the civilian agencies, the General Services Administration is preparing procedures for its Federal Supply Service, and it intends to issue a Federal procurement management regulation for the guidance of other Federal agencies. However, our latest information is that a

draft of the regulation has not been prepared. We understand that July 1, 1966, is the expected date of issuance of a temporary regulation.

During the hearings last year, we suggested that programs be established and implemented to maximize the systematic rotation and transfer of limited-life medical stocks from the civil defense stockpile to the Department of Defense and the Veterans' Administration for immediate use.

In our report to the Congress on this subject issued in February 1966, we pointed out that in October 1965, as a result of a recommendation made by the subcommittee in its report issued in July 1965, officials of the Public Health Service, Department of Defense, Veterans' Administration, and General Services Administration established an interagency coordinating committee to review and resolve standardization problems and to develop a firm routine for maximum utilization of short-shelf-life and excess items in the civil defense medical stockpile.

The Public Health Service also has established interagency agreements with the Veterans' Administration and the Department of Defense governing the rotation of items in the civil defense medical stockpile. During calendar year 1965 and January 1966, items valued at a total of about \$3.8 million were transferred from the stockpile for use in current programs, primarily those of the Department of Defense. (See app. 11, p. 394.)

In July 1965 we issued a report to the Congress on the need for improvement in the management of vaccines stored in the civil defense medical stockpile. In order to prevent the total loss of one or more types of vaccines in the event of damage to or destruction of a storage depot, the Public Health Service initiated action to effect correction of a storage problem resulting from the inadequate deployment of the vaccines.

Also, with regard to a need for conversion of vaccines from the bulk state to finished products so as to enable distribution in a timely manner, the Public Health Service advised us that certain of the vaccines had been converted and that a target of 1970 for completion of the conversion program was dependent upon the availability of sufficient funds.

We understand that no funds were provided for this purpose in the 1967 budget request submitted to the Congress. We also understand that arrangements have been made recently with the Department of Defense to accept some of the vaccines in the stockpile to avoid deterioration. (See p. 394.)

#### COMMON SUPPLY AND SERVICE ACTIVITIES

Turning to the subject of consolidation of common military supply and service activities, this subcommittee has had a continued interest in the consolidation of common military supply and service activities and, as you know, substantial progress has been made by the Department of Defense in this area in recent years.

#### RECRUITING SERVICES

Among the areas your subcommittee has identified for possible consolidation were the individual recruiting organizations and facilities

of the four military services. Our review of this area has disclosed that the military services are carrying out their nationwide recruiting programs through separate networks of many hundreds of branch stations, and that as a result there is substantial duplication of expense for office space, utilities, personnel, office equipment, motor vehicles, recruiting forms and supervision and administration.

We believe that, in addition to the savings that could be realized, consolidation of the recruiting offices of the four military services would help achieve the purpose of the President's program to improve and facilitate communications and contacts with the public.

In commenting on our preliminary report, the Department of Defense stated that a study was underway to develop plans for relocating and combining separate recruiting offices to the extent practicable and advised that this study would identify an appropriate geographical area for conducting a test of consolidated recruiting offices.

#### PRIORITY AREAS NEEDING ATTENTION

In concluding this statement, we would like to comment briefly on four areas of defense activities which we believe merit particular attention.

##### 1. *Inventory Control*

The first is the need for more effective inventory controls.

In the hearings last year, we reported that inventory discrepancies totaling about \$3 million had been identified in connection with the transfer of supply management of paint and related products from the Defense Supply Agency to the General Services Administration. A followup review currently being conducted has identified additional paint costing approximately \$1.3 million which, because of inventory discrepancies, was not transferred to General Services Administration. Prior to the identification of this available inventory, General Services Administration purchased identical items costing about \$565,000.

Our reviews have disclosed other instances of procurement which could have been avoided by accurate inventory information. For example, our report issued in January 1966 (B-146917) on a review of the management of projectile fuze covers disclosed that savings of almost \$600,000 could be realized over a 5-year period through improvements in inventory management procedures and practices.

In addition to unnecessary procurement and the resultant creation of excess and surplus property, the lack of effective accounting control over inventory receipts, issues, and transfers may also lead to shortages in parts needed to maintain combat readiness. The need for improvement in the control of inventory is of vital concern to our office, and we intend to give this matter increased attention during our future reviews.

##### 2. *Use of Excess Material*

The second area is potential savings through greater utilization of excess material to avoid procurement.

As of June 30, 1965, the declared excess stocks of the Department of Defense amounted to \$3.6 billion. As of the same date, there were



also stocks valued at \$3.5 billion which had not been declared excess, but which were considered to be subject to redistribution to avoid procurement. In recognition of the need to effect the most economic use of these stocks, a system for matching proposed procurements with available excess or potential excess stocks, known as project plus, was established during October 1963.

The Department of Defense has reported significant savings as a result of this effort. Nevertheless, our reviews have continued to identify instances of excess stocks which were not being used to avoid unnecessary procurement actions.

We believe that these instances are primarily due to the following basic problem areas which, although recognized by agency personnel, require more aggressive action to provide for the effective use of excess stocks.

(a) Identification of all substitutable and interchangeable stocks and the means of insuring the acceptance of such stocks by the requiring service in lieu of the procurement of preferred items, particularly in the area of nontactical supplies and equipment.

(b) Development of a means of insuring that end item components which are in excess supply are made available as Government-furnished material in the procurement of the end items involved.

(c) Improvement in the reporting of information on all excess stocks and scheduled or anticipated procurements to provide more effective coordination between availability and need.

Unless an effective system is designed and implemented to overcome these problems, there will be continuing failure to use all excess stocks and the resultant procurement which may be avoided. We intend to give this matter our continued attention in the scheduling of future reviews.

### 3. *Adequate Technical Data*

The third area is the need for adequate technical data to permit competitive procurement.

As we have pointed out in previous hearings before this subcommittee, one of the basic problems the services have encountered in endeavoring to increase competitive procurement has been their inability to furnish adequate technical data for the purpose of informing prospective suppliers of what is required.

Our studies of a major aircraft program show that this problem still exists. Many steps have been taken by the Department of Defense to increase the extent of competitive procurements, which is considered to result in savings estimated at 25 cents for each dollar shifted to competitive procurement. Nevertheless, it is important that special effort be undertaken to obtain adequate and complete technical data so that further savings obtainable through competitive procurement may be achieved.

At the request of the chairman, House Committee on Appropriations, we have been conducting cost studies of the entire F-4 aircraft program. Our survey of technical data procured under that program indicates that, although the Government paid at least \$15.9 million for technical data acquired under the F-4 aircraft program, data costing as much as \$7.5 million were inadequate for procurement or maintenance purposes.

We found that complete drawings were missing and many drawings were technically incomplete, illegible, or marked with restrictive legends. As a result, F-4 aircraft parts could not be purchased on a competitive basis, which usually results in substantially lower prices to the Government.

Representative CURTIS. Could you tell me, what do you mean by "restrictive legends"?

Mr. NEWMAN. Well, in many cases the production drawings relating to certain parts or certain pieces have restrictive legends. The contractor has gone ahead and probably made an improvement in the part, or designed a new part, and puts a "proprietary right" stamp on the drawing. In this particular case I would like Mr. Fasick to answer it. He is more familiar with it.

Mr. FASICK. This usually involves a claim by a contractor, almost a unilateral claim of proprietary data.

Representative CURTIS. I see, yes.

Mr. FASICK. And the problem here is that the military have not been challenging this or studying or investigating it to determine the validity of the proprietary claims.

Representative CURTIS. I see. This is most important, because this is one of the techniques that can be used if your specifications are such that only company X happens to be able to meet that particular one. It alone can be the bidder, while it could be an item that does not have to be this restrictive.

Am I hitting at the right thing?

Mr. FASICK. This is quite right. In some cases these claims might be valid, but I think one of the problems is they are not being challenged.

Mr. STAATS. Mr. Keller has something to add to this.

Mr. KELLER. The question of proprietary data is a difficult and sometimes controversial matter. I think, as Mr. Fasick has pointed out, it is necessary for the Government to challenge and verify claims by contractors of proprietary rights, and also to make the terms of the research contract quite clear as to the Government's right to data for production purposes.

Representative CURTIS. Let me ask one thing. It would not be just the proprietary rights from a legal standpoint; it could be just an economic factor that if company X were making the widget in this particular way, company Y, company Z and so forth could not change their line to produce it and yet it would not be necessary to.

In other words, you can have your specifications and drawings in such a way that you have to restrict it to one supplier, when really those restrictions are not necessary. I guess that goes beyond what you meant by restrictive legends.

Mr. KELLER. That is right. I think your point is well taken. We continually run into the question in other areas. We receive many protests alleging that specifications are drawn in such a way that only one company can bid.

When we satisfy ourselves that an allegation is true, we say this is not a valid competitive procurement because you have lined it up for one manufacturer only.

Representative CURTIS. Yes. Thank you.

## RIGHTS TO PATENTS

Representative GRIFFITHS. I would like to ask you, I saw a headline the other day and did not read the story. As I recall, it was that those things that a contractor develops on Government money, will now belong to the contractor.

Did you read that? Do you know what they were referring to?

Mr. KELLER. I think you are referring to a news report that a subcommittee of the Senate Judiciary Committee, which has been considering legislation along this line, had reported a bill dealing patent rights to the full committee.

As I recall the article, it said the legislation would provide that the Government must make up its mind at the time of the contract as to who is going to own the rights, the Government or the contractor.

As you are aware, the question of ownership of patents developed under Government contracts has been going on in Congress for many, many years. Whether this legislation will be finally enacted or not, I would not hazard a guess.

Representative GRIFFITHS. Well, it has been going on, not just in Congress, it has been going on every place. They fought the whole World War I and II protecting the people's patent right where, in theory they did not have the right, but they did by national agreement protect it.

Representative CURTIS. I was largely on the other side of this argument, but it certainly is a relative one.

Representative GRIFFITHS. Well, I think it is terribly tough where the Government supplies the money and you are going to get into additional problems of noncompetitive bidding. I do not happen to believe that you have to have competitive bidding to have low price. I am probably the only person on this committee that feels that better than competitive bidding would be well-informed, well-paid purchasers.

Then I think you would get a low price. I think it is far better, because while you talk about competitive bidding, all you have to do is look at the innumerable bids that have been opened and the Attorney General's action where the bids have been exactly the same from innumerable companies.

## EXECUTIVE BRANCH NOW HAS DEFINITIVE POLICY

Mr. STAATS. The only thing I could add, I believe for the first time the executive branch, at least, has prepared a definitive policy. It is a highly complicated area, as you know, but under the leadership of Dr. Hornig, there has been for the first time put together an executive branch policy in this area.

Up until about a year ago we did not even have that, so I believe we are making some progress, but it is a matter which ultimately, in my opinion, Congress should legislate upon.

Representative CURTIS. We have different policies, as I recall it. In the Atomic Energy Commission they go one way, and this will be a uniform one.

Mr. STAATS. That is correct. This is fairly recent; I do not have the precise dates in mind, Mr. Curtis, but as I recall it is within the last year that we have it.

Representative CURTIS. Fine.

Mr. STAATS. To continue my statement: Furthermore, the ability to obtain maximum economy and efficiency in the maintenance of F-4 aircraft has been precluded because of the inadequacy of technical data.

Had adequate technical data been received for parts which we selected for review, and had these purchases been made on a competitive basis, we estimate that the Government would have saved about \$4.5 million. Moreover, we estimate that the Government would be able to save an additional amount of about \$6.8 million on planned future procurement of these parts.

In addition, we found that one of the Navy's major overhaul and repair activities had experienced difficulties in the overhaul and repair of F-4-type aircraft because of the lack of technical data. In this connection, we found numerous instances where the engineering drawings needed for the repair, overhaul or manufacture of F-4 aircraft parts were not available when needed.

In recent years the Department of Defense and the military services have directed considerable efforts to resolving problems of the management of technical data. We are currently reviewing the broader aspects of technical data acquired under various weapon system programs to evaluate the effectiveness of the corrective action being taken and to offer suggestions as to additional steps to be taken to achieve the desired goals.

#### *4. Effectiveness of Supply Systems*

Fourth and finally, effectiveness of supply systems in meeting operational needs.

Surveys and reviews performed by this office from 1961 to 1965 of supply practices in Okinawa, Korea, Japan, and Hawaii indicate that the military supply systems have not, in some instances, been responsive to demands.

For example, the supply systems in the Pacific theater have experienced such problems as large numbers of unfilled requisitions, a high percentage of items out of stock at depots, and extensive utilization of high priority requisitions.

In view of the possible effect on military operations, the high dollar value of inventories involved, and the observed or indicated special actions initiated by the Department of Defense to resolve some of the supply problems, we are undertaking a broad long-range Defense-wide survey of supply system responsiveness to military needs in the Far East. The purpose of the survey is to obtain information as to the effectiveness of the supply systems in meeting operational needs and to identify supply practices and/or problem areas which require correction.

This concludes our statement, Madam Chairman. We will be pleased to answer any further questions that you have.

Representative GRIFFITHS. Are you saying that right now that there are shortages in Vietnam?

Mr. NEWMAN. Madam Chairman, we have not done any military supply work in Vietnam since 1963. We have done a considerable amount of work in Korea and Okinawa and in Japan during the 4 or 5 years.

Representative GRIFFITHS. And do we not have sufficient supplies, sufficient inventory for Korea, Okinawa, and Japan?

Mr. NEWMAN. Our reports, we have issued about 14 reports and we have another one in the mill now, where we have problems, what we call zero balances in the inventory records.

Representative GRIFFITHS. Of what type of items?

Mr. NEWMAN. Well, I would like Mr. Gutmann to take care of that.

Mr. GUTMANN. Almost every type of item that the Army uses could be represented among the out-of-stock items. This would include parts for vehicles, for aircraft, for weapons of various kinds.

Representative GRIFFITHS. Right now?

Mr. GUTMANN. Yes, ma'am.

Representative CURTIS. Is there an indication of "cannibalism?" That is a good test of short supply like this.

Mr. GUTMANN. Yes, sir. Cannibalism is a rather prevalent practice, as you know, to keep maximum number of equipments functioning in a situation of short supply of parts.

Representative CURTIS. That is the way we did in World War II out in the Far East. But it is a test of whether your supply system has, in effect, collapsed to some degree. That is why I was wondering whether there was evidence of cannibalism there.

Mr. GUTMANN. Yes, sir; there has been.

We have in the past year tested the effectiveness of a supply system primarily by looking into the readiness of selected units. We would look at vehicle units in Korea or aircraft units here and there, missile units, and determine whether or not the supply system is getting parts to the user when, where he needs them in order to keep his equipment running.

Representative CURTIS. From this description, does it look like there is lack of trained supply personnel? This sounds like that is what it would be, some aspects, extensive utilization, high priority requisition, thousands of errors daily in requisitions and other paperwork. It looks like a shortage of trained personnel.

Mr. GUTMANN. Yes, sir; I think this is one of the problems. We have an extraordinarily—it seems to me, an extraordinarily complex supply system. While we train our people, we train a supply sergeant; he has so many, many things to do and so much information to gather from his catalogs and so on to requisition an item that we are beginning to think about means by which the supply system can be simplified.

I emphasize we are beginning to think about this because, as I say, we have emphasized in the past the degradation of material readiness as a result of the failure of people to do things.

One question is, Why do they fail to do it? Your question is training, have they been trained to do it? They have been trained to do it in some cases. In some cases their training has not been adequate.

For example, in Korea we use a lot of local nationals and similarly in Okinawa. We have language problems there.

Some of the supply deficiencies, if we can call them that, occur because these people have not been adequately trained. But then at the next each echelon where we are dealing with trained supply people, we find mistakes have been made, demand data has not been prop-

erly accumulated, so that the forecast for the need for parts can be made accurately.

Then this leads us to the question of, well, if these people are trained and they are not doing the job, is it a management system problem? Is it a motivation and leadership problem? Or can we alleviate all of these things to some degree by simplifying the system?

Representative CURTIS. Very good.

Representative GRIFFITHS. About 10 years ago a man from Detroit who worked for ordnance was inspector, was sent out to Korea and he came back and told me afterward he had written a report which incidentally was filed in the wastebasket, but which I thought was very interesting.

Tanks that were received in Seoul or Inchon or someplace moved 26 miles on a railroad car and when they arrived at their destination were not operational. The parts had been stolen off of them. Is this one of the problems?

Mr. GUTMANN. I am not familiar with this particular situation—

Representative GRIFFITHS. But is this a problem today with your inventory?

Representative CURTIS. With stealing.

Mr. GUTMANN. In many countries in the world, and I think probably Korea has a well-earned reputation for being among the worst, pilfering is a severe problem.

Representative GRIFFITHS. And that is what depletes your inventory?

Mr. GUTMANN. To some extent. Extensive security measures are applied, of course, fencing and patrols and dogs and so on, but these people are in such desperate straits that a gallon of gasoline is a week's salary to them.

Mr. WEITZEL. Madam Chairman, mention was made of the shortage of qualified maintenance personnel. One of the reports that is digested in your background material issued this month is No. 37, our Report B-132990 of April 30, 1965; <sup>25</sup> in that report we pointed out that our review of the maintenance and supply support of aviation units of the 8th U.S. Army in Korea showed that during a 6-month period ending December 31, 1963, the availability of operational aircraft assigned to several units of the 8th U.S. Army in Korea had been less than necessary to meet fully mission requirements, caused to a large extent by (1) shortages of technically qualified maintenance personnel; (2) ineffective utilization of those qualified maintenance personnel who were available; and (3) inadequate supply support.

The Department of the Army in that case indicated an agreement with our findings and advised us of corrective actions taken. The details of that report are classified, I believe. But that is one example of the types of things we have found.

Mr. NEWMAN. Madam Chairman, If I may; in the area of the subjects covered in the hearings on requisitions, we just made a recent analysis of our reports that we have issued in the area of requisitions and filling requisitions from inventories.

We went back and we looked at 100 of our reports, but the significance of it falls into about 10 deficiencies. If I may read this, it would

<sup>25</sup> Staff materials, 1966, p. 89.

give you an indication of the problems we are facing in this supply system.

Representative GRIFFITHS. Please do.

Mr. NEWMAN. No. 1. Requisitions could not be filled because stock cards did not accurately show correct balance of stock on hand.

Representative GRIFFITHS. Why not?

Mr. NEWMAN. There were three reports on that in that area.

No. 2. Requisitions could not be filled, although sufficient stock was available, but in salvage yard awaiting disposal.

No. 3. Requisitions could not be filled because reparable and reusable stock was not returned for repair and reissue.

No. 4. Requisitions could not be filled because suitable substitutes could not be identified.

No. 5. Requisitions could not be filled because of erroneous stock identification numbers.

No. 6. Stock was permitted to deteriorate because the oldest stock was not issued first. This is important in short life items.

No. 7. Stock was permitted to deteriorate because available inside storage was not used.

No. 8. Reclaimable and reusable needed stock was committed to disposal.

No. 9. Requisitions were filled in uneconomical units of issue. That is in our current report to the committee.

No. 10. Retention of unnecessary items in the supply system hampered supply management operations and increased operating costs.

Now, for example, we are working on an excess material problem over in Europe. Mr. Gutmann and I found during our trip last year, that there is considerable material on hand that may eventually be declared surplus.

We found in talking to the people in charge, there was about \$400 million worth of excess supplies. Their problem was that when a requisition came in for an item, if they did not have it, they did not know which items of the \$400 million could be substituted for the item. This is one of the problems that they were facing in filling requisitions.

The general did not want to declare the \$400 million surplus, because he thought the items could be substituted for other items.

Now, of course, we have to realize that the Department of Defense is constantly giving serious attention to the problem. There is nothing comparable with it in commercial business. It is a gigantic problem and we are going to have to keep at it and keep at it. But I will say this: That the Army, the Navy, and the Air Force, and the Department of Defense are very receptive to our findings.

We are trying ourselves to do a better job. Instead of individual examples, we will try to come up with broader reports and solutions to problems in an area that will help to improve conditions.

These gentlemen who are going to be working on this supply program in the Far East, to find out how it can be improved, are our best people.

Mr. STAATS. I would just like to add to what Mr. Newman has said, that while many of the things we have said here today appear critical, and I think in some respects are critical, there is certainly no lack of desire on the part of the Secretary or the Deputy Secretary or the

Assistant Secretary of Defense to cooperate with us and, indeed, they are taking, as you know, many, many actions in this field themselves so that we are all working for the same end.

Representative GRIFFITHS. Good. Keep right on.

BUDGET BUREAU CIRCULAR A-76

Representative CURTIS. I would like, Mr. Staats, since you now have a different hat on, to say personally how pleased I am to see you in this capacity. But now the question relates to something that really was done under the Bureau of the Budget. But now the Government Accounting Office under your jurisdiction is going to have to do some interpreting, too. This involves Bureau of the Budget Circular A-76, which has finally been promulgated. Broadly, it concerns this business of where Government should be in business directly, certain areas they must, but also where should they not be? (See app. 1, p. 203.)

Already a number of private concerns have read this and are worried about whether, for example, is there the presumption still in favor of procuring from commercial sources, as was stated in 60-2? <sup>26</sup>

I presume that it is, but here is a chance for the interpretation by the Comptroller General. Would you read A-76 as saying that this presumption still exists?

Mr. STAATS. The word "presumption" may not be the precise word I would use, Mr. Curtis, but the policy here has not been changed, which is basically to rely upon private industry to supply the commercial and service products that the Government requires for its own use.

The effort in this circular has been: (1) to try to point out more precise guidelines than we had previously; (2) to provide a statement of policy for this administration, because there were many people both in and out of Government who were not certain, since the previous issuance was in 1959, as to whether or not it did represent the policy of this administration; (3) we made an effort to more clearly fix the responsibility at the agency head level than we had before, where previously it was the contracting officer or the administrator down the line who made this judgment, or it was an item which was buried within a large budget total.

We not only will now require that the decisions be made at least at the Assistant Secretary level, but also that there be separated out in the budget separate identification of these items, even though it may be a relatively small item in a several hundred dollar budget item, they will now have to be separately identified.

And (4), we have felt that it was of such importance that we discussed it with the President and the President himself issued the statement from the White House on March 3, so that we have more clearly a statement of presidential policy than we have had in the past.

Where some people felt this was a Budget Bureau action, we felt it was important, and the President agreed that it was a matter that he should act on himself, and his statement, I think, adds a great deal.

<sup>26</sup> For text of Bulletin 60-2 see app. 1, p. 208.



## STATE AND LOCAL TAXES AS COST

Now, the one area where we had the greatest difficulty had to do with the question of whether to include State and local taxes on the Government side for the purposes of a cost analysis.

Representative CURTIS. This is a question I am deeply concerned about.

Mr. STAATS. You have used the words "finally issued." I think that is a well-chosen phrase. This was the area in which we had our greatest difficulty and controversy in negotiating out a statement of policy in this area.

Part of the reason we ran into this difficulty was the question of feasibility, of how do you actually compute State and local taxes for this purpose?

We found that under the old circular which, for example, did make reference to State and local taxes, State and local taxes were being completely disregarded because no one could find a way to do it. You have the case of the prime contractor who deals with subcontractors in many jurisdictions: the tax rates are continually being changed.

That was one consideration.

The other consideration was that we felt the main concern had to do with "new starts," as we call them. These would be cases where the Government is deciding in the first instance to make this decision to make or buy.

For that reason we added a 10-percent factor to cover the so-called new starts. That takes into account the State and local taxes, but it also takes into account the possibility of error.

Thirdly, it takes into account the point you are referring to, that we felt the bias here, if any, should be in favor of contracting out.

So that is the history of the consideration of State and local taxes.

I doubt if it is possible to ever develop a statement which is going to satisfy the people who feel that the Government is still doing too much or for the other side—many people within Government, particularly I am referring here to the employee organizations—who feel that we are contracting out too much at the expense of the taxpayer.

So that this is—

Representative CURTIS. This is the great area in my judgment that has to be developed and will change.

Mr. STAATS. That is correct.

Representative CURTIS. It will change here. But a lot of this we are going to have to live with and see how it develops. I have one way of starting that out.

Here is a specific case that I will turn over to you for interpretation as Comptroller General, not—but the question is this: I will read it, because it is in their words—"Bureau of the Budget Circular No. A-76 defines a Government commercial or industrial activity as one which is owned and managed by an executive agency and which provides for the Government's own use a product or service that is obtainable from a private source."

Is a Government-owned, contractor-operated facility considered to come under this definition? If not, what guidelines are applicable considering the Government bears total investment costs and business risks?

In other words, this is a private company that apparently is in competition with another private company which, though, is using simply under contract operating a Government facility. And the question is: How would you interpret A-76?

Mr. STAATS. I would be very happy to put on my new hat and give you my best judgment on that.

Representative CURTIS. I will turn this over to you and then we can supply this for the record. It will help, I think, if we take specific cases. The sooner we can get an understanding of that, I think the more helpful it will be.

(The materials which follow relate to the preceding testimony:)

#### Position Paper

##### POLICY FOR ACQUIRING COMMERCIAL OR INDUSTRIAL PRODUCTS AND SERVICES FOR GOVERNMENT USE

Union Carbide Corp., Linde Division, is a major supplier of cryogenic propellants (liquid oxygen-liquid nitrogen) to the Government. In anticipation of increased Government requirements in Florida, Linde Division has recently completed a 400 T/day production facility at Mims, Fla., adjacent to Cape Kennedy.

NASA recently undertook a two-step procurement action (IFB CC-1-6) for the supply of cryogenic propellants to Cape Kennedy from commercial sources. Linde Division offered the lowest cost product to NASA under this procurement with product to be supplied from Linde plant at Mims plus operation of AF plant 74 at West Palm Beach to be made available by the Government.

In spite of the established commercial capabilities and favorable costs to NASA, this proposal is to be evaluated against a Government-owned, contractor-operated facility. Such Government-owned, contractor-operated facilities would require relocation and modification of plant 74 at West Palm Beach, Fla., together with plant 73 at Cape Kennedy.

We have attempted to determine established policy which might apply to Government competition with commercial operations in such situations, however, no clearly defined guidelines are apparent. It is our considered opinion that direct Government competition with private industry is not warranted under the circumstances and that expenditures of funds to facilitate such operations by a Government agency is not in the public interest and should not be undertaken until a clearly defined policy is established.

#### Question

Bureau of the Budget Circular No. A-76 defines a Government commercial or industrial activity as one which is operated and managed by an executive agency and which provides for the Government's own use a product or service that is obtainable from a private source. Is a Government-owned, contractor-operated facility considered to come under this definition? If not, what guidelines are applicable, considering the Government bears total investment cost and business risk?

(Answer supplied by General Accounting Office.)

Circular A-76 is not intended to cover the operation of a Government facility by a private company. Circular A-76 is designed to provide guidelines for competition by the Government with private industry. Where two private companies are competing for Government business, the decision to select one or the other company is necessarily based on many factors, such as price comparison, which would include an evaluation of Government-furnished tools, equipment, facilities, etc. Whether Government-owned property occupied by a contractor should be retained by the Government is a separate question not included in Circular A-76.

The specific case referred to involves the procurement of cryogenic propellants from commercial companies. It is understood that both companies competing for this procurement propose using Government facilities to a certain extent. The case does not involve competition by the Government with a private company in the operation of a facility and, consequently, does not come within the scope of Circular A-76.

## PAYMENTS IN LIEU OF TAXES

Representative CURTIS. One of my thoughts is that we should get into a setup where at least the real estate of the Federal Government is set up on the basis of payments in lieu of local taxes, as we have in the law now for Government property that was once owned by RFC and still carries with it the responsibility of paying in lieu of local taxes.

Mr. STAATS. All of that property still carries the payments; that is correct.

Representative CURTIS. In other words, the technique seems to have worked well in that area. I have felt that that is one way of getting some good accounting procedures in the Federal Government and also a discipline for the Federal agencies not using costly land and buildings when cheaper land or buildings could be used.

Also, a method of probably resolving this problem, if we use the 10 percent, and I understand your problem of trying to estimate what it would be, but at least we could get out of that the real estate property tax, which is the essential tax for local government financing.

I am not sure of this, but it is an area that I am interested in developing. I asked a question of the GSA as well as the Defense Department in order to find out what the printing costs are in Government and how much is contracted out, and so forth. (See app. 11, pp. 401, 409.)

This is just one of these other areas that it seems to me we have not looked at. I know the Government printing bill is considerable. We use the Government Printing Office for a great deal of it, but I think every governmental agency probably lets out a lot of printing contracts and so forth.

Mr. STAATS. This is correct.

Representative CURTIS. Has GAO ever been in this at all?

Mr. STAATS. Mr. Weitzel or others would have to speak for the GAO side of this, but I would like—

Representative CURTIS. If you have, could you direct us to what studies you might have made?

Mr. WEITZEL. Mr. Curtis, we are working now with and for the Joint Committee on Printing on certain studies which they are supervising. It might be that Mr. Hammond would want to add a little bit to that.

Mr. HAMMOND. We have had a study underway for about a year now. It involves the cost that the Department of Defense is incurring for printing that equipment contractors furnish with the equipment.

Representative CURTIS. It is a limited study, then, rather—

Mr. HAMMOND. That particular part of it dealt with the comparative costs of the Department of Defense getting manuals through the equipment contractors as contrasted with costs that would be incurred under contracts awarded by the Government Printing Office.

We have other reviews in process, generally covering the supply management of printing; what technical manuals they get and whether they buy them in the most economical quantities.

## SCOPE OF GOVERNMENT'S PRINTING BILL

Representative CURTIS. What I am really directing this to covers the broad aspects on computers. We use the figure of a \$2-billion bill, with

a \$3-billion estimate when you include other things. Was it ever attempted to find out comprehensively what our printing bill is: how much is done by the Government Printing Office; how much is done in other in-house operations of the Federal Government; how much is contracted out?

Mr. STAATS. It also has elements of the make-or-buy problem of A-76, particularly with reference to reproduction facilities that the agencies themselves operate. They have the option of developing production facilities or contracting out.

Now, to some degree this is subject to control of the Joint Committee on Printing.

Representative CURTIS. That would only really be the Government Printing Office that they would have, would it not?

Mr. STAATS. They also have authority with respect to the reproduction facilities operated by the agencies themselves.

Representative CURTIS. Oh, do they? I did not realize that. I thought they were just over the Government Printing Office.

Mr. STAATS. We can supply the details of that for the record, if you wish.

Representative CURTIS. If it is in order, I do not want to make—well, it is an important project, but if you could get a comprehensive estimate of this problem, why, it would be—

Mr. STAATS. We would be happy to do that, Mr. Curtis, but if I may, I would think that the leadership on a study of this kind in terms that you have in mind might come from either the Budget Bureau or GSA or both.

Representative CURTIS. That is why I started out by saying I was not sure this is exactly the area that you would be concerned with. I was going to direct this to the Director of the Budget this afternoon, but I thought possible GAO had happened to make comprehensive studies in this area. It would be helpful to know it.

I will pursue it in this other way, but to the extent that you have data or could have data that would help us on this, we would appreciate having it.

Mr. STAATS. Suppose we get you at least the estimate.

Representative CURTIS. Right, very good. Thank you.

(Information later supplied by General Accounting Office follows:)

#### AUTHORITY OF THE JOINT COMMITTEE ON PRINTING

[Extracts from United States Code, title 44]

SEC. 4. The Joint Committee on Printing shall have power to adopt and employ such measures as, in its discretion, may be deemed necessary to remedy any neglect, delay, duplication, or waste in the public printing and binding and the distribution of Government publications. (Mar. 1, 1919, ch. 86, § 11, 40 Stat. 1270.)

SEC. 111. All printing, binding, and blank-book work for Congress, the Executive Office, the Judiciary (other than the Supreme Court of the United States), and every executive department, independent office and establishment of the Government, shall be done at the Government Printing Office, except (1) such classes of work as shall be deemed by the Joint Committee on Printing to be urgent or necessary to have done elsewhere; and (2) printing in field printing plants operated by any such executive department, independent office, or establishment, and the procurement of printing by any such executive department, independent office, or establishment from allotments for contract field printing, if approved by the Joint Committee on Printing. (July 5, 1949, 63 Stat. 405.)

SEC. 111a. Such printing, binding, and blank-book work authorized by law, as the Public Printer is not able or equipped to do at the Government Printing Office, may be produced elsewhere under contracts made by him with the approval of the Joint Committee on Printing. (Feb. 28, 1929, ch. 367, § 1, 45 Stat. 1400.)

According to information contained in a study made of the Federal printing program which was completed by the Joint Committee on Printing on January 25, 1966, total annual Government expenditures for printing exclusive of Central Intelligence Agency, National Security Agency, and map and chart plants, amounts to about \$254 million. The study shows that of this amount about \$136 million was for printing production by the Government Printing Office (\$69 million), and by other Government agencies (\$67 million), and about \$118 million of printing was procured from commercial sources. Further, we estimate that the printing of technical manuals procured by the Department of Defense through equipment contractors amounts to an additional \$25 to \$30 million a year.

#### GAO'S ROLE IN PROPERTY ACCOUNTING

Representative GRIFFITHS. May I ask, what are you doing about implementing Public Law 152, section 205 and section 206, in laying down lines for property accounting? Where you have the requirement to set up property accounting methods.

Mr. STAATS. This is approval of accounting systems?

Representative GRIFFITHS. Yes.

Mr. STAATS. Mr. Weitzel here, I think, should probably, in view of my recency in this position, would probably be better qualified.

Mr. WEITZEL. Madam Chairman, we do take into account provisions of sections 205 and 206 of the Federal Property and Administrative Services Act, Public Law 152 of 1949, in promulgating our general principles and standards for accounting for agencies, which is done on a full basis under the Budget and Accounting Procedures Act of 1950, and we also perform our property audit responsibilities as a part of our general audit program not only in the Defense Department, but in the civilian agencies and under our International Operations Division in overseas locations, and as evidenced by some of the reports you see here in this group of 80, and the others in the civilian area, we have gone into such areas as improper or poor inventory controls, excess equipment, overstocking, for example, of photographic equipment at a laboratory—

Representative GRIFFITHS. Are you going to or do you consider that you have any authority regarding contractor-held Government-owned inventory?

Mr. NEWMAN. Yes, we do; and as evidenced by our report furnished to the subcommittee March 17, we have made some recommendations to the Department of Defense in this area.

Representative GRIFFITHS. Thank you very much. We are always grateful to have you here.

Mr. NEWMAN. Madam Chairman, you asked about Public Law 152. I would not want to leave the impression, as our statement might indicate, that the Department of Defense is not improving its accounting systems.

Recently, as you know, the new Comptroller of the Department of Defense, Mr. Anthony, took Mr. Hitch's place. The emphasis is now on getting the backup material on financial management and during the past 3 or 4 months there has been considerable effort in this area to get the accounting systems set up in the military in accordance with the principles laid down by the Comptroller General.

I am very much encouraged. It is going to be a long—take quite a few years to get in a good accounting system and have information to back up Secretary McNamara's 5-year budget plans.

Representative GRIFFITHS. Thank you very much.

The meeting for this afternoon, the witness will be Mr. Hughes, the Deputy Director of the Budget, and the meeting will be at 2:30.

We are very grateful to you for being here.

Mr. STAATS. Thank you, Madam Chairman.

(Whereupon, at 12 noon the hearing was recessed, to reconvene at 2:30 p.m., the same day.)

AFTER RECESS

(The committee reconvened at 2:40 p.m., Hon. Martha W. Griffiths, member of the subcommittee, presiding.)

Representative GRIFFITHS. Thank you, very much, for waiting, Mr. Hughes. I am sorry to be late.

I would like to congratulate you, too, on your new promotion.

Mr. HUGHES. Thank you.

Representatives GRIFFITHS. It is very worthy and wonderful.

For the record, Mr. Hughes is quite familiar with the affairs of the Government. He has been for many years in charge of the Division for Legislative Reference in the Budget Bureau.

The letter of February 2, 1966, from Chairman Douglas to Mr. Schultze about these hearings will be placed in the record at this point.

(The letter follows:)

FEBRUARY 2, 1966.

HON. CHARLES L. SCHULTZE,  
*Director, Bureau of the Budget,*  
*Washington, D.C.*

DEAR MR. SCHULTZE: As you probably know, the Subcommittee on Federal Procurement and Regulation began hearings on January 24, 1966, on "The Impact of Federal Procurement on the Economy."

The press of many matters makes it difficult to set a definite schedule for other witnesses this year, but we plan to resume hearings shortly after March 1. At that time, we will want the Budget Bureau witnesses to testify on the specific recommendations pertaining to your Bureau in our report of July 1965.

A progress report on the procurement and management of automatic data processing equipment under the new legislation will also be helpful to the subcommittee, and related thereto, information as to the full employment of the Defense Supply Agency's Battle Creek, Mich., center in the utilization of inventory stock of the Government.

The growing inventory of real property holdings, despite sizable declarations of excesses and surpluses, makes it desirable to review with you the program for identifying and placing unneeded property on the tax rolls or in justifiable public use.

Of growing economic importance to the subcommittee is the subject we have previously discussed; namely, the promulgation of guidelines governing the establishment and continuation of activities that might be performed by the private sector.

You will be advised as soon as a suitable date for the hearings can be arranged. As in former years, we will need 100 copies of your statement at least a day before the hearing date. If further information is needed by you, please contact our economic consultant, Mr. Ray Ward, phone No. 173-8169, Study Room 161, Library of Congress Annex.

Faithfully yours,

PAUL H. DOUGLAS,

*Chairman, Subcommittee on Federal Procurement and Regulation.*

Representative GRIFFITHS. You may proceed with your statement, Mr. Hughes.

**STATEMENT OF PHILLIP S. HUGHES, DEPUTY DIRECTOR, BUREAU OF THE BUDGET; ACCOMPANIED BY HAROLD SEIDMAN, ASSISTANT DIRECTOR FOR MANAGEMENT AND ORGANIZATION; AND GEORGE MULLINS, CHIEF OF PROPERTY AND SUPPLY MANAGEMENT**

Mr. HUGHES. Thank you, Madam Chairman.

With me, I might introduce them, on my right is Mr. Harold Seidman, Assistant Director for Management and Organization, and on my left, Mr. Mullins, Chief of the Property and Supply Management Branch of the Bureau.

Madam Chairman and members of the subcommittee, this is the first time that I have had the opportunity to participate in this subcommittee's annual review of executive efforts to improve the procurement and management of Federal property. You have had extensive testimony from the other agencies on our joint undertakings to continue progress during the past year. The sustained interest and strong support of the subcommittee have helped in sharpening issues, providing points of departure for new work, and giving us an opportunity to assess the strengths and weaknesses of proposed solutions to difficult problems.

I appreciate this opportunity to report on four areas in which the subcommittee has expressed interest. They are:

1. Revision of Bureau of the Budget Bulletin 60-2, which now has been accomplished by issuance of Bureau of the Budget Circular A-76.
2. Management and utilization of automatic data processing equipment.
3. Progress in the development of rational and efficiently coordinated supply system.
4. Improvement in the management of Federal real property.

There is progress in each of these areas. The major credit belongs to the operating agencies; but, as in the past, the Bureau has participated actively under the leadership of my predecessor, Elmer B. Staats, who today appeared before you in his new role of Comptroller General of the United States. Mr. Staats' broad range of personal knowledge and the perspective gained in his 6 years of collaboration with the subcommittee uniquely qualify him as a witness on the matters before you. However, I look forward to working with the subcommittee on these matters and I can assure you that there will be no less-

ening of the cooperation of the Bureau of the Budget in matters of concern to the subcommittee.

I should like to turn now to each of the four areas just referred to. First, the issuance of Bureau of the Budget Circular No. A-76, replacing bulletin No. 60-2. (See app. 1, pp. 203, 208.)

On March 3, 1966, Bureau of the Budget Circular No. A-76 was issued to all executive agencies. The circular restates the guidelines and procedures to be applied by executive agencies in determining whether commercial and industrial products and services used by the Government are to be provided by private suppliers or by the Government itself. The new circular replaces Bureau of the Budget Bulletin No. 60-2, which was issued in 1959. The circular was issued pursuant to a memorandum from the President also dated March 3, 1966, and addressed to the heads of executive departments and agencies.

With your permission, Madam Chairman, I suggest that the President's memorandum and the circular be included in the record of these hearings.

Representative GRIFFITHS. Without objection this will be done. (See appendix 1, p. 203.)

Mr. HUGHES. The new circular reaffirms the Government's basic policy of relying upon the private enterprise system to supply its needs. At the same time, it recognizes that it is necessary or in the national interest in some instances for the Government to provide products and services which it uses.

As Mr. Staats reported to this subcommittee when we were in the process of drafting the circular, there is no substantial change in the basic policy of relying upon private enterprise unless there are definite reasons for not doing so. The principal differences between the new circular and the bulletin it replaces are as follows:

(1) In the earlier bulletin, the justification for relying primarily on commercial sources was the importance of the private enterprise system to the economy. We agree with that proposition, of course; but we do not believe it is the only reason for the policy. Government ownership and operation of commercial facilities also involves inherent risks and uncertainties to the Government itself and to the Nation generally, including unanticipated losses due to obsolescence, changes or reductions in the Government's requirements, removal of property from tax rolls, and diversion of management attention from the Government's primary objectives. The new circular states that the Government should not provide products and services for itself except for reasons which "are sufficient to justify the assumption of these and similar risks and uncertainties."

(2) While the bulletin contained general guidance concerning the cost factors to be considered, there has been a great deal of misunderstanding about the costs which should be charged to the Government. Our Circular No. A-76 provides more detailed guidelines for conducting cost comparisons. We believe this feature will result in a much more effective implementation of the policy. The basic principle for comparing costs is that all of the costs which the Government would incur under each alternative should be considered—even if they are not paid from an agency's current appropriation.

(3) The bulletin provided that Government activities should be avoided unless costs involved in the use of commercial sources would be "disproportionately higher." Since the meaning of this term was



not entirely clear, the circular provides for a more definite cost standard by indicating that Government activities should not be initiated unless costs will be at least 10 percent less than would be incurred if the product or service were obtained from commercial sources.

(4) The circular assigns responsibility for carrying out the policy to the head of each agency. In addition, the President's memorandum directs each agency to designate an assistant secretary or other official of comparable rank to assure that the policy is properly carried out.

(5) The bulletin called for a one-time inventory of commercial industrial activities to be submitted to the Bureau of the Budget. The circular provides for an inventory which is to be maintained on a continuing basis by each agency.

Now, with respect to the automatic data processing program, executive branch efforts to improve the management and utilization of automatic data processing equipment are being helped considerably by Public Law 89-309, which the Congress enacted on October 30, 1965. This act provided specific ADP authorities to the Bureau of the Budget, General Services Administration, and National Bureau of Standards and established the procedural means which are needed to bring about improvements in this field. In addition, we are being guided by the recommendations for improvement that are contained in the report to the President on the management of ADP, which was published as Senate Document No. 15 in March 1965.

Since our report to you last year, the Bureau of the Budget, General Services Administration, and the National Bureau of Standards have made internal organizational adjustments to carry out their increased responsibilities for ADP management, and have provided additional resources for broadening and intensifying their efforts. In addition, working relationships among these agencies have been made closer and more effective. These relationships are aimed at achieving full coordination of the complex and diverse activities to be carried out. This is essential to the full implementation of Public Law 89-306, and is a general prerequisite to effective action in ADP management. We plan to utilize the Federal Automatic Data Processing Council to extend this coordination effort to agencies which are the major users of computers.

Much of the current and future effort is necessarily devoted to the study and development of the ways and means for carrying out the new or expanded programs which have been recommended. These programs include (1) the improvement of procurement and contracting procedures, giving particular attention to the single-purchaser concept, to the problems associated with the provision of software in support of computer hardware, and to the cultivation of additional sources of procurement; (2) the establishment of service centers and other joint utilization arrangements; (3) the achievement of compatibility among ADP equipment and related software through appropriate standardization efforts; (4) the establishment of maintenance and equipment replacement policies; and (5) the provision of a more comprehensive and timely information system to permit effective management action.

Last year we reported that 46 percent of our computer inventory was Government-owned, the remainder being leased from the manu-

facturers of the equipment. The percentage of owned computers is now about 50 percent, and estimates derived from the recent budget reviews indicate that this figure will be slightly higher by the end of fiscal year 1967.

Utilization of computers continues its upward trend. Last year the average monthly utilization of all computers was 330 hours, as compared to 313 and 283 hours for the preceding 2 years. If we exclude the small computers, many of which are used sporadically in the solution of scientific computational problems, the average monthly utilization of the larger and more expensive computers ranges from 374 to 457 hours per month.

We are continuing our efforts to achieve maximum utilization of existing computers for new work in lieu of acquiring additional computer capacity. To facilitate the sharing of computers wherever possible, the GSA has, in the past year, established 13 regional sharing exchanges located in metropolitan areas where there is a high concentration of automatic data processing requirements and we plan to expand this program further.

Excess Government-owned and leased equipment is being redistributed for extended use within the Government as a result of special screening procedures instituted by GSA and by the Defense Supply Agency for the military departments. In calendar year 1965, GSA redistributed equipment valued at \$9.4 million. Defense Supply Agency redistributed equipment within the Department of Defense valued at \$25.5 million.

#### IMPROVEMENTS IN SUPPLY SYSTEMS

Most of the developments with respect to improvement in supply systems have been discussed in detail by other witnesses. I shall comment briefly on a few actions in which the Bureau has been especially interested.

Last year, we reported that a joint study had been arranged by the Bureau of the Budget to determine whether perishable subsistence items should be purchased on a consolidated basis. Since then, a test conducted in the Chicago area has been completed and evaluated by the participating agencies which included the Defense Supply Agency, the General Services Administration, the Veterans' Administration, the Public Health Service, and hospitals managed by the military services.

The test indicated that a complete consolidation at this time would not be desirable but that substantial improvements can be accomplished through cross-servicing arrangements which are now being implemented in several regions. The test also has shown that more complete consolidation action may become feasible after the principal agencies concerned have had an opportunity to develop standard specifications. Arrangements are being made to accomplish that objective.

We also commented last year concerning a consolidation of common supply services at Cape Kennedy. This action has been taken.

We have been interested for some time in accomplishing the optimum amount of standardization and consolidation of supply functions in the Post Office and the GSA. We are pleased that an understand-

ing has been reached between these two agencies which should lead to substantial progress during the next several months.

As reported by representatives of GSA and the Defense Supply Agency, progress has also been made in joint efforts to consolidate the management of selected common commodity classes and in developing an effective approach to improve the management of short shelf-life items.

We agree with the views expressed in the subcommittee's report of July 1965 concerning the major opportunities for improved inventory management and utilization of Federal property by means of the Defense Logistics Supply Center in Battle Creek, Mich. Bureau representatives have visited this installation during the past year and we intend to devote further attention to this excellent opportunity for further improvement.<sup>27</sup>

Finally, the Federal catalog has been completed and is now on a continuing maintenance basis.

Representative GRIFFITHS. How many items are there in the Federal catalog?

Mr. HUGHES. Mr. Mullins?

Mr. MULLINS. It is about 4.2 million items. That includes both military and civilian.

Representative GRIFFITHS. How many are not—

Mr. MULLINS. It, also, includes a small number of NATO items.

Representative GRIFFITHS. How many items are not in the catalog?

Mr. MULLINS. How many are not?

Representative GRIFFITHS. Right.

Mr. MULLINS. Well, the catalog has been completed but there is a continuing flow of new items phasing in and old items phasing out. I cannot remember now—it is a surprisingly high percentage of turnover constantly. Turnover in some of the classes is over 50 percent—with half the items phasing out and being replaced in a year. Others, of course, such as common hardware items and ordinary items do not turn over very fast, but so far as the backlog of uncompleted identification of the items; that is, just getting a number assigned to each item, which was the first phase of the catalog, that has been done.

The Defense portion was done several years ago, about 7 years ago, but there have been problems in getting several of the civilian agencies on the same basis as the military has been for some time.

Representative GRIFFITHS. Thank you.

You may proceed.

Mr. HUGHES. With respect to the improvement in the management of Federal real property, we fully share the subcommittee's interest in the program for identifying and placing unneeded Federal real property on the tax rolls or in disposing of it for other purposes which are in the national interest. The management and maintenance of real property is costly, and disposal of unneeded real estate benefits, not only the Federal Government but also the States and local tax jurisdictions. Bureau of the Budget Circular No. A-2 provides guidelines for identification and disposal of unneeded real property. During the past year, we have completed a review in several principal

<sup>27</sup> See Report, July 1965, pp. 3-4.

agencies to determine whether our circular was effective and what should be done to improve it. Although agencies are accomplishing regular reviews of real property holdings and are identifying unneeded real property for utilization or disposal, we believe that other measures are necessary. Suggestions for changes which would update and strengthen our circular are now being discussed with the agencies. We are also working with the General Services Administration and the principal agencies concerned with real property to develop other more effective approaches to the problems of real property management.<sup>23</sup> (See also, p. 128.)

In conclusion, the year since our last appearance before this subcommittee has been a year of progress, although much remains to be done. Working relationships among the principal agencies are demonstrating their effectiveness. These same relationships will assure prompt attention to new problems as they arise. We welcome the continuing interest and support of your subcommittee to this end.

Representative GRIFFITHS. Thank you, very much. We will, without objection, add the text of Bureau of the Budget Circular A-2, of October 18, 1965, at this point in the record.

Mr. HUGHES. Thank you.

(Circular referred to follows:)

EXECUTIVE OFFICE OF THE PRESIDENT,  
BUREAU OF THE BUDGET,  
Washington D.C., October 18, 1955.

CIRCULAR No. A-2

To: The heads of executive departments and establishments.

Subject: Review of real property holdings (other than public domain).

(1) *Purpose*.—It is desirable that the Federal Government divest itself of real property holdings which are not needed. The head of each agency is requested personally to insure that intensified action is taken to identify and declare as excess real properties which are not needed. The purpose of this circular is to establish general guidelines for the accomplishment of this objective with respect to real properties within the continental United States, exclusive of the public domain.

(2) *Policy guidelines*.—Real properties or portions thereof generally shall be declared excess when:

a. They are not being used by the owning agency and there are no approved plans for future use.

b. Substantial net savings to the Government would result if properties used for essential purposes were sold at their current market values and other suitable properties of substantially lower current values were substituted for them.

c. The costs of operation and maintenance are substantially higher than for other suitable properties of equal or less value which can be made available by transfer, permit, or purchase.

d. They are being leased to private enterprise but could be sold under provisions of the leases and in accordance with existing laws, if the Government's requirements for goods or services produced on such properties would be met satisfactorily with the properties in private ownership.

e. They are being used by the Government to produce goods or services which are available from private enterprise, except when it is demonstrated clearly in each instance that it is not in the public interest to obtain such requirements from private enterprise.

(3) *Financing arrangements*.—It is recognized that, in some instances, action cannot be accomplished in accordance with these guidelines without first

<sup>23</sup> See Report, July 1965, p. 6.

incurring expenses for which appropriate financing arrangements or legislation must be obtained. There should be no delay, however, in making the necessary studies and in submitting proposals for such financing arrangements or legislation, including estimates of replacement costs and ultimate net savings, as part of the budget submissions.

(4) *Implementation.*—The head of each agency should insure that :

a. Instructions and criteria are developed and issued for the application of the guidelines established herein. It is requested that copies of such criteria and instructions be sent to the Bureau of the Budget by November 30, 1955.

b. Thorough reviews of real property holdings are initiated promptly and carried through on an annual basis.

c. Properties or portions of properties are declared excess without delay if continued ownership is not justified.

By direction of the President :

ROWLAND R. HUGHES, *Director.*

Representative GRIFFITHS. You point out that—

The bulletin called for a one-time inventory of commercial industrial activities to be submitted to the Bureau of the Budget. The circular provides for an inventory which is to be maintained on a continuing basis by each agency.

Mr. HUGHES. Yes.

Representative GRIFFITHS. How are you going to do that? Are they going to report annually to the Bureau of the Budget?

Mr. HUGHES. There is no specific provision for reporting in the bulletin or in the related Presidential memorandum.

The bulletin, however, does set up arrangements under which the inventory and the activities under the circular are better integrated with the budget review process than has been the case heretofore, and it would be our hope that the budget review process would be the vehicle for assuring maximum compliance with the circular and conformity with the principles that it establishes.

The circular has just been issued. If the arrangements which it contemplates for review and checking via the budget process are not adequate, we would obviously plan to back them up by some other means, but our basic technique is the budget review process.

Representative GRIFFITHS. How many people are there in the Budget Bureau?

Mr. HUGHES. We have, I think, the current strength of about 503 total employees; I have forgotten the proportion, roughly two-thirds professional, one-third stenographic and clerical.

Representative GRIFFITHS. I think this is one more really large field, I would assume, to put upon you—\$100 billion budget and struggling with what we own and whether we ought to get out of business or so forth and so on.

As a matter of fact, do you feel that the bulletin really will result in more purchases from the private sector or not?

Mr. HUGHES. I do not know that I can answer that question now, Madam Chairman. Our hope for the bulletin is that it will more accurately prescribe the policies of the Federal Government and the procedures through which they are to be achieved.

We do not regard the circular as making any change basically in the policies of the Federal Government in this regard. Rather, we think of it as a clarification of the policies that we have operated under.

The significant changes that it makes are the clearer definition of

cost criteria, the integration of the contracting out or the private purchase part of our Government's activities with the budget process, per se, and we hope a somewhat clearer definition of the criteria under which the Government would make its choices as between in-house activities and dealing with the private sector.

Representative GRIFFITHS. Will it make more facts available to somebody on which to make the decisions as to whether or not you buy in the private sector?

Mr. HUGHES. We think it will. The responsible individual under the terms of the circular is the agency head. The circular spells out criteria for his guidance in carrying out the policies and the procedures that the circular sets forth. We think the cost criteria and the standards generally that are contained in the circular are superior to those that were in the bulletin and will provide him with more precise information upon which to make judgments.

Representative GRIFFITHS. Now that the President has requested that all agencies adopt a budget program by functions, is it not possible, after refining the definition of the functions to identify the common features and bring about a degree of integration where practicable? Is such a plan underway?

Mr. HUGHES. I believe you have reference to the program we have underway to establish a so-called program planning and budgeting system which over a period of years, as we see it, will develop program goals within each agency and facilitate the selection of the best and most efficient means of achieving those goals and then confront the responsible officials of the Government, including the President, with clear choices on a cost and effectiveness basis.

As part of this process, it does seem to me that property management as well as the selection, choosing between Government-performed activities and private-sector activities, that these sorts of choices would be sharpened and made easier.

Representative GRIFFITHS. I was really thinking of your combining services as in the case where we urged the Department of Defense and the GSA to identify common supply and service activities, analyze them and determine then if they could not be combined or integrated. How much of that are you doing or can be done?

Mr. HUGHES. We are just underway with the program planning and budgeting system. I think to my knowledge at this point this type of thing is not being done as a part of that operation.

We are still in the initial stages of this; we are still trying to identify broad program goals and make choices among the alternative procedures for achieving these goals.

We are, however, as a part of our normal budget review activities, interested in the consolidation of functions wherever that is possible and would be doing this sort of thing in that context apart from the program planning and budgeting.

Mr. Seidman just points out, this is a normal management and organization function of the Bureau and we would accordingly be carrying it out.

Representatives GRIFFITHS. Thank you.

Mr. Curtis?

## MANAGEMENT OF HARDWARE AND PAINT

Representative CURTIS. Following up on that, this is something this subcommittee has been trying to stimulate the Bureau of the Budget to become a little more active in and I well recall using or taking a few specific cases.

One was the case of handtools which was finally by arrangement moved from the Department of Defense and put over into GSA.<sup>29</sup>

## BUY AMERICAN ACT

Now we have run into a little difficult problem here where the Buy-American Act is applied by the Defense Department. I think they are using something like a 50-percent additional cost before they will buy outside the United States. The GSA uses a figure, I am not sure, of 7 percent, 6 percent, or 12 percent, but at any rate a much lower figure. This is creating a real problem for this kind of in-house structuring, because obviously the people who sell to the Defense Department, the Defense Supply Agency, are going to want to continue there rather than move it over to the General Service Administration, even though it might be better procured there. (See p. 138, et. seq.)

Now, what is the Bureau of the Budget doing about getting some consistency in this? This does not have to do with whether it is Defense or not; Defense is doing it because of the legitimate concern that has been expressed in regard to our international balance of payments. But if procuring for Defense purposes is to have one standard, for Buy American and another Government agency has another standard, it just is going to create chaos in our procedures.

Has the Bureau of the Budget gone into this, and if so, what are your observations?

Mr. HUGHES. Well, Mr. Curtis, we are aware of this situation and our understanding of the facts of the situation squares entirely with that which you have just outlined.

In short, the Buy American policy within the Defense procurement orbit is different than that with respect to General Services Administration.

This has concerned us as it obviously has you and the subcommittee. We have in all candor been unable to conclude, we the Budget Bureau and we the Administration, have not been able to reach a conclusion as to what should be done.

The dilemma here, I think, is probably quite obvious. We have the 6 percent differential on the one hand, and 50 percent, on the other. Obviously, if the two policies are to be brought into conformity, we need to move one direction or the other, or else find middle ground somewhere in between the two.

Any direction of motion poses some quite serious problems. If we are to liberalize, if that is the right term, the Defense procurement policy, we create for ourselves balance-of-payments problems which are, I think, quite obvious, and at a time when we do not wish to do this.

On the other hand, if we shift from our General Services policy and tighten the criterion there to make it more equal or more nearly

<sup>29</sup> See Report, July 1963, pp. 47-48; see also Report, September 1964, pp. 10-11.

equal to the Defense criterion, we are confronted with the impact of this on our trade negotiations, which are at an important period.

Representative CURTIS. Yes, but whether it is Defense or Government procurement elsewhere, you have the same dilemma. There is no justification at all for different policy. It should be one policy.

The Federal Government has the problem of balance of payments, the Federal Government has the problem of our trade, dealing with trade.

Now, if these were peculiar military items, that might be one thing, but they are not. It is an overall policy. Unless you can tell me there are some peculiarities about the military purchasing that would require a different Buy American interpretation on other Government purchases.

What you have described up to date is a policy that affects any Government procurement.

Mr. HUGHES. I think that is correct, Mr. Curtis.

The dilemma is which direction do we move at this point, and what are the consequences of that movement?

At this point in time we have not to our own satisfaction been able to conclude that a definitive movement away from one policy or the other recognizing the disparity between the two was desirable.

Representative CURTIS. You mean that you would continue to have two different policies? Either one is correct or the other is correct.

Mr. HUGHES. I do not think this is that kind of an issue, Mr. Curtis.

#### EXTRA COST UNDER BUY AMERICAN ACT

Representative CURTIS. Can you tell me why we procure some Government products one way and why we procure others in another way. There might be a difference because of military reasons, but there is not as near as I can see. We are talking about two things, balance of payments and our trade.

I might interject a third one—it is costing us a lot of money to impose the Buy American Act. I think it is around \$70 million in additional costs which the military have undergone as a result of their imposition of Buy American. So there is a third ingredient.

I think about the only thing for me to do is start taking the floor of the House and lambast this thing. It just does not make sense, and if you or anyone in the administration can point out to me any logical reason for having one policy for one arm of Government and another for another, I would be interested. But you have not given me that.

Mr. HUGHES. I think, Mr. Curtis, on the point of costs, your observation is quite correct—either the adoption of either percentage differential involves additional costs to the Government—the higher the percentage the higher the costs. These are considerations in the adjustment of either percentage to establish a common percentage, perhaps somewhere between the two.

The existence of the percentages, though, as you pointed out, as this has been the case over a period of a number of years—

Representative CURTIS. When did the Defense Department begin to apply the 50 percent? I think it was only about a year ago, was it not? Am I in error?



Mr. MULLINS. Longer than that.

Representative CURTIS. What does—

Mr. MULLINS. It was in the summer of 1963—about, I would say, roughly August of 1963.

Representative CURTIS. Yes.

Mr. HUGHES. There have been differentials before that, I believe, Mr. Curtis. I do not have the dates or amounts in mind.

Representative CURTIS. I went into this a little bit with Secretary Ignatius yesterday and at least I satisfied myself for the time being that the power was vested in the executive branch to set these at different levels. But I had never realized that this was so flexible, that one arm of the Government could use 50 percent, another arm could use a 6 percent, and undoubtedly there are probably other departments that might have a different percentage. (See appendixes 2 and 11; also p. 193.)

Do you know whether that is true?

Mr. HUGHES. To the best of my knowledge, Mr. Curtis, there are just the two sets of differentials. I would like to ask Mr. Mullins if he knows of others or if he has comments on that.

#### SAME POLICY FOR SIMILAR ITEMS

Representative GRIFFITHS. I want to ask you, could you not have the same policy for similar items, identical items?

Mr. HUGHES. The range of possibility here is infinite under the statute, Madam Chairman.

As I understand it, the statute is general in its terms and leaves essentially to regulations the establishment of the percentages.

The ones we have are a matter of historical derivation, I think. The problem is to make the best move that we can in present circumstances without doing undue damage either to our balance-of-payments problem or to our trade negotiations, and we in the Bureau—certainly I personally—are unable to do this at this point.

Representative CURTIS. Now, Secretary Ignatius, at least, encouraged me by saying that he was going to look into this right away as far as the handtool situation is concerned because we might just as well give up as far as getting things out of the Defense Supply Agency over to GSA. (See p. 85.)

If we are going to have this kind of thing, of course, American domestic industry will resist every movement, with understanding.

And then you have the Buy-American Act, because it is interpreted differently, impeding the logical organization of procurement between DSA and GSA.

Mr. HUGHES. Mr. Mullins, do you have any comments on either the tool problem or in the general subject?

Mr. MULLINS. Well, I think I might clarify the issue a little bit.

For many years the executive agencies relied only upon what the law provides, the Buy-American Act, and the Buy American Act provides no guidance as to any differential. It merely says that you may make an exception if the costs are unreasonable. So, this became a matter of deciding what was unreasonable.

So then an Executive order was issued which established as a general guideline, a 6-percent differential with the further provision

that if the domestic competitor was either a small business or in a labor surplus area, an additional 6 percent, making a total of 12 percent—

Representative CURTIS. There is where that 12 percent came in?

Mr. MULLINS. Yes; and that applies only if it is either a small business or in a labor surplus area. That is, if the low domestic competitor is in one or both of those two categories.

Representative CURTIS. Yes.

Mr. MULLINS. Now, there are situations of time urgency, or of other special kinds of problems so that the executive order did allow some flexibility. It authorizes the head of an agency to make an exception when he believes that it is either necessary for his program or for some other reason in the national interest.

Representative CURTIS. I think the law says, notwithstanding any other provision of the law, and unless the head of the department or independent establishment concerned shall determine it to be inconsistent to the public interest or the cost to be unreasonable.

Mr. MULLINS. Yes, and then the Executive order goes on beyond that.

#### NEED FOR CONSISTENT POLICY

Representative CURTIS. It goes beyond that.

Well, all I would urge is that the Bureau of the Budget zero in on this thing, because I think we have to have a consistent policy on this, because what we are talking about here, what the Defense Department was talking about was national policy, and this is a national concern as far as the balance of payments is concerned and if it is true there, why, it should be across the board in all our procurement practices.

Mr. HUGHES. Congressman Curtis, I would certainly agree this is an area that does need attention, that the difference here is difficult to rationalize except on pragmatic lines, the ones I have outlined, and we will be struggling with it. (See appendix 11, p. 408.)

#### SURPLUS PROPERTY DISPOSAL

Representative CURTIS. I have been disappointed in the Bureau of the Budget in not being more forceful in bringing the agencies together. This leads me to that other question on the disposal of surplus property.

This committee has been trying to get the GSA and DSA together to work out arrangements where GSA handles that part of the disposal surpluses that are logical and DSA do its job.

My own judgment is that there is very little that DSA needs to do in the disposal area. I understand that the Bureau of the Budget sort of threw up its hands on this, could not get the two agencies together on an agreement, and this is where it sits right now.

Is that true?

Mr. HUGHES. Congressman, as I understand the situation, we have been aware of your interest in this; we have explored rather extensively with GSA and DSA the possibility of achieving economies or greater efficiency through consolidation of their activities or a shift one way or the other.

We are not at the moment convinced that a change from DSA to GSA or vice versa, for that matter, would produce savings. So far as we know, the two agencies themselves are dubious, at least about the possibility of savings.

We have asked them to indicate to us, in support of any proposed shift, whether savings are possible and it is at this point that the matter rests.

Now, in short, we are not convinced that savings will accrue from any change in the existing arrangements.

#### "PUNKIN FUND"

Representative CURTIS. Are you aware of what has been called the "punkin' fund"?

Mr. HUGHES. Yes, sir; in general terms, I think so.

Representative CURTIS. Do you not think, with that in existence, it would be most unusual if the DSA would ever feel that there were any efficiencies in having this or any part of it transferred over to the GSA. Why would not the Bureau of the Budget at least move in to put some controls over this so-called use of the "punkin' fund"?

Mr. HUGHES. Well, I think they are two separable questions as you have suggested, Mr. Curtis.

The financing of DSA via this fund is certainly a departure from, let us say, orthodox financing arrangements by appropriation.

Representative CURTIS. That is a nice way of describing it. [Laughter.]

Mr. HUGHES. It, I think, is probably justified by its defenders and I am not at this point one of them. It is justified by its defenders as an incentive device under which some of the fruits of property disposal accrue to those who manage it and thereby you gain a measure of—they gain a measure of encouragement and incentive.

#### INCREASED COSTS OF DISPOSAL

Representative CURTIS. So you say. I do not know whether you are familiar with the figures, but ever since that technique was developed, the costs of disposal have gone way up. Here it is on page 40 of this document we published in March of 1966. The total of the cost of disposing of this property was \$42.5 million in 1958; and 1959, \$58.3 million; but then the "punkin' fund" comes in and all of a sudden the costs go up to \$78 million in 1961; and in the succeeding years \$84 million, \$72 million, \$77 million, and \$78 million.

The amount of disposed property does not justify those increases. So it looks like we did not end up with efficiency as a result of this.

Mr. HUGHES. Well, two considerations, Mr. Curtis:

My understanding is that some of the more recent figures do show a measure of improvement, but we will—I would like the opportunity if we could, to match up our figures with yours and present for the record either confirmation of your results or alternate figures which may be as I believe they are at this point. (See p. 193.)

There remains, I think, the question of whether an arrangement of this sort does lend some measure of encouragement to disposal. I think we raise—

Representative CURTIS. That is the other end—to encourage them to actually get property that should be disposed of over into that category as opposed to what I have been discussing, the efficiency of actually disposing of it?

Mr. HUGHES. That is right.

Representative CURTIS. I would relate them really to the efficiency of disposing rather than constantly gleaning over their inventories to get property that should be disposed of.

Mr. HUGHES. This is the point, Mr. Curtis.

Again, I am somewhat in the role of a defender of this procedure and I would like to avoid that role institutionally, if not otherwise, but these are the considerations here and we do intend to pursue this matter.

(The Bureau of the Budget later supplied the following information:)

There is no difference in the basic cost data in the subcommittee's possession and the figures in our possession. It is also true that the trend has been upward in recent years in terms of total dollars spent for utilization and disposal work. However, the amount spent should be evaluated on the basis of the volume of work performed and the results achieved. Total utilization and disposal costs as related to the volume of proceeds received were lower in 1965 than in 1964 and also slightly lower than in 1963. Performance during the first half of fiscal year 1966 is slightly better than in fiscal year 1965.

In analyzing these figures, it should be understood that only a small portion of the costs are incurred in selling surplus property. Most of the costs are incurred for the physical handling of the property, including demilitarization of equipment, sorting and processing of scrap, arranging property into lots for sale, storage, transportation, etc. These operations, which account for more than 80 percent of all costs financed from proceeds are performed in military bases and are not involved in the selling operations which were, at one time, considered for possible transfer to GSA. There has been improvement in the years since DSA assumed responsibility for the sales program in the costs of actual sales operations as related to the proceeds being received, as indicated in the last column of the following table:

[Dollar amounts in millions]

Fiscal year:	Total expense of all utilization and disposal activities financed from proceeds	Total proceeds received	Percent total costs to proceeds	Cost of surplus sales operations	Percent cost of sales operations to proceeds received
1962.....	\$77.9	\$144.7	54.0	\$16.5	11.4
1963.....	74.5	109.9	67.8	16.9	15.4
1964.....	80.5	111.4	72.3	15.5	13.9
1965.....	81.7	121.1	67.6	14.0	11.6
1st half 1966.....	59.3	91.0	65.2	10.2	11.2

Representative GRIFFITHS. Will you yield?

Representative CURTIS. Yes, I will yield.

#### VARIATION OF POLICIES UNDER BUY AMERICAN ACT

Representative GRIFFITHS. How many different policies of purchase could we have had if the Buy American plan worked out exactly as the law is written, if you let every agency, every department head decide? Did anybody ever figure it out? It must be an unlimited number.

Mr. HUGHES. Mr. Mullins.

Mr. MULLINS. There is a rather pragmatic answer, I think, since for some years that is exactly what did happen. There was an informal understanding among agencies so that for quite a number of years before the Executive order was issued I believe most agencies used a differential of right around 20—I think a 25-percent differential.

Now, they made exceptions, but there was a gradual accommodation among agencies, I might say, rather of an informal nature, with no central Executive order until, I believe, the Executive Order 10582 which governs this matter was issued sometime in the 1950's—1954—that was the first time that there ever was any central guidance on what would be a proper percentage of differential. (See appendix 2, p. 217.)

And then, of course, even that provided flexibility, as we know.

Representative GRIFFITHS. The act should be amended, we ought to take back this power. Change it. It certainly is poorly drafted, I must say.

Thank you very much, Mr. Curtis.

Mr. HUGHES. Just as a speculation, Madam Chairman, I wonder if the language of the act does not reflect somewhat the difficulty of the problem.

Representative GRIFFITHS. I am sure—obviously, it is a tremendous problem.

Representative CURTIS. We have our own little Smoot-Hawley tariff.

#### APPLICATION OF CIRCULAR A-76

I will probably continue to have questions, of course, on Circular A-76 as it develops. I had one particular one that I asked Mr. Staats this morning. I will just read it here, because it is posed by a specific question:

Do Government-owned, contractor-operated facilities come under your definition of your commercial-industrial activity?

I will turn this over to you as a specific. Where a private concern apparently is in competition with another private contractor, but the other private contractor is using Government-owned facilities, does that come under your definition here in A-76?

Mr. HUGHES. The short answer to your question, Mr. Curtis, is that Government-owned, contractor-operated facilities do not.

Representative CURTIS. Do not?

Mr. HUGHES. Do not come under the provisions of the circular.

I believe Mr. Mullins can probably help you with some of the specifics in this.

Mr. MULLINS. I believe I am familiar with the case you have in mind.

It is true that as the circular is written a Government-owned, contractor-operated plant is not considered as a Government activity. However, all that we intended to say there is that just ownership alone, absent any action or service, is not a problem of competition with private enterprise. We are taking the position that even if there is no competition or private enterprise question whatsoever, or even if it is not a commercial activity, the Government should not own a facility unless it has to.

Representative CURTIS. Yes.

Mr. MULLINS. In other words, we need to make a distinction between the problem of competition in commercial-industrial activities

and the problem of unnecessary ownership. We ought to be hitting the unnecessary ownership regardless of whether it is a commercial-industrial activity. That should not make any difference at all.

Representative CURTIS (presiding). I see your distinction and I agree with that. I do think you go on to say that where you can see for some reason or other the Government military installation might need to have a standby installation, they would continue to own it. I imagine that could happen, although that would be the contract to utilize that would be subject to competitive bids, so that would be where that would come in.

This specific case does not involve this. This specific case, as I judge it, would probably be a Government facility that we should not be owning, or at least I would guess it. I do not know that.

I will supply this specific case for your consideration.

Mr. MULLINS. I am quite sure it is the same one that I have had—

Representative CURTIS. It probably is. There is no secret about it. The company called it to my attention and is the Union Carbide Corp., is that the same one?

Mr. MULLINS. Yes.

Representative CURTIS. And the major supplier of—and I cannot even pronounce it—cryogenic propellants to the Government. Apparently there is a Government facility at Mims, Fla. The question that comes to my mind is how would you in lieu of taxes, for example, be figured there? The Government facility would not be paying taxes, probably, local taxes, and probably the cost therefore to the contractor who uses that facility would be lower than if he had to construct his own plant and equipment and then pay local taxes on it.

Mr. MULLINS. Yes. In this case you had one concern competing on the basis of using a Government-owned plant.

Representative CURTIS. Yes, that is right.

Mr. MULLINS. And their bid is based upon that premise.

The other one has its own plant but would like to use part of the Government's plant, too.

Representative CURTIS. To equalize the competitive aspect, as I understand it.

Mr. MULLINS. Because his own plant does not have quite as much capacity as he would require.

Representative CURTIS. I see, yes.

Mr. MULLINS. I believe our offhand view on this particular case was that this was not a case of Government versus private enterprise, rather this is a case of two very aggressive private enterprises trying to get some Government business.

Representative CURTIS. That is true. But you do get into the same problem when you get your Government facilities and that is why I think it becomes important.

Does the circular apply only to new activities or does it also cover existing ones?

Mr. HUGHES. It covers existing as well as new activities.

#### ROLE OF BOB EXAMINERS IN ENFORCING POLICY

Representative CURTIS. Well, then, on that, have the Bureau of the Budget examiners been instructed to require agencies to justify all

commercial-industrial activities pursuant to the new policy and if so, what are these instructions?

I am talking about the existing ones now.

#### EXAMINERS EXPECTED TO EXAMINE IN-HOUSE ACTIVITIES

Mr. HUGHES. The examiners, Mr. Curtis, would be expected in the course of their normal activity as Budget examiners to examine contracting-out activities, the services purchased from private businesses as well as Government-performed services, and to review them from the standpoint of the newly issued circular.

Our forthcoming budget on which we are now working will reflect these reviews by the examiners in the course of their normal responsibilities.

#### AGENCY HEAD BASICALLY RESPONSIBLE

Representative CURTIS. Well now, will the BOB be policing this itself, or are you going to just require the agencies to review themselves and report?

Mr. HUGHES. The basic responsibility is a part of the program administration responsibility which rests on the agency head. However, one of the features of the new circular, one of the differences between it and the bulletin 60-2 is the effort that we have made in the circular to integrate the activities that it covers with the normal budget review process and the examiners will be expected to police the circular, if you will, in the course of their review of agency budgets and of budget exclusion as the most proper procedure.

#### NO PRESENT INVENTORY OF COMMERCIAL-INDUSTRIAL ACTIVITIES

Representative CURTIS. Have you provided or compiled a list of the commercial-industrial activities that might be reviewed under this new policy?

Mr. HUGHES. So far as I know, there is no new inventory yet. The agencies are to prepare an inventory within their respective areas and maintain that inventory on a current basis.

Representative CURTIS. That is something, of course, this committee will watch with great interest as this develops. I am very pleased that the circular is now out, and as it was pointed out by Mr. Staats this morning that this has Presidential backing.

The other 60-2 was issued by the Bureau of the Budget without a Presidential directive, as he explained it, and that the President actually issued his own comments on this, too.

#### PX'S AND COMMISSARIES NOT COVERED BY A-76

Are the PX's and the commissaries included in this A-76, would you say?

Mr. HUGHES. They are not.

Representative CURTIS. Why not?

Mr. HUGHES. Mr. Mullins?

Mr. MULLINS. They have been excluded on the ground that they do not provide a service to the Government; it is a service to employees, to people who are not in the Government. (See p. 44; see also appendix 1, p. 203.)

Representative CURTIS. Have you got any other exceptions like this? [Laughter.]

I will have to absorb that a bit. At first blush, that is a pretty lame excuse. You could get Government into all aspects of things under that kind of an operation. I am shocked. You can get Government into housing, you can get it—well, there is just no end to the thing.

Let me ask, maybe we better go back to the other, how was it under 60-2, and is that still in effect?

Mr. MULLINS. No, it is not, but it provided the same thing. Neither this circular nor the bulletin has ever had any bearing on commissaries or PX's.

Representative CURTIS. We have a directive on the commissaries. What was the directive the Secretary of Defense put out. That was under appropriation language.

Mr. HUGHES. My recollection is he had a little problem with it, did he not?

Representative CURTIS. In my judgment, it never was enforced; in fact, it was openly violated. After considerable work had been done to try and get good standards in there, the thing was just frankly violated and that is the situation today.

We will be following this, and possibly on this and other areas we may submit written questions which would be in the record. (See appendix 11, p. 406.)

I want to get to Federal real property. I am very much pleased with this development report.

Another subcommittee of the Joint Economic Committee, namely, the Subcommittee on Economic Statistics, held hearings last year on the study that the George Washington University had put out on "Measuring the Nation's Wealth." In this they tried to figure out what our inventory is in this area of real property, as well as the other properties. I also know the Government Operations Committee of the House developed inventories of Government property over a period of years but has discontinued them.

Mr. MULLINS. However, GSA still puts out such a report.<sup>30</sup>

Representative CURTIS. Do you think we have a fairly comprehensive inventory of real property holdings that we can work with?

Mr. MULLINS. Each year since 1954 there has been published a report which showed the real property holdings of the Federal Government.

At first, I believe that was a report prepared by GSA and submitted to the Senate Committee on Appropriations. Later, the House Committee on Government Operations took the position that it should not be limited to real property, so using the data that GSA prepared, augmented with data on personal property supplied by the Treasury Department and other parts of the Government, the House Committee on Government Operations put out each year, until this last year, a report that showed all of the assets of the Government, personal and real, not only personal property but also cash, accounts receivable, everything that you could call an asset.

Representative CURTIS. Yes.

<sup>30</sup> See Staff Materials, 1966, pp. 8-15.



Mr. MULLINS. Now, that report was discontinued, as I say. This is the first year that we have not had it, but the real property portion of it was carried on by GSA and that report for the last year, the one ending last July 1, is due momentarily, any day.

Representative CURTIS. The reports of the committee, as I read them each time, would say that they were just still trying to get on top of the whole thing and that there were many really blank areas in this, particularly when it came to the values to place on some of these assets, real estate and so on.

#### PAYMENTS "IN LIEU OF TAXES"

Well, what I was leading up to is this: We have got a diversity of ways of handling this problem of in lieu of local property taxes. Of course, State taxes also, but I am mainly concerned about property taxes.

I know we have by law some property, real property, that was formerly in RFC that carries with it a provision of how the payment in lieu of taxes shall be made.

Mr. Ward has told me that the U.S. Forest Service, in effect, pays in lieu of taxes through a 25-percent return, I guess, on their timber sales and other receipts.

Mr. HUGHES. Shared revenue arrangements.

Representative CURTIS. I dare say there are all sorts of different techniques throughout Government. I was wondering whether the Bureau of the Budget might not undertake to make a review of all these various methods. Maybe you already have, particularly in lieu of the 10-percent figure that you have now put in this A-76 when you relate it to the problem of Government in competition.

First, let me ask you, has the Bureau of the Budget a comprehensive review of this problem?

Mr. HUGHES. We do not, Mr. Curtis. We are aware of the diversity of arrangements which you have mentioned. There are a variety of them contained in a whole panorama of statutes each for a particular program or resource purpose.

As far as I am aware, the RFC arrangement which you mentioned is the most direct of these and grew out of the technique and the somewhat technical activities of the Reconstruction Finance Corporation.

In years past and as far as I recall, it has been a number of years since, we have worked on the general subject of payments in lieu of taxes and in an endeavor to develop a satisfactory statute—satisfactory both in terms of the executive branch needs and in terms of the possibility of enactment.

We have not made it; I am not aware of any very recent activity, but let me check with my colleague.

Mr. SEIDMAN. My recollection is quite some years ago we did make a thorough review and worked and developed legislation which the then-Senator Humphrey introduced in the Congress, but it was not enacted.

Representative CURTIS. Could you supply that?

Mr. SEIDMAN. I want to check my recollection. This has been about 10 years ago.

Representative CURTIS. I was going to ask if you would expand on this for the record and give us all dates, because I would like to get to it.

I would think this would be a very valuable tool in real property management if you had an in lieu of local taxes. I would think it would be very good accounting procedure in encouraging governmental agencies to get rid of unneeded real estate if they have to be paying out of their current funds in lieu of taxes. It also would be a method of encouraging them to use less valuable real estate locations which would serve their needs rather than the more valuable. I think more of them as a real property management tool, plus, of course, this would be a great way of getting money back into the communities for financing schools, streets, sewers, and the kind of things that we have the Federal Government doing in a direct way. This would possibly be a very beneficial way of doing it.

Mr. HUGHES. Yes, this is a desirable aspect of this kind of a proposal.

One of the problems with solving this problem is the difficulty of coordinating it and integrating it with the wide variety of arrangements that have developed over the years instead of payments in lieu of taxes.

I guess the best known and perhaps in some ways the most extensive is the so-called impacted areas program.

Representative CURTIS. That's right. That started out on that theory of in lieu of taxes and then we got off base and into another theory. But it started out just as you say.

I am interested in the RFC formula. I am curious to know how that might have worked. You do have—you are concerned with all sorts of different local taxing groups with different assessed—

Mr. HUGHES. Different rates and assessments and assessment policies.

Representative CURTIS. That is why I thought maybe the RFC formula, if it has worked well, might be the kind that we could use throughout the Federal Government, but I do not know.

Mr. SEIDMAN. Mr. Curtis, I might say the RFC formula did raise problems; that was not a payment in lieu of taxes, that property was subject to direct local taxation. We found differences; for example, Pennsylvania included the buildings and structures as well as the real property as part of it. Other jurisdictions did not and it created some quite serious problems of discrepancies from one jurisdiction to another.

The intention there was to limit it to the taxation of the real property.

Representative CURTIS. And not the buildings?

Mr. SEIDMAN. Not the buildings.

Representative CURTIS. I think that so long as Uncle Sam is not made a particular target and everyone in the community—by "everyone in the community" I mean other businesses, owners of real estate—meet the same formulas then, there is this divergency of real estate taxes. It is probably a perfectly healthy thing that there is a divergency.

But to the extent you can supply to the record what has been done and any comments you would like to make on this, I would appreciate it.

Mr. HUGHES. All right, sir, we certainly will. (See p. 409.)  
(Information furnished subsequently by the Department follows:)

There is no general legislation providing for payments of taxes or payments in lieu of taxes on Federal property. However, statutes provide for payments under a variety of specific circumstances.

The properties formerly controlled by the RFC were subject to taxation and such payments are continuing although the RFC has been liquidated and former RFC properties remaining in the Federal inventory are now managed and controlled by the GSA and the DOD.

Payments made for assistance to schools in federally affected areas are not, strictly speaking, payments in lieu of taxes on Federal property since the amounts paid are not directly related to the value of the Federal property involved but are related to the number of pupils attending schools whose parents are employed in Federal programs.

There is also a wide variety of shared revenue payments under which portions of funds received by the Federal Government for specific products or services it renders are paid to State or local government bodies. Following is a listing of these arrangements:

National forests and grassland funds.

Payments to States under the Flood Control Act of 1954.

Payments to States and counties from grazing receipts, grasslands, and sales of public lands.

Payments to Klamath area, Arizona and Nevada.

Coos and Douglas Counties, Oreg., shared revenues.

Mineral Leasing Act payments.

Payments to Alaska from Pribilof Island fund.

Wildlife refuge fund and grassland payments.

Federal Power Commission payments to States.

Tennessee Valley Authority payments in lieu of taxes.

Internal Revenue collections, Virgin Islands.

Tax collections for Puerto Rico.

Bureau of Customs: Refunds, transfers, and expenses of operation, Puerto Rico and the Virgin Islands.

In addition to these types of arrangements, the Atomic Energy Commission has discretionary authority to make payments. Payments also are made under various Government programs for property acquired as security for defaulted loans.

Although there is no general legislation for payments of taxes or amounts in lieu of taxes on federally owned property, this subject has received a great deal of attention during the past 25 years. On April 19 and 20, 1956, the Senate Committee on Government Operations held hearings on seven bills relating to payments of taxes or in lieu of taxes but no legislation was enacted. However, during the 86th Congress, the Senate passed a bill, S. 910, which would have provided for a general program of payments in lieu of taxes. On May 25, 1960, the House Committee on Interior and Insular Affairs held hearings on this bill. There have been no hearings on general legislation of this type since 1960.

(The Senate report on S. 910 (S. Rept. No. 869, 86th Cong., 1st sess.), provides a more detailed historical background on this subject. A copy of that report is in the files of the subcommittee.)

Representative CURTIS. A point that has been called to my attention is that the committee has these instances of allegedly unnecessary retention of high value land. One of them is Fort Gordon in Georgia, and the slowness, shall we say, of the agency concerned to do something about it.<sup>31</sup> (See also appendix 7, p. 302.)

Question. What can the Bureau of the Budget do or what does the Bureau of the Budget do toward bringing these matters to a head so that they are not delayed?

Mr. HUGHES. Well, as Mr. Mullins, I think, in his answer to an earlier question indicated, there is a separate circular with respect to

<sup>31</sup> See synopses of GAO reports in "Staff Materials, 1966", pp. 78 and 84.

property holdings, Circular A-2, which spells out the criteria and standards under which property shall be retained or disposed. (See p. 185.)

With respect to the specific situations which you have in mind, we would be glad to look into them and see—

Representative CURTIS. Let us supply those to you and then make your comments in the record, if you would, please.

Mr. HUGHES. We will be glad to do that.

Representative CURTIS. We can use these as examples to give us how the overall policy operates.

(The following material was later supplied by the Bureau of the Budget:)

The Bureau of the Budget was advised informally that comments were requested concerning property at Fort Gordon, Ga., and at Fort De Russy, Hawaii, which the Comptroller General recommended for disposal on the ground that it was not needed by the Department of Defense. (C.G. reports dated Apr. 22, 1965, B-146988 and Apr. 28, 1965, B-135295.)

The property at Fort Gordon, Ga., is a portion of a 344-acre tract purchased in 1942. The property included a hotel which was converted to a hospital. In 1950, the hospital was discontinued and transferred to the VA. Other parts of the land were reported excess and disposed of except for 258 acres for which Fort Gordon is accountable. The property includes 30 buildings, and a golf course, and its predominant use is for recreational purposes except for some of the buildings used as Army Reserve units, an Army Intelligence unit, housing and miscellaneous purposes. The Comptroller General recommended immediate disposal of the property on the ground that other golf courses and recreational facilities were available in the Augusta area, that space was available for construction of an 18-hole golf course in Fort Gordon if needed, and that the miscellaneous activities could be housed elsewhere.

The Department of Defense agreed that the recreational and other activities on the 258 tract could be transferred and action was initiated to relocate the intelligence and Reserve units and to report as excess a 12-acre portion of the property. However, the Department did not agree to immediate disposal of the land used for a golf course and other recreational purposes until adequate substitute facilities could be completed on other available land at Fort Gordon. The Department indicated plans for construction of such facilities using non-appropriated funds and estimated that work could be completed some time in 1968.

The property at Fort De Russy, Hawaii, is located in the beach and resort area of Waikiki and is used primarily as a recreation center for armed services personnel. A small portion is used for training of Reserve personnel and for housing. The Comptroller General recommended that the entire property should be disposed of on the ground that adequate recreational facilities are available elsewhere on the island and that other activities could be transferred in order to make the valuable property in Fort De Russy available for disposal.

The DOD response to the Comptroller General's report was held in abeyance until completion of a study of the utilization and retention of all military installations in the State of Hawaii. That study was completed and on March 22, 1966, the Department advised the Comptroller General that Fort De Russy would be retained because the recreational facilities and housing are needed for armed services personnel. A decision concerning possible relocation of Reserve training activities is deferred pending completion of organizational changes in Army Reserve structure.

The Bureau of the Budget has not conducted independent studies of the properties at Fort Gordon and Fort De Russy. We have conducted a general review in some of the principal agencies to determine whether the policy guidelines and procedures provided in Budget Circular No. A-2 should be revised and have found that agencies generally are conducting regular reviews of their real property holdings. The Department of Defense, in particular, has carried on an aggressive and effective program of identifying and reporting as excess its bases and parts of bases which are not required. However, as a result of our study, we have concluded that stronger guidelines are needed and the circular is being redrafted.

Representative CURTIS. Without objection, all relevant letters, statements, and other material may be inserted in the record of the hearings and members may submit such questions as they deem appropriate for the witnesses for answers. (See app. 11, p. 393.)

Very good, and thank you very much for very helpful testimony.

Mr. HUGHES. Thank you very much, Congressman Curtis.

Representative CURTIS. The subcommittee is adjourned.

(Whereupon, at 3:55 p.m., the hearing was adjourned, to reconvene at the call of the Chair.)

# APPENDIXES

## APPENDIX 1

### POLICY FOR ACQUIRING PRODUCTS AND SERVICES FOR GOVERNMENT USE

EXECUTIVE OFFICE OF THE PRESIDENT,  
BUREAU OF THE BUDGET,  
*Washington, D.C., March 3, 1966.*

#### CIRCULAR No. A-76

To: The heads of executive departments and establishments.  
Subject: Policies for acquiring commercial or industrial products and services for Government use.

#### 1. PURPOSE

This circular replaces the statement of policy which was set forth in Bureau of the Budget Bulletin No. 60-2 dated September 21, 1959. It restates the guidelines and procedures to be applied by executive agencies in determining whether commercial and industrial products and services used by the Government are to be provided by private suppliers or by the Government itself. It is issued pursuant to the President's memorandum of March 3, 1966, to the heads of departments and agencies. (See p. 208.)

#### 2. POLICY

The guidelines in this circular are in furtherance of the Government's general policy of relying on the private enterprise system to supply its needs.

In some instances, however, it is in the national interest for the Government to provide directly the products and services it uses. These circumstances are set forth in paragraph 5 of this circular.

No executive agency will initiate a "new start" or continue the operation of an existing "Government commercial or industrial activity" except as specifically required by law or as provided in this circular.

#### 3. DEFINITIONS

For purposes of this circular:

(a) A "new start" is a newly established Government commercial or industrial activity or a reactivation, expansion, modernization, or replacement of such an activity involving additional capital investment of \$25,000 or more or additional annual costs of production of \$50,000 or more. Consolidation of two or more activities without increasing the overall total amount of products or services provided is not a "new start."

(b) A Government commercial or industrial activity is one which is operated and managed by an executive agency and which provides for the Government's own use a product or service that is obtainable from a private source.

(c) A private commercial source is a private business concern which provides a commercial or industrial product or service required by agencies and which is located in the United States, its territories, and possessions, the District of Columbia, or the Commonwealth of Puerto Rico.

#### 4. SCOPE

This circular is applicable to commercial and industrial products and services used by executive agencies, except that it—

(a) Will not be used as authority to enter into contracts if such authority does not otherwise exist nor will it be used to justify departure from any law or regu-

lation, including regulations of the Civil Service Commission or other appropriate authority, nor will it be used for the purpose of avoiding established salary or personnel limitations.

(b) Does not alter the existing requirement that executive agencies will perform for themselves those basic functions of management which they must perform in order to retain essential control over the conduct of their programs. These functions include selection and direction of Government employees, assignment of organizational responsibilities, planning of programs, establishment of performance goals and priorities, and evaluation of performance.

(c) Does not apply to professional staff and managerial advisory services such as those normally provided by an office of general counsel, a management and organization staff, or a systems analysis unit. Advisory assistance in areas such as these may be provided either by Government staff organizations or from private sources as deemed appropriate by executive agencies.

(d) Does not apply to products or services which are provided to the public (But an executive agency which provides a product or service to the public should apply the provisions of this circular with respect to any commercial or industrial products or services which it uses.)

(e) Does not apply to products or services obtained from other Federal agencies which are authorized or required by law to furnish them.

(f) Should not be applied when its application would be inconsistent with the terms of any treaty or international agreement.

#### 5. CIRCUMSTANCES UNDER WHICH THE GOVERNMENT MAY PROVIDE A COMMERCIAL OR INDUSTRIAL PRODUCT OR SERVICE FOR ITS OWN USE

A Government commercial or industrial activity may be authorized only under one or more of the following conditions:

(a) Procurement of a product or service from a commercial source would disrupt or materially delay an agency's program. The fact that a commercial or industrial activity is classified or is related to an agency's basic program is not an adequate reason for starting or continuing a Government activity, but a Government agency may provide a product or service for its own use if a review conducted and documented as provided in paragraph 7 establishes that reliance upon a commercial source will disrupt or materially delay the successful accomplishment of its program.

(b) It is necessary for the Government to conduct a commercial or industrial activity for purposes of combat support or for individual and unit retraining of military personnel or to maintain or strengthen mobilization readiness.

(c) A satisfactory commercial source is not available and cannot be developed in time to provide a product or service when it is needed. Agencies' efforts to find satisfactory commercial sources should be supplemented as appropriate by obtaining assistance from the General Services and Small Business Administrations or the Business and Defense Services Administration. Urgency of a requirement is not an adequate reason for starting or continuing a Government commercial or industrial activity unless there is evidence that commercial sources are not able and the Government is able to provide a product or service when needed.

(d) The product or service is available from another Federal agency. Excess property available from other Federal agencies should be used in preference to new procurement as provided by the Federal Property and Administrative Services Act of 1949, and related regulations.

Property which has not been reported excess also may be provided by other Federal agencies and unused plant and production capacity of other agencies may be utilized. In such instances, the agency supplying a product or service to another agency is responsible for compliance with this circular. The fact that a product or service is being provided to another agency does not by itself justify a Government commercial or industrial activity.

(e) Procurement of the product or service from a commercial source will result in higher cost to the Government. A Government commercial activity may be authorized if a comparative cost analysis prepared as provided in this circular indicates that the Government can provide or is providing a product or service at a cost lower than if the product or service were obtained from commercial sources.

However, disadvantages of starting or continuing Government activities must be carefully weighed. Government ownership and operation of facilities usually involve removal or withholding of property from tax rolls, reduction of revenues from income and other taxes, and diversion of management attention from the Government's primary program objectives. Losses also may occur due to such factors as obsolescence of plant and equipment and unanticipated reductions in the Government's requirements for a product or service. Government commercial activities should not be started or continued for reasons involving comparative costs unless savings are sufficient to justify the assumption of these and similar risks and uncertainties.

#### 6. COST COMPARISONS

A decision to rely upon a Government activity for reasons involving relative costs must be supported by a comparative cost analysis which will disclose as accurately as possible the difference between the costs which the Government is incurring or will incur under each alternative.

Commercial sources should be relied upon without incurring the delay and expense of conducting cost comparison studies for products or services estimated to cost the Government less than \$50,000 per year. However, if there is reason to believe that inadequate competition or other factors are causing commercial prices to be unreasonable, a cost comparison study will be directed by the agency head or by his designee even if it is estimated that the Government will spend less than \$50,000 per year for the product or service. A Government activity should not be authorized on the basis of such a comparison study, however, unless reasonable efforts to obtain satisfactory prices from existing commercial sources or to develop other commercial sources are unsuccessful.

Cost comparison studies also should be made before deciding to rely upon a commercial source when terms of contracts will cause the Government to finance directly or indirectly more than \$50,000 for costs of facilities and equipment to be constructed to Government specifications.

(a) Costs of obtaining products or services from commercial sources should include amounts paid directly to suppliers, transportation charges, and expenses of preparing bid invitations, evaluating bids, and negotiating, awarding, and managing contracts. Costs of materials furnished by the Government to contractors, appropriate charges for Government-owned equipment and facilities used by contractors, and costs due to incentive or premium provisions in contracts also should be included. If discontinuance of a Government commercial or industrial activity will cause a facility being retained by the Government for mobilization or other reasons to be placed in a standby status, the costs of preparing and maintaining the facility as standby also should be included. Costs of obtaining products or services from commercial sources should be documented and organized for comparison with costs of obtaining the product or service from a Government activity.

(b) Costs of obtaining products or services from Government activities should include all costs which would be incurred if a product or service were provided by the Government and which would not be incurred if the product or service were obtained from a commercial source. Under this general principle, the following costs should be included, considering the circumstances of each case:

(1) Personal services and benefits: Include costs of all elements of compensation and allowances for both military and civilian personnel, including costs of retirement for uniformed personnel, contributions to civilian retirement funds (or for social security taxes where applicable), employees' insurance, health, and medical plans (including services available from Government military or civilian medical facilities), living allowances, uniforms, leave, termination and separation allowances, travel and moving expenses, and claims paid through the Bureau of Employees' Compensation.

(2) Materials, supplies, and utilities services: Include costs of supplies and materials used in providing a product or service and costs of transportation, storage, handling, custody, and protection of property, and costs of electric power, gas, water, and communications services.

(3) Maintenance and repair: Include costs of maintaining and repairing structures and equipment which are used in providing a product or service.

(4) Damage or loss of property: Include costs of uninsured losses due to fire or other hazard, costs of insurance premiums, and costs of settling loss and damage claims.



(5) Federal taxes: Include income and other Federal tax revenues (except social security taxes) received from corporations or other business entities (but not from individual stockholders) if a product or service is obtained through commercial channels. Estimates of corporate incomes for these purposes should be based upon the earnings experience of the industry, if available, but if such data are not available, "The Quarterly Financial Report of Manufacturing Corporations," published by the Federal Trade Commission and the Securities and Exchange Commission may be consulted. Assistance of the appropriate Government regulatory agencies may be obtained in estimating taxes for regulated industries.

(6) Depreciation: Compute depreciation as a cost for any new or additional facilities or equipment which will be required if a Government activity is started or continued. Depreciation will not be allocated for facilities and equipment acquired by the Government before the cost comparison study is started. However, if reliance upon a commercial source will cause Government-owned equipment or facilities to become available for other Federal use or for disposal as surplus, the cost comparison analysis should include as a cost of the Government activity, an appropriate amount based upon the estimated current market value of such equipment or facilities. The Internal Revenue Service publication, "Depreciation; Guidelines and Rules" may be used in computing depreciation. However, rates contained in this publication are maximums to be used only for reference purposes and only when more specific depreciation data are not available. Accelerated depreciation rates permitted in some instances by the Internal Revenue Service will not be used.

(7) Interest: Compute interest for any new or additional capital to be invested based upon the current rate for long-term Treasury obligations for capital items having a useful life of 15 years or more and upon the average rate of return on Treasury obligations for items having a useful life of less than 15 years. Yield rates reported in the current issue of the "Treasury Bulletin" will be used in these computations regardless of any rates of interest which may be used by the agency for other purposes.

(8) Indirect costs: Include any additional indirect costs incurred by the agency resulting from a Government activity for such activities as management and supervision, budgeting, accounting, personnel, legal, and other applicable services.

#### 7. ADMINISTERING THE POLICY

##### (a) *Inventory*

Each agency will compile and maintain an inventory of its commercial or industrial activities having an annual output of products or services costing \$50,000 or more or a capital investment of \$25,000 or more. In addition to such general descriptive information as may be appropriate, the inventory should include for each activity the amount of the Government's capital investment, the amount paid annually for the products or services involved, and the basis upon which the activity is being continued under the provisions of this circular. The general descriptive information needed for identifying each activity should be included in the inventory by June 30, 1966. Other information needed to complete the inventory should be added as reviews required in paragraphs 7b and c are completed.

##### (b) *"New starts"*

(1) A "new start" should not be initiated until possibilities of obtaining the product or service from commercial sources have been explored and not until it is approved by the agency head or by an assistant secretary or official of equivalent rank on the basis of factual justification for establishing the activity under the provisions of this circular.

(2) If statutory authority and funds for construction are required before a "new start" can be initiated, the actions to be taken under this circular should be completed before the agency's budget request is submitted to the Bureau of the Budget. Instructions concerning data to be submitted in support of such budget requests will be included in annual revisions of Bureau of the Budget Circular No. A-11.

(3) A "new start" should not be proposed for reasons involving comparative costs unless savings are sufficient to outweigh uncertainties and risks of unanticipated losses involved in Government activities.

The amount of savings required as justification for a "new start" will vary depending on individual circumstances. Substantial savings should be required as justification if a large new or additional capital investment is involved or if there are possibilities of early obsolescence or uncertainties regarding maintenance and production costs, prices and future Government requirements. Justification may be based on smaller anticipated savings if little or no capital investment is involved, if chances for obsolescence are minimal, and if reliable information is available concerning production costs, commercial prices and Government requirements. While no precise standard is prescribed in view of these varying circumstances a "new start" ordinarily should not be approved unless costs of a Government activity will be at least 10 percent less than costs of obtaining the product or service from commercial sources.

A decision to reject a proposed "new start" for comparative cost reasons should be reconsidered if actual bids or proposals indicate that commercial prices will be higher than were estimated in the cost comparison study.

(4) When a "new start" begins to operate it should be included in an agency's inventory of commercial and industrial activities.

(c) *Existing Government activities*

(1) A systematic review of existing commercial or industrial activities (including previously approved "new starts" which have been in operation for at least 18 months) should be maintained in each agency under the direction of the agency head or the person designated by him as provided in paragraph 8. The agency head or his designee may exempt designated activities if he decides that such reviews are not warranted in specific instances. Activities not so exempted should be reviewed at least once before June 30, 1968. More frequent reviews of selected activities should be scheduled as deemed advisable. Activities remaining in the inventory after June 30, 1968, should be scheduled for at least one additional followup review during each 3-year period but this requirement may be waived by the agency head or his designee if he concludes that such further review is not warranted.

(2) Reviews should be organized in such a manner as to ascertain whether continued operation of Government commercial activities is in accordance with the provisions of this circular. Reviews should include information concerning availability from commercial sources of products or services involved and feasibility of using commercial sources in lieu of existing Government activities.

(3) An activity should be continued for reasons of comparative costs only if a comparative cost analysis indicates that savings resulting from continuation of the activity are at least sufficient to outweigh the disadvantages of Government commercial and industrial activities. No specific standard or guideline is prescribed for deciding whether savings are sufficient to justify continuation of an existing Government commercial activity and each activity should be evaluated on the basis of the applicable circumstances.

(4) A report of each review should be prepared. A decision to continue an activity should be approved by an assistant secretary or official of equivalent rank and the basis for the decision should appear in the inventory record for the activity. Activities not so approved should be discontinued. Reasonable adjustments in the timing of such actions may be made, however, in order to alleviate economic dislocations and personal hardships to affected career personnel.

#### 8. IMPLEMENTATION

Each agency is responsible for making the provisions of this circular effective by issuing appropriation implementing instructions and by providing adequate management support and procedures for review and follow-up to assure that the instructions are placed in effect.

If overall responsibility for these actions is delegated by the agency head, it should be assigned to a senior official reporting directly to the agency head.

If legislation is needed in order to carry out the purposes of this circular, agencies should prepare necessary legislative proposals for review in accordance with Bureau of the Budget Circular No. A-19.

#### 9. EFFECTIVE DATE

This circular is effective on March 31, 1966.

CHARLES L. SCHULTZE, *Director*.

## MEMORANDUM FROM THE PRESIDENT TO HEADS OF DEPARTMENTS AND AGENCIES

Each of you is aware of my determination that this administration achieve maximum effectiveness in the conduct of day-to-day operations of the Government.

We must seek in every feasible way to reduce the cost of carrying out governmental programs. But we must remember that our budgetary costs—our current out-of-pocket expenditures—do not always provide a true measure of the cost of Government activities. This is often true when the Government undertakes to provide for itself a product or a service which is obtainable from commercial sources.

At the same time, it is desirable, or even necessary, in some instances for the Government to produce directly certain products or services for its own use. This action may be dictated by program requirements, or by lack of an acceptable commercial source, or because significant dollar savings may result.

Decisions which involve the question of whether the Government provides directly products or services for its own use must be exercised under uniform guidelines and principles. This is necessary in order—

To conduct the affairs of the Government on an orderly basis ;

To limit budgetary costs ; and

To maintain the Government's policy of reliance upon private enterprise.

At my direction the Director of the Bureau of the Budget is issuing detailed guidelines to determine when the Government should provide products and services for its own use. These guidelines are the result of long study, based on experience over the past 6 years since the current guidelines were issued.

Each of you is requested to designate an assistant secretary or other official of comparable rank to—

Review new proposals for the agency to provide its own supplies or services before they are included in the agency's budget ;

Review experience under the new guidelines ; and

Suggest any significant changes to the guidelines which experience may indicate to be desirable.

I do not wish to impose rigid or burdensome reporting requirements on each agency with respect to the new guidelines. However these guidelines will require that appropriate records be maintained relative to agency commercial or industrial activities. I am also requesting the Budget Director to report to me from time to time on how the new directives are being carried out, and whether experience suggests changes in the guidelines or in agency reporting requirements.

LYNDON B. JOHNSON.

EXECUTIVE OFFICE OF THE PRESIDENT,  
BUREAU OF THE BUDGET,  
Washington, D.C., September 21, 1959.

Bulletin No. 60-2.

To the heads of executive departments and establishments.

Subject: Commercial-industrial activities of the Government providing products or services for governmental use.

## 1. PURPOSE

The purpose of this bulletin is (a) to clarify the application of existing policy regarding competition between the Government and private enterprise in the light of executive branch experience under Bureau of the Budget Bulletins No. 55-4 of January 15, 1955, and No. 57-7 of February 5, 1957, and (b) to provide for the evaluation of all commercial-type enterprises not previously reviewed. To make this program more manageable, procedures have been designed to simplify reporting and to permit agencies to direct their major attention to those activities of greatest significance and budgetary impact.

## 2. POLICY

It is the general policy of the administration that the Federal Government will not start or carry on any commercial-industrial activity to provide a service

or product for its own use if such product or service can be procured from private enterprise through ordinary business channels.<sup>1</sup>

### 3. EXCEPTIONS

Because the private enterprise system is basic to the American economy, the general policy establishes a presumption in favor of Government procurement from commercial sources. This has the twofold benefit of furthering the free enterprise system and permitting agencies to concentrate their efforts on their primary objectives. However, in specific situations certain factors may make it necessary or advisable for a Government agency to produce goods or services for its own use. In these situations the burden of proof lies on the agency which determines that an exception to the general policy is required. A finding must be made that there are compelling reasons for Government provision of a product or service before an exception is authorized. All relevant factors must be taken into account, including pertinent economic and social aspects of public policy, even though they may not be the immediate concern of the agency or official directly responsible for the particular activity.

Compelling reasons for exceptions to the general policy include national security; relatively large and disproportionately higher costs; and clear unfeasibility. Each of these is discussed below.

(a) *National security.*—"National security" as a compelling reason for continued Government ownership and operation of an activity is not meant to be all inclusive of all products or services with restricted classifications. Commercial contractors operating under proper security clearances and safeguards have been, and should continue to be, essential to the national defense effort. There are instances, however, when for reasons of national security, an activity cannot be turned over to private industry. These activities may include, but are not necessarily limited to, functions which must be performed by Government personnel in order to provide them with vital training and experience for maintaining combat units in readiness.

(b) *Costs.*—Continuation of Government operation on the ground that procurement through commercial sources would involve higher costs may be justified only if the costs are analyzed on a comparable basis and the differences are found to be substantial and disproportionately large. In such cases the costs of both Government operation and private procurement must be fairly computed and complete. The costs assigned to Government operation must cover all direct and indirect outlays, such as pay and other allowances for personal services and leave; contributions for retirement and disability; supplies; materials; transportation; warehousing; utilities; maintenance; repairs, and similar factors. Appraisal of elements not usually chargeable to current appropriations, such as depreciation, interest on the Government's investment,<sup>2</sup> the cost of self-insurance (even though it is unfunded), and exemption from Federal, State, and local taxes<sup>3</sup> must also be made to the extent necessary to put the costs on a comparable basis. On the other hand, costs attributed to procurement from private sources must be computed on an equally fair and complete basis. They should be truly representative of the lowest price the

<sup>1</sup> "Commercial-industrial activity \* \* \* for its own use" includes the provision of services or products primarily for the use of a Government agency (whether the providing agency or other agencies), but excludes, for the purpose of this bulletin, activities producing a service or product primarily for the public or agency employees. Also excluded are functions which are a part of the normal management responsibilities of a Government agency or a private firm of comparable size (such as accounting, personnel work, and the like). In determining whether an activity is "commercial-industrial" in nature and "can be procured from private enterprise through ordinary business channels," reference may be made to the "Standard Industrial Classification Manual" (available from the Superintendent of Documents, U.S. Government Printing Office). Additional information about both source and ability of private enterprise to provide a product or service may be secured from the Business and Defense Services Administration of the Department of Commerce.

<sup>2</sup> Initial costs may be used for determining the value of the Government's investment. However, if the initial costs are no longer valid for purposes of a cost analysis, the estimated current fair market value may be used, instead.

After having determined the value of the Government's investment in the activity, the interest cost should be computed by using the current average market yield of outstanding marketable obligations of the United States having maturities comparable to the useful life of the item.

<sup>3</sup> Benchmarks for estimating taxes may be obtained from tables 1 and 3, Statistics of Income, 1956-57, Corporation Income Tax Returns, publication No. 16, U.S. Treasury Department, Internal Revenue Service.

Government would pay for the quantity and quality needed, taking into account all applicable costs of the Government for such procurement, and costs of handling and delivery.

The admissibility of relatively large and disproportionately higher costs as a possible compelling reason for continued Government operation does not alter the general policy which establishes a presumption in favor of Government procurement from commercial sources and does not prohibit procurement from more costly commercial sources. For instance, it may be found to be in the public interest to purchase the product or service, regardless of cost factors, in order to foster or maintain the development or growth of commercial production capabilities to meet ultimate governmental and nongovernmental needs at potentially lower costs.

The existence of Government-owned capital assets is not in itself an adequate justification for the Government to provide its own goods or services. The need for continued Government ownership or operation must be fully substantiated. In many instances, evaluation may show that excessive operating costs, obsolescence, replacement costs, or low rates of utilization make continued Government operation unwarranted and liquidation of the asset preferable. Similar examination should be made of any reasons that tend to substantiate a compelling need for continued Government ownership and operation. Even the operation of a Government-owned facility by a private organization through contractual arrangement does not automatically assure that the Government is not competing with private enterprise. This type of arrangement could act as a barrier to the development and growth of competitive commercial sources and procurement through ordinary business channels.

(c) *Clear unfeasibility.*—Certain products or services may be found to be clearly unfeasible to procure from private enterprise through ordinary business channels due to the fact that the product or service is:

- (1) An integral function of the basic mission of the agency, or
- (2) Not available in the particular instance, nor likely to become available commercially in the foreseeable future because of the Government's unique or highly specialized requirements or geographic isolation of the installation, or
- (3) Administratively impractical to contract for commercially.

(4) Scope of evaluation. Each agency shall:

(a) Make an evaluation and report of all its commercial-industrial activities not evaluated under Bureau of the Budget Bulletins No. 55-4 or 57-7. This should include activities which are Government-owned, contractor-operated and those which were established after December 1956.

(b) Report the current status of those activities which were evaluated previously under Bulletin No. 55-4 or 57-7, including new starts established prior to December 31, 1956.

To permit speedy evaluation of commercial-industrial activities warranting detailed review and analysis, agencies may indicate their intention to eliminate from all extensive evaluation those activities which must be continued, in whole or in part, because it is clearly unfeasible to procure the products or services from private enterprise through ordinary business channels as defined in paragraph 3C.

When continued Government operation of an activity is determined to be mandatory in the public interest because of one of the compelling reasons enumerated in paragraph 3, such operation should be at a reasonable level of efficiency and economy.

##### 5. PROMPT AND ORDERLY ACTION IN TERMINATION OR CURTAILMENT

Activities which are not authorized as an exception to the general policy because of a compelling reason should be discontinued as soon as reasonably possible. Similarly, activities which are to be curtailed should have their operations reduced as speedily as possible.

Each agency should exercise diligence in carrying out such actions in an orderly way and should proceed on a reasonable time schedule. Adequate notice should be given to the community and employees in advance of discontinuance or curtailment, and each agency should assist employees as necessary in finding other employment. Where statutory changes would be necessary to permit discontinuance or curtailment, the agency head should seek such changes promptly,

submitting drafts of legislation or appropriation language, as may be required, to the Bureau of the Budget in the usual manner.

#### 6. STEPS TO BE TAKEN BEFORE ESTABLISHING NEW ACTIVITIES

No new commercial-industrial activity shall be started until the responsible official has made a formal finding for the record that, due to one of the compelling reasons stated in paragraph 3, Government provision of the product or service is in the public interest. Proposed starts should be subjected to the same review outlined in this bulletin for the evaluation of existing activities.<sup>4</sup>

#### 7. REPORTS

The forms are designed for the evaluation of existing and newly established activities not evaluated previously, and to serve as a basis for review of the current status of activities evaluated previously under bulletin No. 55-4 or 55-7. Instructions for subsequent progress reports will be issued at a later date. It is intended that future reporting will be limited generally to activities: (a) whose status has changed since their previous evaluations; (b) for which substantiating data on agency determinations have been requested by the Bureau of the Budget; or (c) which have been newly established since July 31, 1959.

Three types of reports are to be submitted. Paragraphs 7A and 7B apply to commercial-industrial activities established prior to December 31, 1956. The total number of installations and activities in these summary and individual reports should equal the total number of installations and activities listed in the "Inventory of Certain Commercial-Industrial Activities of the Government,"<sup>5</sup> plus these new starts previously reported to the Bureau of the Budget in accordance with bulletin No. 57-7. Any differences should be explained.

Those commercial-industrial activities established during the period of January 1957 through July 1959 are discussed in paragraph 7C.

A. Summary evaluation reports of actions and decisions to discontinue, curtail, or continue commercial-industrial activities will be made according to exhibit 60-2A (copy attached), if the annual estimated cost or value of the product or service is less than \$250,000.

Part I applies to activities previously evaluated in accordance with Bureau of the Budget Bulletin No. 55-4 or 57-7. Part II applies to activities newly evaluated in accordance with Bureau of the Budget Bulletin No. 60-2.

B. Individual evaluation reports of actions and decisions to discontinue, curtail, or continue commercial-industrial activities will be made according to exhibit 60-2B (copy attached), if the annual estimated cost or value of the product or service is \$250,000 or more.

Part I applies to activities previously evaluated in accordance with Bureau of the Budget Bulletin No. 55-4 or 57-7. Part II applies to activities newly evaluated in accordance with Bureau of the Budget Bulletin No. 60-2.

C. Individual reports of commercial-industrial activities established from January 1957 through July 1959, regardless of the annual estimated cost or value of the product or service, will be made according to exhibit 60-2C (copy attached).

Two copies of each report shall be submitted to the Bureau of the Budget on or before December 31, 1959. Negative reports should be submitted if appropriate. Detailed substantiating data need not be submitted, but the agency should be prepared to justify its findings.

No reports need be submitted for activities, other than transportation, conducted outside the States of the Union and the District of Columbia.

Up to 50 copies of these report forms may be obtained from the Bureau of the Budget Publications Unit, code 113, extension 2333; if more copies are needed, the agencies should have them reproduced.

#### 8. DELEGATION

The agency head may delegate to officials within his agency his responsibility for decisions and findings on activities with an annual estimated cost or value

<sup>4</sup> Establishment of new activities includes the establishment, acquisition, or reactivation of any commercial-industrial activity, regardless of the annual estimated cost or value of the product or service.

<sup>5</sup> Issued by the Bureau of the Budget in May 1956.

of product or service of \$1 million or less. In such cases, the one to whom such authority has been delegated must sign the report. No delegation may be made to the official immediately responsible for producing the product or service.

#### 9. DISSEMINATION OF POLICY

The agency head should take appropriate steps to insure that responsible officials in his agency are familiar with this bulletin and with the need for continuing review and evaluation. When needed, agency heads shall develop and issue specific instructions and criteria to supplement this bulletin.

#### 10. AGENCY RESPONSIBILITY FOR CONTINUING REVIEW

Although this bulletin does not deal with products or services provided primarily to the public or agency employees, each agency shall keep such activities under continuing review and evaluation to determine if such products or services can be procured from private enterprise through ordinary business channels.

Similarly, although this bulletin calls only for action and reports on certain commercial-industrial activities conducted by the Government for its own use, agencies are expected to review all commercial-industrial activities on a continuing basis.

By direction of the President :

MAURICE H. STANS, *Director.*

LINDE CO.,  
DIVISION OF UNION CARBIDE CORP.,  
*Washington, D.C., March 25, 1966.*

Mr. GEORGE G. MULLINS,  
*Chief, Property and Supply Management Branch, Bureau of Budget, Executive Office Building, Washington, D.C.*

DEAR MR. MULLINS: During the Bureau of Budget testimony before the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee, the question was raised by Congressman Curtis as to whether or not Government-owned, contractor-operated facilities would be considered as a Government commercial or industrial activity under the definitions established in Circular A-76. The position of the Bureau of Budget was that such GOCO facilities did not come under the definition established in this circular and you further commented to the effect that ownership of real estate was not the criterion for a Government-commercial facility.

It is our considered opinion that if the Government owns the real estate, invests the required capital funds, and undertakes the business risks of operating facilities, that such operations are indeed "commercial" in spite of the fact that operators would be supplied from industrial firms and paid for by the Government.

In the specific instance of NASA IFB CC-1-6, which you are familiar with, the establishment of such GOCO facilities in spite of the obvious industrial capability is certainly contrary to the policy as outlined in Circular A-76, A-2, and as further stated in the testimony of Mr. Philip S. Hughes before the committee.

It was noted in the testimony before the committee that Union Carbide Corp., Linde Division, proposed to utilize a portion of the facilities at Government Plant 74 due to the fact that our own production facilities were not capable of supplying the total Government requirement. While our proposal does include the operation of part of the facilities of Government Plant 74 in addition to supply of product from our newly constructed Mims Plant, in the event that the Government should elect to dispose of such Government property, Linde Division is ready, willing, and able to supply the total Government requirements of cryogenic propellants at Cape Kennedy from our own facilities.

We are confident that the best interest of the Government will be served through consideration of the intent of the policies set forth by Bureau of Budget.

Very truly yours,

G. A. KAZANJIAN,  
*Washington Manager,*  
*Cryogenic Products.*

COUNCIL FOR PRIVATE ENTERPRISE,  
Washington, D.C., March 24, 1966.

HON. PAUL H. DOUGLAS,

*Chairman, Subcommittee on Federal Procurement and Regulation, Joint Economic Committee, Congress of the United States, Washington, D.C.*

DEAR MR. CHAIRMAN: The Council for Private Enterprise (formerly the Committee To Reduce Government Competition), composed of individuals and private organizations representing electrical contractors, cinema laboratories, photogrammetrists, employment agencies, consulting engineers, aerospace services, small businessmen, shipyards, printing endeavors, milk and ice cream manufacturers, and others, has reviewed the new guidelines pertaining to "policies for acquiring commercial or industrial products and services for Government use," and uses this means to bring the following observations to the attention of the Joint Economic Committee for inclusion in the record of current hearings.

Circular A-76, as issued by the Bureau of the Budget on March 3, 1966, it seems to us, is commendably motivated. It underscores the Government's historic and continuing policy of primary reliance on private enterprise. In several respects, it is much more precise than the predecessor document—Bureau of the Budget Bulletin 60-2. On balance, Circular A-76 can be regarded as a step forward in terms of endeavoring to control or limit the extent to which the Government should engage in activities or services which compete with private enterprise. But, a long journey begins with this single step.

These guidelines, no matter how well motivated or clearly defined, will only be as effective as the monitoring which ensues. Words without restraint in these types of situations are meaningless. We would therefore urge that a division or section of the Bureau of the Budget or the Department of Commerce be assigned the basic responsibility of careful surveillance over all commercial-industrial activities conducted by all agencies and departments of the Federal Government with the objective of assessing, more frequently than every 3 years, those that might more economically be procured from private enterprise.

The above objective would seem to be in keeping with the "Memorandum From the President to Heads of Executive Departments and Agencies" dated March 15, 1966, in which the need to hold unnecessary "expenditures to the absolute minimum" was cited as "doubly imperative." President Johnson's instructions that the Budget Director "report to me from time to time on how the new directives are being carried out, and whether experience suggests changes in the guidelines or in agency reporting requirements" also indicates, quite forcefully, that the administration of Circular A-76 is not to be treated superficially and that stringent monitoring should be invoked.

As to "new starts," we have some reservations with respect to certain of the cost factors which compose a cost comparison analysis between Government and private endeavors. Except for the exclusion of State and local taxes and a consideration of profit in connection with nongovernmental procurements. Circular A-76 generally represents an improvement over Bulletin 60-2. Nonetheless, the integrity of the cost comparison will be only as good as the data on which it is based, and a "new start" predicated on erroneous, incomplete or unrealistic cost estimates could frustrate the stipulated objectives of the President and the new guidelines. To avoid this possibility, and the unpleasant and expensive task of discontinuing a "new start," the surveillance group suggested earlier should, in our judgment, also have the responsibility of reviewing cost comparisons of all agencies and departments contemplating activities or services which are normally available in the private enterprise community. This review, of course, should be undertaken prior to any final decisions.

As to activities already in existence, we would also anticipate that the inventory as envisioned by paragraph 7(a) of Circular A-76 will provide a basis by which the effectiveness of the new guidelines can be promptly demonstrated. It is perhaps a reasonable assumption that the Bureau of the Budget, at this moment, has knowledge of specific examples of governmental activities which are more economically obtainable from commercial sources and which could be turned over to private enterprise without detriment to the orderly conduct of the affairs of the Government. These should be identified, and the manner by which application of Circular A-76 can prove effective should be made known to the public and the Congress alike. In this way, the true meaning of reliance on private enterprise can be demonstrated for all to see—and for all to understand—so as to motivate not only Government but to motivate and encourage private enterprise as well.

Sincerely,

EDWIN M. HOOD, *Chairman.*



## APPENDIX 2

### "BUY-AMERICAN" POLICY AND RELATED MATERIAL

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE,  
WASHINGTON, D.C., February 8, 1966.

Memorandum for Mr. Moot.

Subject: Balance-of-payments policies.

The following information is supplied in accordance with Mr. Moot's inquiries into our policies and procedures on balance of payments for the Joint Economic Committee.

General policy within the executive branch of the Government with respect to balance of payments is developed by the Cabinet Committee on Balance of Payments and is approved by the President. Secretary McNamara is the DOD member of this committee.

DOD was the first agency to utilize a cost differential evaluation factor to inhibit the purchase of foreign end products or services. The cost differential was set at 25 percent in 1961 and was changed to the present factor of 50 percent in July 1962.

DOD and the Coast Guard utilize the 50 percent cost differential factor in evaluating the prices offered for foreign items in two different situations.

- (1) The foreign items are purchased for use in the United States.
- (2) The foreign items are purchased for use outside the United States.

In the first situation noted above the Buy-American Act also applies with its evaluation factor of 6 percent or 12 percent which, unlike the 50-percent differential, is applied to the total cost including duty. The ASPR and the Coast Guard procurement regulations require purchasing officers to use that factor which results in the greater evaluated foreign price.

In the second situation the Buy-American Act does not apply. Hence, in the absence of balance-of-payments restrictions, contracts for supplies or services for use outside the United States would be awarded to the low responsible offeror without regard to whether the item is a foreign end-product or a domestic end-product.

Prior to 1964, other executive agencies did not use a cost differential to restrict the purchase of foreign end products or services. However, as a result of consideration by the Cabinet Committee on Balance of Payments in December 1963, it was decided that other agencies, except for AID, would adopt the 50 percent cost differential factor when making purchases for use outside the United States. At the same time, it was decided that the other executive agencies would not apply the 50-percent cost differential where the foreign items were being purchased for use in the United States. The basis for these policy decisions is set forth in the attached material.

J. M. MALLOY.

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EXECUTIVE OFFICE OF THE PRESIDENT,  
BUREAU OF THE BUDGET,  
Washington, D.C., March 3, 1964.

HON. ROBERT S. MCNAMARA,  
Secretary of Defense,  
Washington, D.C.

DEAR MR. SECRETARY: As you know, the Cabinet Committee on the Balance of Payments met on December 10 to consider policy to be followed by the Federal Government in procuring foreign goods. The committee had before it a detailed study of the Government's foreign procurement policies which was distributed by the Bureau of the Budget in August.

The committee agreed to recommend no change at this time in Executive Order 10582, as amended, or in current agency practices under that order. It was also

agreed that, with the exception of AID, all Federal agencies procuring for use abroad should, in general, procure domestic materials unless the delivered cost of domestic materials is estimated to be 50 percent greater than the cost of like materials of foreign origin. AID is expected to follow this policy on its administrative procurement only, continuing its more restrictive tying policies on other procurement. For purposes of carrying out this decision on procurement for use abroad, it is suggested that agencies generally follow the definition of "domestic product" which is provided in Executive Order 10582, although it is recognized that some flexibility in the use of this definition may be warranted in exceptional circumstances.

Sincerely,

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KERMIT GORDON, *Director.*

TREASURY DEPARTMENT,  
Washington, D.C., December 13, 1963.

MEMORANDUM

To: Cabinet Committee on Balance of Payments; Secretary of Defense; Secretary of Commerce; Under Secretary of State; Administrator of AID; Special Representative for Trade Negotiations; Director, Bureau of the Budget; Chairman, Council of Economic Advisers; Mr. Bundy, the White House.

Attached is a copy of a memorandum which was sent by Secretary Dillon to the President, reporting to him on the results of the Committee's meeting of December 10.

JOHN C. BULLITT.

MEMORANDUM FOR THE PRESIDENT

The Cabinet Committee on the Balance of Payments met on December 10, under my chairmanship, to consider questions related to U.S. Government procurement of foreign goods.

The issues related to the standards which should be followed by Government agencies in procuring goods abroad for use in the United States and for use abroad.

In the case of procurement for use in the United States, the Government-wide practice, pursuant to an Executive order issued during the Eisenhower administration under the Buy-American Act, has been to require procurement in the United States unless the cost was more than 6 percent greater than the cost of foreign procurement (or 12 percent, in certain cases). The Executive order permitted the head of each agency to make exceptions to this rule. For some time now, Secretary McNamara has followed a policy of generally returning procurement to the United States unless the cost of U.S. procurement was 50 percent higher than foreign procurement. In some cases he has required an even greater differential. He has done this because of our balance-of-payments problem. While the amount saved for our balance of payments by this particular measure is not large, it is an integral part of a whole series of measures taken to reduce the adverse impact of our large defense expenditures on our balance of payments.

The Budget Bureau recently concluded a study of the Buy-American Act which it had initiated some time ago and which was used as a basis for the Cabinet Committee discussion. The choices were (a) to issue a new directive applying a 50-percent differential to all agencies, (b) to have Defense return to the 6- to 12-percent differential being followed by other agencies or (c) to continue the present nonuniform practices. As a result of our meeting, it was agreed that the present practices of Defense and those of the other agencies should be continued and that no new directive should be issued.

This conclusion was reached because it did not seem wise either to increase the general level of protection because of the damage this could do to our position in the forthcoming trade negotiations, or to abandon the present Defense practice because of the implications of complacency regarding the balance of payments and the difficulties that would be created for Defense in other parts of their balance-of-payments program.

The Buy-American Act does not apply to procurement by U.S. agencies for use overseas. Defense has generally been using a 50-percent price differential test for this purpose, while other agencies have applied varying differentials. The

Budget Bureau recommended that all agencies should follow the Defense practice in this area, and this was agreed by the Cabinet Committee. Budget will work out the implementation of this decision with those agencies affected.

These conclusions do not affect AID, whose policy is to restrict at least 80 percent of its overall commitments to financing of U.S. exports.

(S) DOUGLAS DILLON.

[Excerpts from United States Code]

TITLE 41.—PUBLIC CONTRACTS

§ 10. Contracts for material for public improvements.

CODIFICATION

Section, act Mar. 3, 1875, ch. 133, § 2, 18 Stat. 455, relating to preferential treatment of American material in contracts for public improvements, is now covered by sections 10a-10d of this title.

§ 10a. American materials required for public use.

Notwithstanding any other provision of law, and unless the head of the department or independent establishment concerned shall determine it to be inconsistent with the public interest, or the cost to be unreasonable, only such unmanufactured articles, materials, and supplies as have been mined or produced in the United States, and only such manufactured articles, materials, and supplies as have been manufactured in the United States substantially all from articles, materials, or supplies mined, produced, or manufactured, as the case may be, in the United States, shall be acquired for public use. This section shall not apply with respect to articles, materials, or supplies for use outside the United States, or if articles, materials, or supplies of the class or kind to be used or the articles, materials, or supplies from which they are manufactured are not mined, produced, or manufactured, as the case may be, in the United States in sufficient and reasonably available commercial quantities and of a satisfactory quality. (Mar. 3, 1933, ch. 212, title III, § 2, 47 Stat. 1520.)

EXEMPTION OF FUNCTIONS

Functions authorized by Mutual Security Act of 1954 as exempt, see Ex. Ord. No. 10784, set out as a note under section 1793 of Title 22, Foreign Relations and Intercourse.

CROSS REFERENCES

Low-rent housing projects, application of this section to, see section 1406 (c) of Title 42, Public Health and Welfare.

§ 10b. Contracts for public works; specification for use of American materials; blacklisting contractors violating requirements.

(a) Every contract for the construction, alteration, or repair of any public building or public work in the United States growing out of an appropriation heretofore made or hereafter to be made shall contain a provision that in the performance of the work the contractor, subcontractors, material men, or suppliers, shall use only such unmanufactured articles, materials, and supplies as have been mined or produced in the United States, and only such manufactured articles, materials, and supplies as have been manufactured in the United States substantially all from articles, materials, or supplies mined, produced, or manufactured, as the case may be, in the United States except as provided in section 10a of this title: *Provided, however*, That if the head of the department or independent establishment making the contract shall find that in respect to some particular articles, materials, or supplies it is impracticable to make such requirement or that it would unreasonably increase the cost, an exception shall be noted in the specifications as to that particular article, material, or supply, and a public record made of the findings which justified the exception.

(b) If the head of a department, bureau, or agency, or independent establishment which has made any contract containing the provision required by subsection (a) of this section finds that in the performance of such contract there has been a failure to comply with such provisions, he shall make public his findings, including therein the name of the contractor obligated under such contract, and no other contract for the construction, alteration, or repair of any public building or public work in the United States or elsewhere shall be awarded to such contractor, subcontractors, material men, or suppliers with which such con-

tractor is associated or affiliated, within a period of three years after such finding is made public. (Mar. 3, 1933, ch. 212, title III, § 3, 47 Stat. 1520.)

## STANDARD FORMS OF CONTRACT

Domestic Preference, Art. 18, Construction Contract, see section 54.13 of Appendix to this title.

**§ 10c. Definition of terms used in section 10a and 10b.**

When used in sections 10a and 10b of this title—

(a) The term "United States", when used in a geographical sense, includes the United States and any place subject to the jurisdiction thereof:

(b) The terms "public use", "public building", and "public work" shall mean use by, public building of, and public work of, the United States, the District of Columbia, Hawaii, Alaska, Puerto Rico, American Samoa, the Canal Zone, and the Virgin Islands. (Mar. 3, 1933, ch. 212, title III, § 1, 47 Stat. 1520; 1946 Proc. No. 2695, eff. July 4, 1946, 11 F. R. 7517, 60 Stat. 1352.)

## CODIFICATION

Words "the Philippines Islands" in subsec. (b) were deleted as obsolete in view of recognition of independence of the Philippines by Proc. No. 2695, which was issued pursuant to section 1394 of Title 22, Foreign Relations and Intercourse, and is set out as a note under section 1394.

## EFFECTIVE DATE

Section 4 of act Mar. 3, 1933, provided: "This title [this section and sections 10a and 10b of this title] shall take effect on the date of its enactment [Mar. 3, 1933], but shall not apply to any contract entered into prior to such effective date."

## SEPARABILITY OF PROVISIONS

Section 5 of act Mar. 3, 1933, provided: "If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act, and the application thereof to other persons or circumstances, shall not be affected thereby."

**§ 10d. Clarification of Congressional intent regarding sections 10a and 10b(a).**

In order to clarify the original intent of Congress, hereafter, section 10a of this title and that part of section 10b (a) of this title preceding the words "*Provided, however,*" shall be regarded as requiring the purchase, for public use within the United States, of articles, materials, or supplies manufactured in the United States in sufficient and reasonably available commercial quantities and of a satisfactory quality, unless the head of the department or independent establishment concerned shall determine their purchase to be inconsistent with the public interest or their cost to be unreasonable. (Oct. 29, 1949, ch. 787, title VI, § 633, 63 Stat. 1024.)

## EX. ORD. NO. 10582. UNIFORM PROCEDURES FOR DETERMINATIONS

Ex. Ord. No. 10582, Dec. 17, 1954, 19 F. R. 8723, provided:

SECTION 1. As used in this order, (a) the term "materials" includes articles and supplies, (b) the term "executive agency" includes executive department, independent establishments, and other instrumentality of the executive branch of the Government, and (c) the term "bid or offered price of materials of foreign origin" means the bid or offered price of such materials delivered at the place specified in the invitation to bid including applicable duty and all costs incurred after arrival in the United States.

SEC. 2. (a) For the purposes of this order materials shall be considered to be of foreign origin if the cost of the foreign products used in such materials constitutes fifty per centum or more of the cost of all the products used in such materials.

(b) For the purposes of the said act of March 3, 1933 [sections 10a-10c of this title], and the other laws referred to in the first paragraph of the preamble of this order, the bid or offered price of materials of domestic origin shall be deemed to be unreasonable, or the purchase of such materials shall be deemed to be inconsistent with the public interest, if the bid or offered price thereof exceeds the sum of the bid or offered price of like materials of foreign origin and a differential computed as provided in subsection (c) of this section.

(c) The executive agency concerned shall in each instance determine the amount of the differential referred to in subsection (b) of this section on the basis of one of the following-described formulas, subject to the terms thereof:

(1) The sum determined by computing six per centum of the bid or offered price of materials of foreign origin.

(2) The sum determined by computing ten per centum of the bid or offered price of materials of foreign origin exclusive of applicable duty and all costs incurred after arrival in the United States: provided that when the bid or offered price of materials of foreign origin amounts to less than \$25,000, the sum shall be determined by computing ten per centum of such price exclusive only of applicable duty.

SEC. 3. Nothing in this order shall affect the authority or responsibility of an executive agency:

(a) To reject any bid or offer for reasons of the national interest not described or referred to in this order; or

(b) To place a fair proportion of the total purchases with small business concerns in accordance with section 302(b) of the Federal Property and Administrative Services Act of 1949, as amended [section 252 (b) of this title], section 2 (b) of the Armed Services Procurement Act of 1947, as amended [former section 151 (b) of this title], and section 202 of the Small Business Act of 1953 [section 631 of Title 15] ; or

(c) To reject a bid or offer to furnish material of foreign origin in any situation in which the domestic supplier offering the lowest price for furnishing the desired materials undertakes to produce substantially all of such materials in areas of substantial unemployment, as determined by the Secretary of Labor in accordance with such appropriate regulations as he may establish and during such period as the President may determine that it is in the national interest to provide to such areas preference in the award of Government contracts :

*Provided*, that nothing in this section shall prevent the rejection of a bid or offered price which is excessive ; or

(d) To reject any bid or offer for materials of foreign origin if such rejection is necessary to protect essential national-security interests after receiving advice with respect thereto from the President or from any officer of the Government designated by the President to furnish such advice.

SEC. 4. The head of each executive agency shall issue such regulations as may be necessary to insure that procurement practices under his jurisdiction conform to the provisions of this order.

SEC. 5. This order shall apply only to contracts entered into after the date hereof. In any case in which the head of an executive agency proposing to purchase domestic materials determines that a greater differential than that provided in this order between the cost of such materials of domestic origin and materials of foreign origin is not unreasonable or that the purchase of materials of domestic origin is not inconsistent with the public interest, this order shall not apply. A written report of the facts of each case in which such a determination is made shall be submitted to the President through the Director of the Bureau of the Budget by the official making the determination within 30 days thereafter.

DWIGHT D. EISENHOWER.

#### STATEMENT OF EUGENE L. STEWART, COUNSEL FOR THE SERVICE TOOLS INSTITUTE

Mr. Chairman, and members of the subcommittee, I am Eugene L. Stewart, an attorney located in Washington, D.C. This statement is made on behalf of the Service Tools Institute, a trade association representing manufacturers of handtools.

The Service Tools Institute wishes to thank the subcommittee for the privilege of presenting this statement for the record, but more importantly for the subcommittee's excellent surveillance of the development and administration of a Federal-wide supply system and the policies followed in the procurement of common supply items for use by the Federal Establishment.

We wish to pay our respects, also, to the General Services Administration which has specific responsibility for procurement of handtool items for use by Government agencies. As the Administrator of GSA, Lawrence B. Knott, Jr., advised this committee last April, GSA has been energetically developing competitive specifications for handtool items and through this effort is achieving substantial savings in the procurement of handtools.

Our specific interest in the present hearings relates to a matter referred to by the Joint Economic Committee in its 1966 Joint Economic Report. The committee report recognized that one of the two major factors serving to throw out payments balance into deficit is our heavy military expenditures overseas. The minority views in the report stated that "the added requirements of the war in Vietnam lend special urgency to finding means of reducing the foreign exchange costs of other expenditures by the U.S. Government overseas."

Apropos of this concern, the General Services Administration has already acted to reduce dollar expenditures abroad in the discharge of its procurement responsibilities. On February 12 the Administration published amendments of the Federal Procurement Regulations to set forth GSA policies and procedures with respect to procurement for use abroad and the balance-of-payments program.

The essence of these amendments is that in procurements for use abroad, if the domestic cost of an end product is estimated by GSA to exceed the foreign cost by not more than 50 percent of the foreign cost, the solicitation for bids shall be restricted to U.S. end products.

This action was consistent with a similar step taken by the Secretary of Defense in adopting the 50-percent benchmark as the criterion of reasonableness of costs or consistency with the public interest under the Buy-American Act. Section 6-104.4 of the Armed Services Procurement Regulations as amended to carry out the Secretary's determination provides that for the purposes of evaluating foreign and domestic bids, each foreign bid shall be adjusted either

by excluding any duty from the foreign bid and adding 50 percent of the bid (exclusive of duty) to the remainder, or by adding to the foreign bid (inclusive of duty) a factor of 6 percent of that bid, which ever results in the greater evaluated price. If the firm submitting the low acceptable domestic bid is a small business concern, or is located in a labor surplus area, or both, a factor of 12 percent is used in lieu of the 6-percent factor referred to above.

The major difference between the policy followed in the Defense Establishment and that set forth in the General Services Administration procurement regulations as of February 12, 1966, is that in Defense procurement the 50-percent factor is applied across the board to all procurement, whether or not for use abroad. Contrariwise, in the case of the General Services Administration the 50-percent factor is used only in connection with procurement of articles for use abroad, and, more specifically, for products to be delivered outside of the United States.

This difference has special relevance in the case of handtools. By their nature handtools are shelf items. Under the sensible approach to procurement of these common use items by a single agency, the General Services Administration, procurements of handtools are commonly for delivery within the United States. Thereafter distribution to the various using Government agencies takes place, and handtools required for use abroad are then shipped from Government warehouses.

Today it is reasonable to conclude that a substantial portion of the procurement of handtools is either for direct use abroad, or to replenish stocks which have been depleted by shipments to fill the needs of our troops overseas. In a very real sense, therefore, the current procurement of handtools can reasonably be said to be "for use abroad" though the actual delivery is made inside the United States.

The basic objective of the 50-percent rule—reducing dollar expenditures abroad and improving the Government's current balance-of-payments position—would be served if the General Services Administration were allowed to apply the 50-percent rule in evaluating foreign bids on procurement of handtools regardless of the immediate destination of deliveries called for by such procurements.

This is not merely an academic matter. One of the institute's members has made an analysis of GSA bid openings for all types of handtools in the member's product line during the period October 28, 1965, to February 10, 1966. The total dollar value of such procurement was \$781,571. Foreign suppliers of handtools bid on \$756,000, or 96.7 percent of this procurement. To date, 44 percent of the dollar value of these procurements have been made the subject of contract awards. Foreign bidders received the majority of these awards. They received contracts accounting for 55 percent of the dollar value of these awards.

The dollar value of the procurement of certain handtools during this 15-week period is not, of course, representative of the total handtool procurement for Government use. In 1965, total Government procurement of handtools was somewhat in excess of \$12 million. If the success of foreign bidders during the 15-week period cited proves to be representative of their success in competing for total handtool procurement in the course of a year, the domestic industry faces the loss of some \$7 million or more in business. While such a loss might conceivably be absorbed during a period in which the economy is operating close to capacity, this incursion by foreign producers into the Government market would have disturbing implications for the long term.

As a sidenote, it may be worth mentioning that the foreign producers have been assisted in competing for this business by a Comptroller General's ruling on bid samples. In handtool procurement where the agency requires the submission of a sample with the bid, foreign producers are allowed to submit as their sample the particular handtool as manufactured by a U.S. producer. The foreign bidder simply supplies an article manufactured by one of the domestic companies, for example, those who are members of the Service Tools Institute, as a sample of what the foreign bidder proposes to supply if it is awarded the contract. This may strike you, as it does our members, as being unfair. The General Services Administration, however, has no choice but to permit it since the point has been squarely ruled upon by the Comptroller General in Decision B-133114 dated October 6, 1959.

I refer to the practice here not by way of complaint, but rather to illustrate the fact that bidding by foreign producers on handtool procurement has been facilitated and they are taking advantage of the opportunities thus presented.

Our major concern here is to assist the General Services Administration in securing the necessary clearance from the Bureau of the Budget for an extension of the 50-percent rule to handtool procurement. With such clearance the Administration could either amend its regulations or make an administrative construction of its present regulations and determine that handtool procurement, being substantially for use abroad, is subject to the 50-percent test in the evaluation of foreign bids under the Buy-American Act rather than merely the 6-percent test.

Because of this subcommittee's helpful attention to procurement policy and administration by the General Services Administration, it seemed to the institute that this was an appropriate matter to call to your attention. In doing so we do not wish to be understood as in any way suggesting or implying criticism of the General Services Administration or of the Bureau of the Budget. As is not unusual in policymaking matters, it may be that the subcommittee's interest could serve to accelerate the resolution of the necessary forces underlying an extension of present policy to a unique area. Accordingly, we respectfully request that the subcommittee give this matter its attention.

## BUY AMERICAN

MICHAEL S. BARAM\*

The role of American technology in the Western Alliance has recently become a much-discussed issue. As should have been apparent long ago, this technology is the basis for America's economic dominance of the Alliance and, therefore, for its military and political dominance as well. This connection between technological and political supremacy has only recently received the public discussion it deserves, largely as a result of the economic hardships facing the British airframe and shipbuilding industries.<sup>1</sup>

In the early 1950's, federal government agencies began dispensing the funds that fed American industrial and academic research. Today, the expenditure of billions of dollars for research is a fixture of the annual federal budget. New technologies have grown from the confines of their initial military environment, and thousands of American "new-technology" firms are now applying the fruits of their sponsored research to commercial products and services. The Western Alliance relies increasingly on this new American industry for support and technological progress. Reliance on American industry for most of the know-how behind the new technologies poses a serious threat to the European partners in the Alliance. It seems that only de Gaulle has had the foresight to realize that, today, technological independence is the key to economic and political independence.<sup>2</sup> Gaullist "go-it-alone" policies, particularly France's independent nuclear force, supersonic aircraft and space programs, have lessened French dependence on American technology.<sup>3</sup> The cost has been great, and much enmity has

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<sup>1</sup> The Aerospace Industry Situation, 20 *Interavia* 1373 (1965).

<sup>2</sup> See, e.g., Address by General Charles de Gaulle, quoted in 149 *Science* 1217 (1965):

To safeguard our independence—economic, scientific, technical—we must ensure that our activities remain under French direction and administration, even though we confront the enormous wealth of certain countries and although we will not refuse to carry out all kinds of exchanges with them. Likewise, we must support, no matter what the cost, those activities which assure the value, the autonomy, the very life of all our industry, those sectors which require the most research, experiment and sophisticated tools or which need the largest team of scientists, technicians and workers of the highest quality. Finally, when it is opportune in a selected branch to join our inventions and money and skills with those of another country, we must choose the country nearest to us and whose weight could not crush us.

<sup>3</sup> French Avionics Industry Expands in Size and Diversity, *Aviation Week and Space Technology*, June 14, 1965, p. 118; French Nationalism vs. U.S. Technology, *id.* at 120.



been incurred;<sup>4</sup> but French airframe employment is up, the French aerospace industry has blossomed, Paris is now the center of Europe's space efforts, and France is America's major rival in international arms trade.<sup>5</sup>

There are signs of American recognition of the problem confronting its allies and the Alliance. The recent visit of Secretary of Defense McNamara to England was presumably made to allay British concern. As a step in this direction, some American military ship orders may soon be placed with British shipyards, despite the fact that the governors of several states have lodged public protests. The late Adlai Stevenson, in his recent magnificent commencement address at Harvard, maintained that:

... Our best policy is, I think, on the one hand, to keep our defense commitment to Europe unequivocal and to explore all reasonable ways of transferring greater responsibility to them by joint purchasing, by joint burden-sharing, by our readiness to consider any pattern of cooperation that Europeans care to suggest.<sup>6</sup>

A logical beginning for the implementation of Mr. Stevenson's suggestion is the relatively limited NATO market place. Small NATO procurements, generally for construction and supplies, fall within NATO's Infrastructure Program, and are open to international bidding from NATO country firms.<sup>7</sup> However, the large multi-million dollar procurements of weaponry, planes and tanks are placed after high-level negotiations between defense and other governmental officials, in which the American presence naturally dominates.

An even more basic method of curing the stifling effect of American technological dominance, however, would be a revision of the "Buy-American" Act,<sup>8</sup> a little-publicized statute, passed by Congress in 1933, which remains as today's major protectionist barrier favoring United States industry. "Buy-American," straightforwardly entitled "American Materials Required for Public Use," was an anti-depression measure passed in the first Roosevelt administration. It provides simply that

... only such unmanufactured articles, materials, and supplies as have been mined or produced in the United States, and only such manufactured articles, materials, and supplies as have

<sup>4</sup> Is French Scientific Policy Chauvinist? 149 Science 1216 (1965).

<sup>5</sup> N.Y. Times, May 24, 1965, p. 1, col. 5.

<sup>6</sup> Boston Herald, June 18, 1965, p. 1, col. 3.

<sup>7</sup> Gov't Cont. Rep. ¶¶ 4045, 4048.

<sup>8</sup> American Materials Required for Public Use, 47 Stat. 1520 (1933), 41 U.S.C. § 10(a) (1964).

been manufactured in the United States substantially all from articles, materials, or supplies mined, produced, or manufactured, as the case may be, in the United States, shall be acquired for public use.<sup>9</sup>

Four exceptions to this general rule are noted:

This section shall not apply with respect to articles . . . for use outside the United States, or if articles . . . of the class or kind to be used or the articles, materials, or supplies from which they are manufactured are not mined, produced, or manufactured . . . in the United States in . . . reasonably available commercial quantities and of a satisfactory quality.<sup>10</sup>

The act also states that the general rule applies "unless the head of the [federal] department or independent establishment concerned shall determine it to be inconsistent with the public interest, or the cost to be unreasonable."<sup>11</sup>

The history of the act is one of continually increasing significance. At the time of its passage, Government procurement and, indeed, the federal budget itself, were relatively minor factors in both the American economy and international trade. Further, during the following decade of war preparation and effort, American economic policy was, of necessity, protectionist.

In the years following 1945, national trade barriers began to fall, largely at American instigation, and an Atlantic community of interests was conceived and implemented. The Buy-American Act became, for a time, an anachronism and an embarrassing legacy to post-war administrations. Nevertheless, its self-interest philosophy was applied in various foreign aid programs. As much as seventy per cent of the Marshall Plan funds provided European countries were tied to the purchase of American supplies; and eighty per cent of the commitments made by the Agency for International Development to foreign countries today similarly require the procurement of United States goods and services.<sup>12</sup>

In the early 1950's, the act itself was "rediscovered" and invoked by important segments of American industry which realized that they had a strong potential weapon against a revived and highly competitive European industry. Today, the act applies to virtually all procurement placed under the mammoth \$100 billion annual federal

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<sup>9</sup> Ibid.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> Letter From Secretary of the Treasury Douglas Dillon to Senator Hugh Scott, June 8, 1964.

budget, and is thereby a major factor in the national and international economies.

The "rediscovery" of the act occurred when several federal agencies, including the Tennessee Valley Authority, sought to buy heavy electrical equipment by means of the normal federal procurement practice of formal advertising. The formal advertising procedure consists of the solicitation of bids and award of the contract to the lowest bidder who is both responsive to the specifications of the solicitation document and responsible in terms of management and plant. Low bids for several procurements came from qualified British and Japanese firms, and awards of the contracts to them would have resulted in a saving of millions of dollars to the federal government. American firms in each case sought strict application of the Buy-American Act by raising the spectre of the irreparable damage which allegedly would result to important segments of American industry as well as the detrimental effect such awards would have on national security. Despite convincing proof to the contrary offered by the federal agencies concerned, the American firms raised sufficient political support to win awards of the procurements to domestic businesses.<sup>13</sup>

Not until the late 1950's, when liberal trade attitudes had gained ground in Washington, were federal agencies able to buy such goods from low-bidding foreign firms. An unpublished executive branch study has since reported that the savings from turbine orders placed with British and Japanese firms in 1959 and 1960 approximated some \$19 million.<sup>14</sup> Two other aspects of the turbine procurements subsequently came to light. In 1958, the Comptroller General reported to Congress that the Tennessee Valley Authority, which had been stymied in its efforts to buy from foreign sources, had experienced major technical difficulties and financial damage with domestic steam turbine generators.<sup>15</sup> This was followed by the largest price-fixing conspiracy uncovered by the United States Department of Justice, involving the same American firms that had so successfully invoked the Buy-American Act.<sup>16</sup> The evidence, thus, is convincing that "Buy-American" is not always in the best interests of the nation. Nevertheless, the act has recently been embellished and implemented so that it is more effective than ever.

As mentioned, the original act is brief and to the point, simply stating that only United States-made goods will be purchased with federal funds unless such goods are to be used outside the country

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<sup>13</sup> See N.Y. Times, April 17, 1953, p. 17, col. 1; J. of Commerce, April 16, 1953, p. 1, col. 6.

<sup>14</sup> See Knapp, *The Buy-American Act*, 61 Colum. L. Rev. 430 (1961).

<sup>15</sup> Comp. Gen. Audit Rep. to Congress on TVA, Feb. 14, 1958, quoted *id.* at 449, n.70.

<sup>16</sup> *Ibid.*

(offshore procurement and overseas base supplies), or the goods are not available from domestic sources, or the price of the American goods is unreasonable, or if it is determined at Secretarial level that the best interests of the United States are served by purchasing such goods from foreign sources.

To provide guidelines for federal agencies and thereby promote uniformity of federal policy, a 1954 Executive order set forth "Uniform Procedures for Certain Determinations" regarding the permissibility of foreign purchases.<sup>17</sup> The order provides that goods are foreign in origin if the costs of the foreign materials used in the end product constitute fifty per cent or more of the total cost of all products used in the finished item, without considering assemblage or manufacturing costs which are incurred in the United States and may constitute most of the final cost of the item. As a result of this order, an administrative board has determined that nails manufactured in the United States of only one component, Belgian wire, were foreign goods and could not be purchased unless one of the four exceptions applied in the case.<sup>18</sup>

In addition, the largest federal purchaser, the Department of Defense, provides that the transportation costs and import duties of foreign materials and components are to be included in totalling costs and determining the "source" of the end item.<sup>19</sup> As a result, a recent procurement of lime packed in pails from an American firm was halted because it was found that the end item was "foreign."<sup>20</sup> The lime was imported, and its cost including duties and transportation to the American firm came to \$1.40 per end item. The only other components were the domestically-produced pails costing eighty cents each. Packaging costs, labor and overhead incurred in the United States were not considered in determining the "source" of the end item. Therefore, \$1.40 of the total component cost of \$2.20 per end item was for foreign components; the end item was from a "foreign source" and, hence, was ineligible for procurement unless one of the four statutory exceptions applied. It should also be noted that components are "foreign" even if furnished by the foreign subsidiary of an American firm.

The Executive order also defines as an "unreasonable price" for an American product, one exceeding the bid price of a like foreign item, including its shipping and duty costs, by six per cent of the bid price

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<sup>17</sup> Uniform Procedures for Determination, Exec. Order No. 10582, 19 Fed. Reg. 8723 (1954).

<sup>18</sup> Comp. Gen. Op. No. B-154501 (1964).

<sup>19</sup> 41 C.F.R. § 1-6.101 (1965).

<sup>20</sup> Comp. Gen. Op. No. B-152352 (1963).

of the foreign item.<sup>21</sup> The percentage handicap favoring American items has been raised to twelve per cent if the domestic goods are to be supplied by a firm located in an area designated by the Department of Labor as one of substantial unemployment, or if the United States supplier is deemed to be a "small business" within the regulations of the Small Business Administration.<sup>22</sup> A "small business" is generally one employing less than five hundred people, that is not dominant in its field, and is independently owned and operated.<sup>23</sup>

The Department of Defense, in a burst of zeal prompted by the continuing "gold outflow," has gone far beyond the guidelines suggested in the order, which are followed by all other agencies. Since the Department's annual budget is half the total federal budget of \$100 billion, the departure is significant. In a memorandum dated July 16, 1962,<sup>24</sup> Secretary McNamara directed that procurements by the Department's contracting offices that will result in dollar expenditures outside the United States shall be held to an absolute minimum, and may be made only in the following cases: (1) Procurements required to be made pursuant to a treaty or executive agreement between governments; (2) procurements estimated not to exceed \$500; (3) procurements estimated not to exceed \$10,000 required by compelling emergencies; (4) procurement of perishable subsistence items; and (5) procurements as to which it is determined in advance that the requirements can only be filled by foreign supplies or services. Such a determination must be made by various designated officials, depending upon the total dollar amount involved. The memorandum further provides that

... (1) when it is estimated that the price delivered from US sources will not exceed \$10,000, procurement shall be restricted to domestic source end products, or services of domestic concerns *without regard to possible price differentials*, and (2) such procurements which are estimated to exceed \$10,000 shall be similarly restricted provided that *the cost of domestic source end products or services . . . is estimated to be not more than 50 percent in excess of the cost of foreign*

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<sup>21</sup> Or, in the alternative:

The sum determined by computing ten per centum of the bid or offered price of materials of foreign origin exclusive of applicable duty and all costs incurred after arrival in the United States: provided that when the bid or offered price of materials of foreign origin amounts to less than \$25,000, the sum shall be determined by computing ten per centum of such price exclusive only of applicable duty.

Exec. Order No. 10582, *supra* note 17.

<sup>22</sup> This is a result of internal agency practices.

<sup>23</sup> 41 C.F.R. § 1-1.701-1 (1965).

<sup>24</sup> Reprinted in Gov't Cont. Rep. ¶ 80,308.

*supplies or services . . . .* [I]f the estimated or actual cost differential exceeds 50 percent, the matter shall be referred to the Secretary of Defense for determination. (Emphasis supplied.)<sup>25</sup>

The real impact of this memorandum is felt in those situations where the procurement is expected to exceed \$10,000 and both foreign and domestic goods are available. In such cases, the foreign goods must be less than two-thirds the price of the American goods to reach the point of even being considered for procurement. As a result, few foreign firms can expect to be awarded Department of Defense contracts for supplies or services.

The 1954 Executive order provided finally that the agencies can reject any bid "to protect essential national-security interests" or "for reasons of the national interest not described or referred to in this order." This open-end clause has unfortunately resulted in a diversity of criteria which the order sought to prevent, such as the Department of Defense memorandum which has been cited.

Policing the sources of components and materials used by American firms has naturally proven a difficult task. The usual method is to require that each prospective American contractor certify, before award of a contract, the amount of foreign source components and materials which he intends to use in the performance of his work. Justification for such foreign subcontracting is required, and the certification becomes a part of the terms of the contract. Prime contractors, in turn, require similar certification from significant subcontractors. Breach by the prime or subcontractor of the certification terms can result in contractor debarment—ineligibility for future work for a period of several years.<sup>26</sup> Upon such a breach, the contractor is not entitled to the stipulated contract price, but only, at best, to payment on a *quantum valebat* basis.<sup>27</sup>

Contracts for research, while not clearly within the scope of the act and 1954 Order, nevertheless are rarely awarded competitively to foreign firms. The Department of Defense has directed that research and development contracting outside the United States should be held to an absolute minimum and be undertaken only pursuant to treaty obligations or if the research could not be performed in this country. Additionally, security, quality control and administrative requirements preclude consideration of foreign firms in many cases.

Other relevant federal regulations allow the purchase of specified raw materials, from antimony to vanilla beans, from almost any

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<sup>25</sup> Ibid.

<sup>26</sup> 32 C.F.R. § 1.6 (1965).

<sup>27</sup> Comp. Gen. Op. No. B-141911 (1960).

source;<sup>28</sup> but no purchase of these or any other items for public use can be made from Soviet-controlled areas, including by some stretch of the imagination China and Albania.<sup>29</sup> Canadian-American relations are favored by provisions that certain Canadian materials and goods should be listed by the agencies and regarded for procurement purposes as American and, hence, not subject to the price differentials and strictures of the Buy-American Act.<sup>30</sup> Finally, the Berry Amendment, incorporated into the Defense Department's procurement regulations, provides that no Department funds can be used to buy food, clothing, cotton, silk or wool not grown, reprocessed, reused or produced in the United States unless such items are not available in the United States, or are needed for emergencies or combat.<sup>31</sup>

Despite these obstacles to foreign firms, federal contracts continually are awarded to firms such as Rolls-Royce for their high-quality aircraft engines and to Martin-Baker for the ejection seat used in virtually all American aircraft. Some \$50 million in American funds have been awarded to British firms for research and development of the V/STOL aircraft and engines because of the British leadership in this new technology.<sup>32</sup> The Army continues to buy antibiotics from Italian firms at a price below the low American bid, despite the fact that the Italians are accused by the American pharmaceutical industry of infringing American-held patents. Thus far, administrative decisions have upheld the Army procurements,<sup>33</sup> probably because the Federal Trade Commission has leveled price-fixing charges against several American firms for their activities in the commercial pharmaceutical market.

A 1963 study of foreign procurement by federal agencies compiled by the Bureau of the Budget<sup>34</sup> indicates that contracts placed by all agencies with foreign firms because of the unreasonable cost of domestic goods and services totalled \$25 to \$30 million per year in the years 1960, 1961, and 1962. And contracts placed in those years with foreign firms, on the basis of the nonavailability in this country of like items or services approximated another \$140 million annually. Nonavailability of domestic items was, therefore, the primary cause for foreign procurement. For this reason, the Bureau of the Budget study concluded that various suggestions for further reducing foreign procurement, such as raising price differentials for all agencies to

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<sup>28</sup> 32 C.F.R. § 6.105 (1965).

<sup>29</sup> 32 C.F.R. §§ 6.401-1, -2 (1965).

<sup>30</sup> 32 C.F.R. § 6.103-5 (1965).

<sup>31</sup> 32 C.F.R. § 6.304-1 (1965).

<sup>32</sup> Fed. Cont. Rep., No. 45, Dec. 28, 1964, p. A-7.

<sup>33</sup> Comp. Gen. Op. No. B-141459 (1960).

<sup>34</sup> Bureau of the Budget, Staff Study on the Foreign Procurement of the United States Government (1963).

twenty-five per cent, were impractical and would result in additional cost to the Government.<sup>85</sup> The problem of foreign competition for federal contracts would seem to be a negligible one for American industry, since less than two per cent of the total dollars spent annually by federal agencies goes to foreign firms.

With so little opportunity to sell to the biggest customer in the world, science-based industry in Western Europe is forced to eke out support from its own governments, which are concerned with cutting costs and which buy much of their military hardware from American companies. To encourage this advantageous relationship, the Department of Defense has appointed a Deputy Assistant Secretary for International Logistics Negotiation, Henry Kuss, Jr. Kuss aids the United States defense industry in selling its products overseas. He has been provided with a \$1.5 billion credit insurance fund to support export sales.<sup>86</sup> Last year, sales reached \$1.4 billion, and Kuss was commended by Secretary McNamara at a special ceremony. This maximization of exports offsets much of the gold outflow resulting from the support of American troops overseas. But as a recent New York Times headline ("U.S. Leads World in Sale of Arms") illustrates, this "success" has its dubious aspects as well.<sup>87</sup>

For America to grant a greater share of its "new-technology" research and hardware procurement to non-American firms would be a selfless deed of heroic proportions, for governments at all times have favored domestic sources, often to a greater degree than does current United States policy. A State Department study of foreign procurement policies of member countries of the Organization for Economic Cooperation and Development indicates that few have defined their "buy national" policies as clearly and as publicly as has America. They rely instead on unpublished, confidentially-placed procurements with national sources, cumbersome administrative requirements, and closed supplier lists.<sup>88</sup>

A more generous American attitude at NATO negotiations and a revision or revocation of "Buy-American" principles are possible, but depend on several factors. The President and Secretary of Defense must be willing to act, despite the public outcry of American aerospace and defense firms and their groupings, such as the National Security Industries Association, the military personnel of the Department of Defense, labor unions, and congressional representatives. The American public must also appreciate the essential fairness of the situation. There is joint burden-sharing among the allies, and, therefore,

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<sup>85</sup> Id. at 16.

<sup>86</sup> Defense Department Does its Bit, *Business Week*, May 8, 1965, p. 82.

<sup>87</sup> *N.Y. Times*, supra note 5.

<sup>88</sup> Bureau of the Budget, supra note 34.



there should be joint sharing of the technological and economic benefits; further, "Buy-American" does not always work in the public interest.

The increasing role that new technology plays in the national economies of this country and its allies, the need for economic independence, and the equities of the situation all demand a diminution of the "Buy-American" philosophy. Otherwise, de Gaulle's example will not be difficult for America's other allies to follow.<sup>39</sup> As the advertisements of Premier Precision Ltd. have put it so clearly in London newspapers: "The United States Sells Defense Products to Us—but, they *Will Not Buy* from us!"<sup>40</sup>

<sup>39</sup> The Technological "Spin-off" (editorial), N.Y. Times, Sept. 15, 1965, p. 42, col. 1.

<sup>40</sup> The Observer, London, Sept. 20, 1964, p. 4, cols. 1-3. Another example:

Friends, Patrons, Patriots, lend us a drum—of your ear . . . Listen! . . . The roaring flood of increasing technological imports from abroad—which can be made far better and much cheaper in Britain—mutes the Boom of Britain's car exports to a mere whisper. The absurd sound made by our trivial share of the vast equipment contracts which arm N.A.T.O., C.E.N.T.O., S.E.A.T.O.: our diminishing share of Commonwealth and world trade; the enormous volume of misguided and perverse purchases of U.S. aircraft, technological devices and electronic Systems annually multiplied by obligatory expenditure upon expensive spare parts and costly maintenance are the basic cause of such discordant harsh warning notes within our Economy. All very sweet music to the expanding giant industries of our most powerful trade rival . . . .

. . . . Remember, all contracts placed with British companies pay taxes to the British Exchequer—which cures inflation! . . . Stagnation! . . . Technical Frustration! . . . and, even Brainpower Emigration!

Id., Sept. 26, 1964, p. 4, cols. 1-4.

MARCH 21, 1966.

HON. WENDELL WYATT,  
*House of Representatives, Washington, D.C.*

DEAR WENDELL: Thanks for your letter of March 19, 1966, in regard to our present Federal procurement laws, and the hearings scheduled for later this week by the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee, of which I am a member.

You discuss a real problem in your letter, and I appreciate having it. Be assured that the information therein set forth is being kept in mind.

Best wishes.  
 Sincerely,

THOMAS B. CURTIS.

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CONGRESS OF THE UNITED STATES,  
 HOUSE OF REPRESENTATIVES,  
*Washington, D.C., March 19, 1966.*

HON. THOMAS CURTIS,  
*House Office Building, Washington, D.C.*

DEAR TOM: It is my understanding that your Joint Economic Committee on March 23 and March 24 will conduct hearings on the economic impact of Federal procurement.

It has come to my attention that our American small handtool manufacturers are beginning to suffer severe hardships occasioned by present Federal procurement law which requires the General Services Administration purchase from the lowest bidder, foreign bidders included, and that only a 6-percent differential in favor of American manufacturers is allowed, except for small business firms for depressed areas where a 12-percent differential is permitted. I am advised that the Department of Defense, however, is permitted a 50-percent differential in its procurements to help offset our balance-of-payments problem.

I am reliably advised that unless our Federal procurement laws and procedures are changed to permit our American small-tool manufacturers to sell to the Federal Government under the 50-percent differential, as enjoyed by the Department of Defense, that they will face virtual extinction from foreign competitors whose hourly wage rates are ridiculously low compared to American wage rates.

It would be deeply appreciated if during the course of your hearings you could pose questions involving this problem to representatives of the General Services Administration and to other parties in an effort to determine just what might be done to help alleviate the plight of our American small-tool manufacturers. While I realize full well the need for competition and the need for our Federal Government to purchase at the lowest possible prices, I certainly do not feel that it is in the best interests of the United States through its own procurement policies to force our own tool manufacturers to go out of business by virtue of competition with foreign manufacturers paying unrealistic labor costs.

Thank you very much for your cooperation.

Sincerely yours,

WENDELL WYATT, *Member of Congress.*

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CONGRESS OF THE UNITED STATES,  
 HOUSE OF REPRESENTATIVES,  
*Washington, D.C., April 22, 1966.*

JOINT ECONOMIC COMMITTEE,  
*Subcommittee on Federal Procurement and Regulations,  
 U.S. Congress, Washington, D.C.*

DEAR COLLEAGUES: It has come to my attention that the Subcommittee on Federal Procurement held hearings on March 23 and 24, regarding economic problems in Federal procurement.

I understand that, as a result of great concern on the part of the handtool industry, many of whom contacted your committee regarding these hearings, the question was raised regarding the threat to this industry from the increasing

volume of foreign-made handtools now being purchased by the General Services Administration for Federal Government purposes.

As you know, there currently exists a considerable difference in the protection provided the domestic handtool manufacturers under GSA regulations, as compared with the regulations applied by the Department of Defense. Briefly, it involves a considerable disparity since the GSA is bound by the 6-percent preference for American industry—with a maximum of 12 percent under certain conditions—under the Buy American Act. On the other hand, I understand that the Department of Defense utilizes a different criteria to provide added protection to American industries, as justified by the balance-of-payments deficit. The DOD criteria will allow a preference amounting to nearly 50 percent.

Within the past 12 months, it has been estimated that a potential \$3 to \$4 million worth of contracts have been awarded to bidders by the GSA for the supply of products of the handtool industry of foreign origin.

In view of the apparent need for some means of providing greater protection to this American industry, I urge your consideration of this matter. The suggestion has been made that a change in the controlling Executive order, permitting GSA to utilize the same criteria now employed by DOD, might be an expeditious way of providing this badly needed relief.

The concern of the Congress must reflect, not only the immediate impact of this loss of business to our domestic manufacturers, but the long-range implications of the in-roads being made in the entire domestic market by these foreign manufacturers.

In the event the above-proposed relief does not materialize, it would appear imperative that the Congress explore other means of increased protection for the handtool industry and others similarly endangered. Such action would insure no further increase in our balance-of-payments deficit from this source.

With warmest personal regards and my appreciation for your consideration of this matter, I am,

Sincerely yours,

SILVIO O. CONTE,  
*Member of Congress.*

APPENDIX 3

CAREER DEVELOPMENT OF MILITARY AND CIVILIAN PROCUREMENT PERSONNEL

AUGUST 12, 1965.

J. M. LYLE,  
*Vice Admiral, SC USN, Director, Defense Supply Agency, Cameron Station,  
Alexandria, Va.*

DEAR ADMIRAL LYLE: Thank you for your letter of August 9, 1965, and the enclosures accompanying it, each relating to the new training and career development program recently initiated for Defense procurement personnel.

I very much appreciate your promptness in sending this information to me following our breakfast meeting, and this is exactly the material I was seeking.

Best wishes.

Sincerely,

THOMAS B. CURTIS.

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HEADQUARTERS, DEFENSE SUPPLY AGENCY,  
*Alexandria, Va., August 9, 1965.*

HON. THOMAS B. CURTIS,  
*House of Representatives, Washington, D.C.*

DEAR MR. CURTIS: Pursuant to your request, enclosed are copies of the principal pertinent documents relating to the new training and career development program recently initiated for Defense procurement personnel.

The enclosure contains copies of the following documents:

Secretary Vance's memorandum of January 7, 1965, setting forth the objective of the program and directing that a plan be prepared to achieve the stated objective;

Secretary McNamara's memorandum of May 3, 1965, approving the recommendations of a joint study group convened to prepare the career development plan. (Recommendations of the study group are attached thereto);

Secretary Ignatius' memorandum of June 26, 1965, establishing working groups to give effect to the joint study group recommendations; and

Secretary McNamara's memorandum of June 22, 1965, requesting that the Defense Supply Agency develop and operate an automated inventory and referral system for all civilian personnel participating in the program and serve as executive agent for the automated phase of the Defense civilian procurement career development program.

You mentioned during last week's breakfast that you had discussed a training program with Secretary McNamara in the course of a subcommittee hearing, but could not recall whether it related solely to procurement or to the whole spectrum of supply management. A record of one such discussion, dealing specifically with personnel engaged in contract administration, appears on page 33 of the 1964 hearings.

Thank you again for a very pleasant and interesting breakfast.

Sincerely,

J. M. LYLE,  
*Vice Admiral, SC USN, Director.*

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THE DEPUTY SECRETARY OF DEFENSE,  
*Washington, D.C., January 7, 1965.*

Memorandum for the Secretary of the Army, the Secretary of the Navy, the Secretary of the Air Force, the Assistant Secretary of Defense (I. & L.), the Assistant Secretary of Defense (Manpower), the Director, Defense Supply Agency.

Subject: Career development of military and civilian procurement personnel

(1) Recently an analysis was made of 150 military and 114 civilian personnel occupying key procurement positions in the Department of Defense. The analysis indicated that the typical civilian has had long service in the procurement organization and has remained in one location for a considerable period of time. His formal education in many instances is not as complete as that of his military counterpart. The typical military procurement official has had limited prior experience in procurement and his future assignments are not likely to be in this field.

(2) Because of the great importance of the procurement function, we must insure that key positions are occupied by highly qualified individuals, and that orderly career development programs for military and civilian personnel are established within each Department and the Defense Supply Agency.

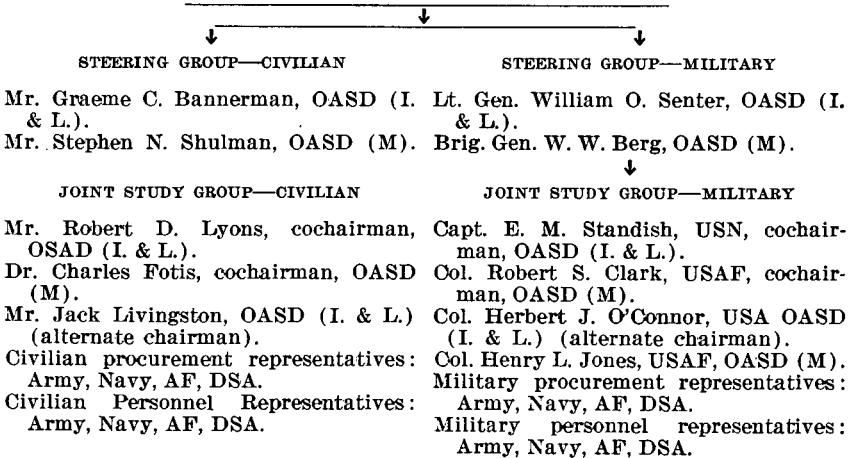
(3) Accordingly, I am asking the Assistant Secretary of Defense (Installations and Logistics), in coordination with the Assistant Secretary of Defense (Manpower), to submit plans to Mr. McNamara and me by March 15, 1965, for achieving the objectives outlined above. Mr. Ignatius and Mr. Paul, and representatives of their respective offices, will solicit the assistance of the Departments and the Defense Supply Agency in developing the necessary plans.

CYRUS VANCE.

#### ORGANIZATION, PROCUREMENT CAREER DEVELOPMENT STUDY

##### DOD POLICY GUIDANCE COMMITTEE

ASD (I. & L.)—Mr. Paul R. Ignatius  
 ASD (M)—Mr. Norman S. Paul  
 OASD (I. & L.)—Mr. Graeme C. Bannerman  
 OASD (M)—Mr. Stephen N. Shulman  
 OASD (I. & L.)—Lt. Gen. Wm. O. Senter  
 OASD (M)—Brig. Gen. W. W. Berg



THE SECRETARY OF DEFENSE,  
 Washington, May 3, 1965.

Memorandum for the Secretary of the Army, the Secretary of the Navy, the Secretary of the Air Force, Assistant Secretary of Defense (Manpower), Assistant Secretary of Defense (Installations and Logistics), Director, Defense Supply Agency.

Subject: Career development of military and civilian procurement personnel.

The Department of Defense now spends about \$28 billion each year in procuring the equipment and services needed to support our Armed Forces. It is essential that recognition be given to the men and women responsible for this

important function, and that they have adequate opportunities for improved career specialization and promotion. To accomplish this, in January 1965, I requested that the Assistant Secretary of Defense (Manpower), the Assistant Secretary of Defense (Installations and Logistics), and military and civilian designees from the military departments and the Defense Supply Agency conduct a study of the career procurement personnel field and recommend to me those actions necessary to assure, on a continuing basis, that qualified men and women were available to carry out these functions in the Department of Defense.

The recommendations submitted by the Military Joint Study Group and by the Civilian Joint Study Group (attached) have the concurrence of the Assistant Secretaries of Defense (Manpower, and Installations and Logistics). When implemented, they will represent an important step toward achieving improved career progression in the procurement function.

I approve these recommendations and the recommendation of the Assistant Secretaries of Defense (Manpower, and Installations and Logistics) (also attached) and request that you institute the necessary action to assure timely implementation on the schedule indicated in the attached recommendations.

Implementation of these recommendations will be monitored by the Assistant Secretary of Defense (Manpower) in coordination with the Assistant Secretary of Defense (Installations and Logistics). A progress report on implementation of the recommendations should be forwarded to me by the Assistant Secretary of Defense (Manpower) every 2 months beginning July 1, 1965.

ROBERT S. McNAMARA.

#### RECOMMENDATIONS OF THE MILITARY JOINT STUDY GROUP ON THE MILITARY PROCUREMENT CAREER PROGRAM

1. Each military department should insure within current programs that its career development programs provide for the:

(a) Establishment of a broader base of procurement billets in the grade of captain/lt. and 1st lt./lt. (j.g.) to provide an adequate flow of junior officers into the procurement field at an early date.

(b) Normal rotation patterns that will utilize to the maximum extent practicable those individuals with procurement experience.

(c) Recognition of the broader aspects of procurement.<sup>1</sup>

(d) Maximum utilization of college and graduate education in the assignment of personnel in the procurement field. Recognition of the desirability of bachelor's degree as a prerequisite for personnel entering the procurement field in the future.

(e) Establishment of minimum tour lengths for all procurement positions.

(f) Minimum experience and educational requirements for each level of responsibility.

(g) Assignment of personnel to designated procurement billets based on established standards of experience and education.

(h) Maintenance of complete and current data on procurement personnel resources and requirements.

(i) Coordination of the career development program of each military department with the Defense agencies so that the long-range personnel requirements of those agencies will be met.

2. Each military department should establish a uniform system for insuring that qualified personnel are assigned to key billets by:

(a) Designating its key procurement billets.

(b) Establishing the minimum standards required for qualification for key procurement billets. These standards should include:

(1) Three years direct procurement experience within the last 10 years of service.<sup>1</sup>

(2) Three additional years experience within any related or direct procurement duty<sup>1</sup> (no time frame).

(3) Attendance at an executive training refresher course.

3. The Assistant Secretary of Defense (Manpower), in coordination with the Assistant Secretary of Defense (Installations and Logistics), should provide the

<sup>1</sup> See attached definitions.

military departments the long-range requirements for procurement personnel in the Office of the Secretary of Defense and Defense agencies.

4. The Assistant Secretary of Defense (Installations and Logistics) should establish an executive procurement refresher training course for those personnel assigned to key positions.

5. Within a 6-month period from the date on which these recommendations are approved, each military department should provide for approval by the Assistant Secretary of Defense (Manpower) (in coordination with the Assistant Secretary of Defense (Installations and Logistics)) a time-phased plan for accomplishment of the foregoing recommendations.

RECOMMENDATIONS OF THE CIVILIAN JOINT STUDY GROUP ON THE CIVILIAN  
PROCUREMENT CAREER PROGRAM

1. The Assistant Secretary of Defense (Manpower), in coordination with the Assistant Secretary of Defense (Installations and Logistics), shall establish within 12 months, a civilian procurement career management program.

(a) The occupational areas under the civilian procurement career management program will be:

Series and title:

- GS-1101 General Business and Industry
- GS-1102 Contract and Procurement
- GS-1103 Industrial Property
- GS-1150 Industrial Specialist

In addition, civilian positions in any other series are included where 50 percent or more of the duties and responsibilities involve either preaward or postaward contracting functions.

(b) The program should provide for:

- (1) The development of a system to assure the entrance of an adequate number of highly qualified personnel at all levels of responsibility, particularly at a trainee level.
- (2) Mandatory training at the entrance, intermediate, and senior levels of the career field.
- (3) Mandatory appraisal and counseling at least annually.
- (4) Mandatory registration and referral of employees covered by the career program throughout the Department of Defense for certain key positions.

2. Each military department, the Defense Supply Agency, and other Defense agencies, as appropriate, will periodically evaluate and inspect the operation of the civilian procurement career management program within its jurisdiction and make an annual report to the Assistant Secretary of Defense (Manpower), who will take whatever action is appropriate on the basis of the reports in coordination with the Assistant Secretary of Defense (Installations and Logistics).

3. Rotation or cross-training among DOD components in establishing the civilian procurement career management program shall be considered for employee development.

4. Authority should be delegated to the military departments and, as appropriate, the Defense agencies, for the administration of the civilian procurement career management program under the monitorship of the Assistant Secretary of Defense (Manpower) in coordination with the Assistant Secretary of Defense (Installations and Logistics).

5. An executive agent should be designated for those phases of the civilian procurement career management program which should be automated; automation should be applied to the maximum extent feasible.

6. The Assistant Secretary of Defense (Manpower), in coordination with Assistant Secretary of Defense (Installations and Logistics) should establish working groups to:

(a) Develop a DOD career appraisal system utilizing the best features of the Army and DSA career programs.

(b) Study and develop a DOD-wide master training agreement to facilitate the entry, assignment and qualification of personnel for careers in the field of procurement.

(c) Investigate and develop a plan to provide for rotational assignments in industry.

## RECOMMENDATION OF ASSISTANT SECRETARY OF DEFENSE (MANPOWER) AND ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS)

Each military department should identify within 6 months of the date of approval of this recommendation those key procurement positions which should be filled (1) only by military personnel and (2) only by civilian personnel.

## DEFINITION OF PROCUREMENT

For the purposes of this study the group agreed on the definition of procurement as defined in paragraph 1-201.13 of Armed Services Procurement Regulations as follows:

"Procurement includes purchasing, renting, leasing, or otherwise obtaining supplies or services. It also includes all functions that pertain to the obtaining of supplies and services, including description but not determination of requirements, selection, and solicitation of sources, preparation and award of contract, and all phases of contract administration."

The functional elements included within the framework of this definition were classified as either direct or related as follows:

DIRECT	RELATED
Procurement contracting officer (PCO)	Auditor
Contract negotiator	Government (independent) cost estimator
Buyer	Financial program manager
Cost and price analyst	Systems' support (project officers)
Preaward	Legal (procurement)
Administrative contracting officer (ACO)	Small business
Estimating system reviews	Industrial security
Purchasing system reviews	Industrial planning
Terminations	Data and financial management (includes management data, accounting, and payments of contractors)
Industrial property administration	
Production: Industrial engineering expediting	
Procurement packing and preservation analyst	
Management of procurement (Staffs for review and approvals)	

ASSISTANT SECRETARY OF DEFENSE,  
Washington, D.C., June 26, 1965.

## Memorandum for the—

Assistant Secretary of the Army (I. & L.).  
Assistant Secretary of the Navy (I. & L.).  
Assistant Secretary of the Air Force (I. & L.).  
Director, Defense Supply Agency.

Subject: Career development of civilian procurement personnel.

On May 3, 1965, Secretary McNamara authorized the establishment of working groups to implement the recommendations of a civilian joint study group on the civilian procurement career program. In order to adhere to the schedule of the phased plan of the joint study group, it will be necessary to receive personnel support from the Departments in developing further refinements to the DOD-wide master training agreement, the master training plan, and the DOD career appraisal system.

It is desirable that all departments and all levels of activity be represented in these efforts. July 6-9, 1965, has been selected as the time for a meeting which will be convened in 1ES01, conference room No. 5, the Pentagon, at 9:30 a.m. To avoid an excessive requirement on your department for personnel, the civilian joint study group have recommended representation to the working groups as shown in the attached.

Additional time and the use of various functional specialists may be required in the future for a limited period. Please submit the names of your nominees to Robert D. Lyons, Director of Procurement Management, OSD (I. & L.).

PAUL R. IGNATIUS,  
*Assistant Secretary of Defense (Installations and Logistics).*



## CIVILIAN PROCUREMENT CAREER PROGRAM WORKING GROUPS

## DEPARTMENT OF THE ARMY

1. Procurement Specialist, AMC.
2. Procurement Specialist, Procurement Management Review Group.
3. Representative from Army Service Schools (ALMC, AMETA) or training specialist familiar with procurement courses and course content.

## DEPARTMENT OF THE NAVY

1. Procurement Specialist, Bureau of Supplies and Accounts, who is familiar with field purchasing organizations.
2. Procurement Specialist, Procurement Management Review Group.
3. Procurement Specialist utilizing procurement training.

## DEPARTMENT OF THE AIR FORCE

1. Procurement Specialist, AFSC, division level (e.g., ASD, SSD, ESD or BSD).
2. Procurement Specialist, Procurement Management Review Group.
3. Representative from AFIT-SL, WPAFB or Air University, Maxwell Air Force Base or training specialist familiar with Air Force procurement courses and course content.

## DEFENSE SUPPLY AGENCY

1. Procurement Specialist, Procurement Management Review Group.
2. Procurement Specialist from DSA center.

THE SECRETARY OF DEFENSE,  
*Washington, June 22, 1965.*

Memorandum for Director, Defense Supply Agency.

Subject: DOD career program for civilian procurement personnel.

In my memorandum dated May 3, 1965, subject: "Career Development of Military and Civilian Procurement Personnel" (attachment I), I approved the recommendations of the civilian and military joint study groups, the purpose of which are to achieve improved Department of Defense career development of military and civilian personnel.

In order to insure the availability, on a continuous basis, of highly qualified individuals to carry out the procurement functions in the Department of Defense and to achieve the greatest possible efficiency in the operation of the personnel inventory and referral system established for this purpose, it is desired to establish one central point where all personnel participating in the program would be registered. In turn, those registered would be referred to position vacancies, as appropriate, by means of an automatic data processing system.

The Defense Supply Agency and the commander, Defense Electronic Supply Center, have done an outstanding job in programing the DOD Nationwide Priority Referral System for computer operation. We believe this experience, combined with other work which the DSA has done in automating personnel data, make DSA the most desirable Agency to serve as the executive agent for those phases of the DOD career program for civilian procurement personnel which are to be automated.

I request, therefore, that your Agency under the policy direction of the Assistant Secretary of Defense (Manpower) program such a system for machine operation and serve as executive agent for the automated phases of the DOD civilian procurement career development program. It is desired that this system be operational by January 1, 1966, with registration of all key personnel in positions GS-13 and above to be completed by April 1, 1966, and the remainder of the registration (GS-12 and below) to be completed by September 1, 1966.

The system to be developed should consider compatibility with any existing DOD systems. It should be developed so that it may be expanded to include other DOD career programs, if found desirable and feasible.

The general outline of the concept of the automatic data processing system is contained in attachment 2.

The Assistant Secretary of Defense (Manpower) will provide you with further information on the content of the system should it be desired.

(Signed) ROBERT S. McNAMARA.

#### CONCEPT OF PERSONNEL INVENTORY AND REFERRAL SYSTEMS IN CERTAIN DOD CAREER PROGRAMS

1. Personnel data will be fed into a central computer on each employee who has satisfied the requirements for participating in a DOD career program and is registered in the program. The data should contain a résumé of the employee's experience; full information on his qualifications including the specific types and levels of positions for which he is qualified; résumé of his education, training, and background; security clearance; and other data including data extracted from the appraisal and counseling documents which will reflect the quality of employee's performance and potential for assuming positions of greater responsibility. The system should be able to reflect the specific desires and willingness of the employee to accept positions at other locations, and at lower, lateral or higher levels. Further, the system should be capable of continuous speedy updating of data maintained on the employee. A minimum requirement for complete updating annually should be imposed. The system should provide for identifying those individuals who are not being considered for promotional opportunities because they have failed to comply with the requirements of the program.

2. Each component within the Department of Defense will be required to check against the central computer register for qualified employees before filling vacancies for GS-14 level and above except for lateral reassignment within the same series within an installation, reclassification of jobs resulting from gradual job enlargement, placement of employees exercising mandatory reemployment rights, and placement of employees being displaced due to reduction-in-force or base closure. The computer will match the qualification of the registrants with the established job profile qualification requirements of the vacancy and will forward to the installation having the vacancy a referral list containing full data on all eligible employees. The executive agent in collaboration with the services will develop and submit to the ASD(M) indexes which will enable the system to identify, in a referral list, the best qualified candidates (approximately 20) from among the eligibles registered in the program. The individuals on the list will then be rated and ranked against the established criteria of the position by the DOD component having the vacancy and the best qualified will be selected. A method will also be established by which the installation having the vacancy will report promptly to the executive agent the action taken regarding the filling of vacancy.

3. Each department and agency will establish its system of referral for GS-13 level positions and below which will include optional use of the DOD Central Computer Nationwide Referral System. The DOD central system should be compatible, insofar as possible, with the services and DSA in order to permit installations, and/or Command or Bureau-wide and/or servicewide competition filling vacancies under the optional as well as the mandatory provisions of the program. The system should be geared to permit, as appropriate, direct communications between the user and the executive agent.

4. The inventory system will provide for mandatory registration of all personnel who are engaged in procurement functions and are classified in the GS-1101, GS-1102, GS-1103, and GS-1150 series at the grades GS-5 and above. In addition, personnel in other classification series whose duties and responsibilities include preaward or postaward contracting functions which entail 50 percent or more of their total job responsibilities will be registered.

5. Optional registration will be provided for by the system for personnel who by virtue of their total work experience, training, and other developmental activities are qualified for procurement jobs and who desire to participate in the program.

6. The Assistant Secretary of Defense (Manpower) will be responsible for policy direction of the system and for followup for possible improvements and for expansion of the system to include other DOD career programs as they are developed.

## APPENDIX 4

### ADEQUACY OF CONTROLS OVER GOVERNMENT-OWNED PROPERTY IN THE POSSESSION OF CONTRACTORS<sup>22</sup>

REPORT TO SUBCOMMITTEE ON FEDERAL PROCUREMENT AND REGULATION, JOINT  
ECONOMIC COMMITTEE, CONGRESS OF THE UNITED STATES

(By the Comptroller General of the United States, March 1966)

COMPTROLLER GENERAL OF THE UNITED STATES,  
Washington, D.C., March 17, 1966.

B-140389.

HON. PAUL H. DOUGLAS,  
*Chairman, Subcommittee on Federal Procurement and Regulation, Joint Economic Committee, Congress of the United States.*

DEAR MR. CHAIRMAN: In accordance with recommendations contained in your subcommittee's 1965 report, we have performed a limited survey of the adequacy of controls over Government-owned property in the possession of Defense contractors.

Our survey indicates that there is a need for the Department of Defense to improve the quality of the work being performed by Government property administrators. Under the prevailing practices at the four contractor plants we visited, the required surveillance of contractor controls over Government-owned property is only partially performed or is poorly documented. Our survey was not extensive enough to determine how widespread these conditions are. We noted that the Department of Defense had drafted uniform regulations relating to the activities of the property administrators of all Defense agencies and military departments. The proposed regulations appear to require more effort for property administration than that generally being devoted to this area at the present time.

Before the Department's regulations can be fully effective, we believe that further study needs to be given to the problem of how much responsibility the contractors should have for reasonable care of Government property in their possession. The effect of the Department's current policy for noncompetitive contracts is that contractors are generally not held liable for the loss, damage, destruction, or disappearance of Government property while it is in their possession. This policy was adopted many years ago when it was believed that further liability on the part of the contractor would lead to increases in contract prices not commensurate with the benefits received. Since there have been significant changes in the Department's procurement practices in recent years, we believe that reevaluation of the policy is warranted. We believe also that this matter warrants thorough study to insure that the Government would realize commensurate benefits from the surveillance provided by new methods or policies adopted. We are suggesting in our report that your subcommittee recommended to the Department of Defense that it undertake such a study.

In view of the time limitation on reporting to your subcommittee, we were unable to solicit formal comments on this report from the Department of Defense. Therefore, we do not have the benefit of any further information the Department may be able to present on the problem areas discussed in our report.

Copies of this report are being sent today to the Secretary of Defense for information pursuant to arrangements with your staff. We plan to make no further distribution of this report unless copies are specifically requested, and then copies will be distributed only after your approval has been obtained or public announcement has been made by you concerning the contents of our report.

We trust that our report provides you with the information required. We have several examinations currently in progress which are concerned with the

<sup>22</sup> See also app. 8, re Contract Administration Services.

administration of Government-owned property in the possession of Defense contractors. We shall be pleased to provide you with copies of any reports which may result from these reviews.

Sincerely yours,

ELMER B. STAATS,  
*Comptroller General of the United States.*

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#### REPORT ON SURVEY OF ADEQUACY OF CONTROLS OVER GOVERNMENT-OWNED PROPERTY IN THE POSSESSION OF CONTRACTORS, DEPARTMENT OF DEFENSE

##### INTRODUCTION

At the request of the Subcommittee on Federal Procurement and Regulation, Joint Economic Committee, in its 1965 report on the "Economic Impact of Federal Procurement," the General Accounting Office has made a limited survey of the adequacy of controls over Government-owned property in the possession of contractors.

In performing our survey, we visited various offices of the Department of Defense (DOD) and the military services and the plants of four Defense contractors. The contractors selected for our survey included one Army plant, two Navy plants, and one Air Force plant. We examined (1) the policies established by DOD, as set forth in its regulations for the control of Government-owned property in the possession of contractors, and (2) the related implementing instructions issued by the military services. We selected for further evaluation those policies which appeared to warrant particular attention. In addition, we inquired into whether the Government's property administrators were performing the duties prescribed for them in the regulations. We also reviewed audit reports and agency management reports relating to the control over Government-owned property. We did not examine into the controls over military personal property and certain categories of facilities.

We did not review activities being managed by the Defense Contract Administrative Services, a component of the Defense Supply Agency; because, at the time we initiated our survey, that agency's internal auditors had already started their own review of Government-owned property. We have requested the agency to furnish us with a copy of its report.

##### BACKGROUND

The Government's inventory of property in the hands of contractors consists of all property owned by the Government or acquired by the Government under the terms of a contract. It includes both property which the Government may furnish to a contractor and property procured or otherwise provided by a contractor, title to which is vested in the Government.

The policies governing the control of this property are set forth in the Armed Services Procurement Regulation (ASPR). As prescribed in this regulation, there are five classes of Government property: Material, special tooling, special test equipment, military property, and facilities. A definition of these terms and the Government's reported investment in 1965 for each class of property at the plants administered by the military services were as follows:

*Material*

This class includes all property which may be incorporated into or attached to an end-item to be delivered under a contract or which may be consumed or expended in the performance of a contract. The value of material was \$2,167 million.

*Special tooling*

This is defined as being all jigs, dies, fixtures, molds, patterns, taps, gages, other equipment and manufacturing aids, and replacements thereof, which are of such a specialized nature that, without substantial modification or alteration, their use is limited to the development or production of particular supplies or parts thereof or the performance of particular services. The acquisition cost of the Government's inventory of special tooling was \$1,778 million.

*Special test equipment*

This means electrical, electronic, hydraulic, pneumatic, mechanical, or other items or assemblies of equipment, which are of such a specialized nature that, without modification or alteration, the use of such items (if they are to be used separately) or assemblies is limited to testing in the development or production of particular supplies or parts thereof or in the performance of particular services. The value of special test equipment is included in special tooling above.<sup>1</sup>

*Military property*

This class consists of military personal property, such as an airplane, which is provided to the contractor to assist him in performing a contract but which is not consumed or incorporated in the end-items produced. The Government's investment in this property was \$194 million.<sup>2</sup>

*Facilities*

This term refers to industrial property for production, maintenance, research, development, or test; including real property and rights therein, buildings, structures, improvements, and plant equipment. Plant equipment includes personal property, such as furniture, machinery, equipment, machine tools, and accessory and auxiliary items, regardless of cost, which is used or capable of being used in the manufacture of supplies or in the performance of services. The investment in this property totaled \$2,961 million.

It is the policy of DOD to have its contractors maintain the official records of Government-owned property in their possession. The Department holds the contractor accountable for this property until an agent of the Government relieves the contractor of further responsibility to account for the property. The Department requires that a property administrator be designated for each contract involving Government property. The designated property administrator is the key Government employee with respect to the control over Government-owned property. His more significant duties, as set forth in the ASPR, include the responsibility for (1) reviewing and approving the contractor's property accounting system, (2) examining documents to the extent necessary to establish the correctness and completeness of the contractor's property records, (3) determining whether the contractor is reasonably using the property, and (4) furnishing management data required by the military services. The methods to be followed by the property administrators in achieving the policy objectives set forth in the ASPR are discussed in instructions issued by each of the military services.

Government-owned property is located at about 5,000 plants operated by Defense contractors, but only about 50 of these plants were engaged in the manufacture of major weapons systems at the time of our review. As the responsibility for contract administration for these major weapons systems is with the Army, Navy, and Air Force, the individual services currently have responsibility for control of Government-furnished property at the contractors' plants involved.<sup>3</sup>

The responsibility for contract administration at other contractor plants has been delegated by the Department of Defense to the newly formed Defense Contract Administration Services (DCAS), a component agency of the Defense Supply Agency. Accordingly, responsibility for control of property at contractor

<sup>1</sup> Prior to April 1965, this class of property was considered to be special tooling.

<sup>2</sup> This amount includes Army and Air Force property. The Navy included the cost of its military property in the other amounts it reported for material, special tooling, and facilities.

<sup>3</sup> While our review was in process, DOD assigned to the Navy the responsibility for control over Government property at 85 plants engaged in building or repairing ships.

plants not involving major weapons systems procurement rests with DCAS. This agency was created as a result of a DOD study known as Project 60. The study recommended the above-described division of property administration responsibilities, but suggested that DCAS eventually become responsible for control of Government property at all contractors' plants.

A list of principal officials of DOD and the military departments responsible for the administration of activities discussed in this report is included as appendix I.

#### SURVEY FINDINGS AND RECOMMENDATION

Information developed during our survey of four defense plants indicates that there is a need for DOD to improve the quality of the work being performed by Government property administrators. Under the prevailing practices, the required surveillance work is only partially performed or is poorly documented. We noted that DOD has drafted uniform regulations pertaining to the activities of property administrators of all defense agencies. The proposed regulations appear to require more effort for property administration than that generally being devoted to this area at the present time.

Before the Department's new regulations can be fully effective, we believe that further study needs to be given to the problem of how much responsibility the contractors should have for reasonable care of Government property in their possession. The effect of the Department's current policy for noncompetitive contracts is that contractors are generally not held liable for the loss, damage, destruction, or disappearance of Government property while it is in their possession. This policy was adopted many years ago when it was believed that further liability on the part of the contractor would lead to increases in contract prices not commensurate with the benefits received. Since there have been significant changes in DOD procurement practices in recent years, we believe that reevaluation of the policy is warranted.

The details of our findings and our conclusions are presented in the following sections of the report.

#### *Need to improve the quality of surveillance work performed by Government property administrators*

Our survey disclosed that there are an abundance of rules and regulations covering the activities of property administrators. However, the quality of the surveillance work actually being performed by Government property administrators needs to be improved. Attempts to improve the quality of the work have been made in the past, and at the present time DOD is considering taking action in this area. Details on these matters are presented below.

*Insufficient record of extent of surveillance work performed.*—The ASPR and each of the military services require, in varying degrees, that the property administrator must perform surveillance examinations of contractor property control practices to insure that adequate controls are employed over Government-owned property. Our survey of four selected contractors disclosed that, at each location, the files maintained by the Government's property administrator did not contain documentary evidence covering their surveillance activities in certain areas.

The problem of poorly documented work is illustrated by the conditions found at a contractor's plant where the Army is responsible for the administration of Government property. These are summarized below.

The Army's regulations specify that (1) the property administrator must conduct periodic surveillance tests of contractor controls and must prepare workpapers outlining the scope of the surveillance check and items covered and (2) the file of workpapers prepared by the property administrator shall be relied upon as one of the most important indications of the effectiveness of the property administrator's work. Our survey indicates that the Army's property administrator did obtain and review the contractor's written property control procedures and the property administrator contended that he had, in fact, made periodic tests of the application of these procedures. The property administrator, however, could not furnish us any workpapers which showed that he had made tests of the application of these procedures, nor could the property administrator furnish any documentation showing (1) the scope and frequency of the tests he allegedly made or (2) the findings developed from such tests. The property administrator informed us that he had many other duties assigned to him and that he was understaffed and, as a result, he had not been able to satisfy all requirements of Army regulations.

We found that substantially similar documentation problems prevailed at both of the Navy plants we visited. However, at the plant under the cognizance of the Air Force, we found that the property administrator's activities were supported in many areas by some form of documentation or workpapers.

In the absence of documentation showing the scope and nature of the property administrators' tests of the contractors' property control procedures, we were precluded from evaluating the overall effectiveness of the property administrators' work within the time limits of our survey.

*Insufficient review as to need for retention of Government-owned equipment.*—Our survey revealed that the military services were not complying with certain control measures which had been established over plant equipment.

With respect to plant equipment, our survey showed that, in March 1964, DOD issued a directive which required each of the military services to perform periodic assessments of the actual use of plant equipment in the possession of contractors. In May 1965 the Assistant Secretary of Defense (Installations and Logistics) issued a supplemental memorandum which established criteria to be used in determining the reasonableness of the contractor's actual use of industrial plant equipment. In his letter, the Assistant Secretary of Defense expressed concern that instances had been noted where machines had been given minimum use in order to evade the requirement that idle machines be declared excess and be made available for use by other contractors. For example, the Assistant Secretary cited 1 installation that had 47 turret lathes but only 17 operators and another facility that had 30 grinders but only 40 hours of grinder work a month. The Assistant Secretary stated that the work had been spread out over the 30 machines so that all could be reported as active when it could have been accomplished by 1 machine in 1 week.

With the exception of the Navy, the military services issued directives to their procurement offices instructing them to comply with the DOD directive. The only Navy requirement in this area that we found was a directive of January 1959, which specifies that the property administrator is to make a test to ascertain whether there is any equipment not in current productive use and not contemplated for use within 30 days. This regulation does not require an assessment of the extent of utilization of the equipment.

Our survey revealed that the DOD requirement for a periodic assessment of actual use of industrial production equipment had not been adhered to at the four plants we visited.

At one contractor's plant where the Navy has responsibility for property administration, we found that the property administrator was not aware of the DOD directive or its contents and had not performed an assessment of the use of production equipment. We examined the contractor's plant equipment utilization records and found that:

(1) With respect to turret lathes and grinders, the current capacity of of machines on hand far exceeded the machine capacity needed for projected business, as computed by the contractor.

(2) The contractor had 104 lathes but its personnel records showed that only about 73 machinists were available in January 1966 on 1 shift. With respect to grinders, the contractor had 30 machines but only 16 operators.

We discussed this matter with a contractor official, and he indicated that a number of machines could be declared idle but that, if the contractor did this and later on had a requirement for the machines, there was a possibility that the Government would not be able to provide the machines at that time.

At the other contractor plants we visited, we were informed that at one location the contractor did not record data on machine utilization.<sup>4</sup> At another location the contractor had the data but the property administrator did not use it to make an assessment of the use of plant equipment, and at the other location the contractor had installed on December 1, 1965, a system to provide the necessary data.

*Agency actions affecting the Government's property administration program.*—Our survey disclosed that for some time the military services had been concerned with the quality of surveillance work being performed by property administrators. In this regard, the Air Force furnished us a copy of a man-

<sup>4</sup>At this plant the contractor was engaged in a substantial expansion program, and, therefore, the matter of excess machine capacity may not have been a problem at this location.

agement study concluded by the Air Force in early 1963. This study states that the ASPR, as revised in August 1959, substantially increased the authority and responsibilities of property administrators but that the job standards published for property administrators in February 1959 had not been updated to correspond with the increased authority, latitude of judgment, and independence of action vested in property administrators by the new regulations. The study also shows that in 1962 deficiencies in contractors' controls over Government property were being found at many locations. The study pointed out that the Air Force had been unable to employ and retain the caliber of personnel needed to adequately perform the duties and responsibilities assigned to the property administrators. The study proposed to improve the quality of the work being performed by upgrading the personnel assigned to this work. We were advised by the Air Force that action had not been taken to accomplish the upgrading of these personnel.

During our survey, we ascertained that the ASPR Committee was in the process of finalizing a comprehensive manual for the control of Government property. We have been informed by an Air Force official that the present draft of this comprehensive manual was put together by Army, Navy, and Air Force representatives and that the manual is a consolidation of the best points contained in existing regulations and includes updated ideas of the members of the Committee. It is contemplated that this comprehensive manual will become the standard manual of all the services and that individual service implementing regulations will no longer be required.

Although we haven't evaluated all the individual requirements of the proposed regulations, we believe that these regulations, if properly implemented, offer a basis for improving the quality of the surveillance work now being performed by property administrators. For example, the proposed regulations emphasize the importance of verifying the adequacy of procedures by making tests of transactions and state that:

"\* \* \* it is vital that the property administrator develop by physical test, supported by work-papers in acceptable form, whether the approved procedures are consistently applied. If deficiencies in physical control or records are disclosed by physical tests, corrective action on the deficiencies must be secured, the effectiveness of such correction in turn to be evaluated through physical tests. Recommended approaches for tests of critical areas are set forth in the following paragraphs."

The proposed regulations appear to require substantially more effort for property administration than is generally being devoted to this area at the present time.

*Need for study to reevaluate policy covering contractor's responsibility for property*

As previously stated on page 4, it is the policy of DOD to hold its contractors accountable for all Government property furnished to them until an agent of the Government relieves the contractor of further responsibility to account for the property. Although the contractor has the responsibility to account for Government property, we found that DOD has different policies regarding the contractor's actual liability for Government property while it is in its possession.

Under one policy, the contractor is responsible for all Government property, except for reasonable wear and tear and items consumed in the performance of the contract. This policy is applicable to competitively awarded fixed-price contracts and appears to be reasonable in that it requires the contractor to exercise care over the property. In noncompetitive procurements, where cost data are used in negotiating the price paid by the Government. DOD's current policy is that the contractors are generally not held responsible for the loss, damage, or destruction of Government property unless it can be established that the loss was caused by willful misconduct or lack of good faith on the part of the contractors' managerial personnel. We believe that this latter policy imposes too little responsibility on the contractor and weakens the control over property in the possession of contractors. Since this policy was adopted many years ago and since procurement conditions have change substantially in recent years, we believe that reevaluation of this policy is warranted. Details of our findings in this area are presented on the following pages.

*Contractors' liability for Government property under noncompetitive contracts is practically nonexistent.*—Under negotiated noncompetitive contracts DOD does not generally hold contractors liable for any Government property lost, damaged,



or destroyed unless it can be established that the loss was caused by willful misconduct or lack of good faith on the part of the contractors' managerial personnel. From our review of the reports of lost, damaged, or destroyed property which were prepared by agency personnel, we found no cases where the contractor was held responsible because its top management was guilty of willful misconduct or lack of good faith.

The following examples illustrate the type of situations that arise under the existing policy.

At an Air Force contractor's plant, a building containing highly combustible materials caught fire and approximately \$8 million worth of Government-owned property was destroyed. This property was not covered by insurance. Our review of available documents disclosed that the contractor held a hearing to determine the cause of the fire, and several witnesses testified that conditions in the building prior to the fire may not have been in conformance with proper fire prevention procedures. Some of the specific allegations made by these witnesses indicated that there may have been overloaded circuits, a defective fire hydrant, and smoking in designated nonsmoking areas and that the minimum safety distances between combustibles had not been maintained. Government officials informed us that, even if these allegations were established as fact, they could not hold the contractor liable, since there was no willful misconduct or lack of good faith on the part of management.

At a Navy contractor's plant, an inventory taken by the contractor disclosed that about \$227,000 worth of Government property was missing and could not be located. The missing property was considered to be plant equipment and most of these items cost less than \$200 each. The missing property included such items as fire extinguishers, workbenches, vises, storage cabinets, racks, pallets, and tables. Although the Navy's regulations provide that it contractors be required to take an inventory of such minor property items every 3 years, we were informed that this was the first inventory of minor plant equipment taken at this location in 13 years. Information obtained during our survey indicates that the contractor's property accounting procedures were approved by the Navy's property administrator for the first time on December 15, 1964. However, the contractor's actual practices had been under surveillance by the property administrator for several years. Navy records state that its investigations of the circumstances pertaining to the losses failed to establish that the contractor was liable for the losses. The records also state that the losses were within normal industrial expectancy.

When property of this nature is provided under noncompetitive contracts, the contractor ordinarily is not responsible for its loss, damage, or destruction. Therefore, the Government would generally bear the full consequences of all property losses of this type, as well as any other losses that might arise from other conditions, such as careless actions on the part of employees of a Defense contractor. This imposes a greater risk on the Government than is ordinarily assumed by the owner of property delivered to another party in trust for a special purpose.

*High degree of risk assumed by Government for contractor property losses requires heavy stress on surveillance work.*—The ASPR provides that the Government's property administrator should require the contractor to report to him all cases of loss, damage, or destruction of Government property as soon as such facts become known. The ASPR provides further that the property administrator report to higher officials the facts of the case and his recommendations thereon. In implementing these regulations, the Navy has issued instructions which require the property administrator to obtain from the contractor a report setting forth the facts of the case and the actions taken or planned to prevent repetition of similar instances. However, the reports that we examined generally do not indicate that the Navy property administrators have required Navy contractors to take any action to prevent repetition of the losses. The requirements imposed on property administrators in the regulations discussed above are, in our opinion, proper requirements and should be enforced as long as DOD continues its existing policies regarding contractors' liability.

In 1963 many people in the Air Force thought they had found a trend toward increased major deficiencies in control of Government property in the possession of contractors and concluded that undetected deficiencies or delays in correcting

deficiencies in a contractor's system for control of Government property could result in substantial losses to the Government. At that time, the Air Force had made a review of the property administration function. In the resultant report, it was stated that the Air Force was unable to employ or retain the caliber of personnel needed to adequately perform the duties and responsibilities assigned to property administrators. The report recommended an increase in the grade level of the property administrators. In this connection, our review indicates that property administrators generally now occupy positions having a civil service rating of GS-9 (salary \$8,500 a year).

In order to attain a maximum degree of effectiveness in its surveillance program, the Air Force, on January 4, 1965, issued to property administrators standard instructions covering the techniques and methods to be used in evaluating contractor's property control systems. These instructions prescribed the extent of coverage to be given each functional area and have been considered in the preparation of the proposed revision to the ASPR covering property administration. As stated previously, the proposed ASPR places heavy stress on improving the extent of surveillance work.

*Present policy may be outdated.*—During our review, we discussed with agency officials the history of the Government's present policy with regard to contractors' liability for Government-owned property. We were informed that, prior to World War II, contractors were responsible for all Government property in their possession. During 1942, the military departments determined that the Government should generally assume responsibility for property furnished to contractors. We were advised that the principal factors in this decision were (1) the extensive use of cost-type contracts under which the Government was charged the full cost of performance, (2) the inability of the contractors to obtain commercial insurance coverage in amounts large enough to cover certain property items, and (3) the possibility of savings to the Government to the extent of the overhead and profit of commercial insurance companies.

Existing conditions differ substantially from the conditions that prevailed during World War II. At that time, manufacturing effort was centered almost exclusively on the production of items for the Government and it was not uncommon to find contractors operating, on a cost-plus basis, Government-owned plants which were filled exclusively with Government-owned materials and equipment. Under these conditions, it may have been reasonable for the Government to assume general responsibility for the loss, damage, or destruction of any of its property.

In recent years, cost-type contracts are being used less frequently and the Government is emphasizing competitive procurements under fixed-price contracts. Also, most Government contractors have substantial investments in their own facilities, and these facilities are being used both for Government work and for commercial work. Therefore, the conditions prevailing during World War II have significantly changed. In fact, at the present time many contractors simultaneously perform work on commercial businesses, on a Government contract awarded on a competitive basis, and on a Government contract awarded on a noncompetitive basis.

Although the work is performed in the same general area where it is subject to the same general risks, contractors may have vastly different degrees of responsibility for the property in their possession. For example, on commercial work a contractor is fully responsible for all of his own property regardless of type, area, or risk. Under competitively awarded fixed-price contracts, the contractor is responsible for all Government property except for reasonable wear and tear and items consumed in performance of the contract. Under negotiated noncompetitive contracts, the contractor is generally not responsible for the loss, damage, or destruction of Government property unless it can be established that the loss was caused by willful misconduct or lack of good faith on the part of the contractors' managerial personnel.

Since the existing conditions significantly differ from conditions prevailing during World War II, it seems reasonable for the Department to reevaluate its policy with respect to contractors' responsibility for Government-owned property in their possession. In this connection, we noted during our review of the ASPR Committee files that an Air Force officer had recommended a change in the policy regarding contractors' liability. This recommendation had been considered, but at the time of our survey action had not been taken to implement it.

We informally discussed the subject of increased contractor liability with DOD officials, who contended that such a proposal might result in increased costs to the Government. We recognize that, if the liability policy were changed to pro-

vide that contractors would assume more risk, the contractors involved might have a basis for requesting an increase in contract prices. The amount of such increases actually borne by the Government would, of course, be dependent upon a number of factors, including the extent of any such additional risk, the ability of the contractor to have the additional risk blanketed by his existing insurance, the ability of the Government's negotiators to resist such upward pressure on prices, and the extent to which the cost of the risk would be offset by a reduction in the cost of property control measures required or to be required by the Government. If, in an individual case, it were determined that the cost of risk to be borne by the contractor was excessive in relation to the benefit to be derived, the Government could continue to assume responsibility for the property.

#### CONCLUSIONS

We believe that the information developed during our survey shows that the quality of surveillance work being performed by Government property administrators needs to be improved. Although DOD might substantially improve the quality of the Government's surveillance activities by requiring proper implementation of the existing or revised regulations and by increasing the grade levels of its property administrators, we believe that it is reasonable to expect that the benefits that may be derived from such improved surveillance could be largely negated unless the contractors' responsibility for Government property is increased.

We believe that the Department's present policy should be reevaluated and a current determination should be made as to whether an increase in contractors' responsibility would result in a significant increase in costs to the Government and, if so, whether it is possible to offset the amount of such an increase by reducing losses or the cost of the surveillance that might otherwise be required.

#### Recommendation

We, therefore, suggest that the subcommittee consider recommending to the Department of Defense that it undertake a thorough study to determine, under current and foreseeable conditions, the most effective and economical method of obtaining adequate control over Government-owned property in the possession of Defense contractors.

#### [Appendix I]

#### *Principal officials of the Department of Defense and the military departments responsible for the administration of activities discussed in this report*

	Tenure of office	
	From—	To—
Department of Defense:		
Secretary of Defense: Robert S. McNamara .....	January 1961 .....	Present.
Deputy Secretary of Defense:		
Cyrus R. Vance .....	January 1964 .....	Do.
Roswell L. Gilpatric .....	January 1961 .....	January 1964.
Assistant Secretary of Defense (Installation and Logistics):		
Paul R. Ignatius .....	December 1964 .....	Present.
Thomas D. Morris .....	January 1961 .....	December 1964.
Department of the Army:		
Secretary of the Army:		
Stanley R. Resor .....	July 1965 .....	Present.
Stephen Ailes .....	January 1964 .....	July 1965.
Cyrus R. Vance .....	July 1962 .....	January 1964.
Elvis J. Stahr, Jr. ....	January 1961 .....	June 1962.
Under Secretary of the Army:		
David E. McGiffert .....	November 1965 .....	Present.
Vacant .....	July 1965 .....	November 1965.
Stanley R. Resor .....	April 1965 .....	July 1965.
Vacant .....	December 1964 .....	March 1965.
Paul R. Ignatius .....	March 1964 .....	December 1964.
Vacant .....	January 1964 .....	February 1964.
Stephen Ailes .....	February 1961 .....	January 1964.
Assistant Secretary of the Army (Installations and Logistics):		
Dr. Robert A. Brooks .....	October 1965 .....	Present.
Daniel M. Luevano .....	July 1964 .....	October 1965.
A. Tyler Port (acting) .....	March 1964 .....	June 1964.
Paul R. Ignatius .....	May 1961 .....	February 1964.
Commander, Army Materiel Command: Gen. Frank S. Besson, Jr. ....	July 1962 .....	Present.

*Principal officials of the Department of Defense and the military departments response for the administration of activities, discussed in this report—Con.*

	Tenure of office	
	From—	To—
Department of the Navy:		
Secretary of the Navy:		
Paul Nitze.....	November 1963.....	Present.
Fred Korth.....	January 1962.....	November 1963.
John B. Connally.....	January 1961.....	December 1961.
Under Secretary of the Navy:		
Robert H. B. Baldwin.....	July 1965.....	Present.
Kenneth E. BeLieu.....	February 1965.....	July 1965.
Paul B. Fay, Jr.....	February 1961.....	January 1965.
Assistant Secretary of the Navy (Installations and Logistics):		
Graeme C. Bannerman.....	February 1965.....	Present.
Kenneth E. BeLieu.....	February 1961.....	February 1965.
Chief of Naval Material:		
Vice Adm. Ignatius J. Galantin.....	Mar. 1965.....	Present.
Vice Adm. William A. Schoech.....	July 1963.....	Mar. 1965.
Vice Adm. G. F. Beardsley.....	July 1960.....	June 1963.
Chief, Bureau of Naval Weapons (Bureau activated September 1959. Bureau of Aeronautics and Bureau of Ordnance merged with the Bureau in December 1959):		
Rear Adm. Allen M. Shinn.....	May 1964.....	Present.
Rear Adm. W. T. Hines (acting).....	Mar. 1964.....	May 1964.
Rear Adm. Kleber S. Masterson.....	Nov. 1962.....	Mar. 1964.
Rear Adm. Paul D. Stroop.....	Sept. 1959.....	Oct. 1962.
Chief, Bureau of Ships:		
Rear Adm. Edward J. Fahy.....	Feb. 1966.....	Present.
Rear Adm. William A. Brockett.....	Apr. 1963.....	Jan. 1966.
Rear Adm. Ralph K. James.....	Apr. 1959.....	Apr. 1963.
Department of the Air Force:		
Secretary of the Air Force:		
Dr. Harold Brown.....	Oct. 1965.....	Present.
Eugene M. Zuckert.....	Jan. 1961.....	Oct. 1965.
Under Secretary of the Air Force:		
Norman S. Paul.....	Oct. 1965.....	Present.
Dr. Drockway McMillan.....	June 1963.....	September 1965.
Vacant.....	Apr. 1963.....	May 1963.
Dr. Joseph V. Charyk.....	Jan. 1960.....	Mar. 1963.
Assistant Secretary of the Air Force (Installations and Logistics) (formerly Materiel):		
Robert H. Charles.....	Nov. 1963.....	Present.
Vacant.....	Oct. 1963.....	
Joseph S. Imirie.....	Apr. 1961.....	Sept. 1963.
Philip B. Taylor.....	Apr. 1959.....	Feb. 1961.
Commander, Air Force Systems Command (created Apr. 1, 1961, formerly Air Research and Development Command):		
Gen. Bernard A. Schriever.....	Apr. 1959.....	Present.

DEFENSE SUPPLY AGENCY,  
Alexandria, Va., March 7, 1966.

Memorandum for Deputy Director for Contract Administration Services.

Subject: Audit analysis of the management of Government-furnished property at selected Defense Contract Administration Services regions.

(1) The attached analyses of the management of Government-furnished property at the Philadelphia, Dallas, and Cleveland Contract Administration Services regions have been restricted to a review of property administrators' procedures and controls, inventory verification at contractors' plants, and management of plant equipment, which are of the most immediate significance in meeting the General Accounting Office requirements.

(2) Our scope was extremely limited in order to meet the time requirements established by the General Accounting Office since they were requested by a congressional committee to prepare a report on the subject to be completed in March 1966. It is the intention of the GAO to review and consider the DSA internal audit results in their report.

(3) At the three DCASR's included in our review, there were 1,315 contractors having 7,543 contracts involving Government-furnished property. From that total we selected 29 contractors to be used for our evaluation of property administrators' procedures and controls, the reliability of stated physical inventories of approximately \$231 million, and the management of plant equipment. Time did not permit coverage of other equally important areas.

(4) As indicated in the attached reports on the individual Defense Contract Administration Services regions, more specific coverage of the entire area will be completed at a later date and subsequent audit reports issued thereon. Because these reports are of an analytical nature and do not contain specific recommendations for action by the Defense Contract Administration Services, no command reply is required under the provisions of DSAR 7600.1. Your comments, however, if desired are welcomed.

(5) Our review has disclosed that, except in the area of utilization, the DSA manual covering the administration of Government-furnished property published under your direction adequately meets, in our opinion, the procedural guidelines and criteria necessary for the effective administration of Government property. In general, we found that property administration responsibilities were being effectively executed by property administrators and contractors. Individual shortcomings on the part of property administrators were, in some cases, due to either shortage of personnel in the function or maldistribution of workload between property administrators which precluded the necessary application of time to effectively carry out responsibilities. In a few cases the ineffective application of effort on the part of contractors, as well as property administrators, resulted in ineffectual management of Government-furnished property.

(6) We believe that significant advantages can accrue to the Government if greater diligence is exercised in the control over Government-furnished equipment in the possession of contractors. More adequate surveillance and improved contractor records regarding equipment utilization time by the contractors should result in substantial rental payments being made to the Government by contractors when Government equipment is used in commercial application.

(7) Our audit discloses a need for clarification of DOD policies with respect to utilization of plant equipment. Property administrators are required by DSAM 8135.1 to perform utilization tests. The property administrator receives assistance in plant equipment surveys from production personnel in accordance with guidance in DSAM 8300.1. Neither of these manuals nor ASPR provide guidance as to the minimum utilization required of contractors. We understand that the referenced manuals are being amended to provide guidance in determining retention. Instruction from procuring activities and ASPR requires that contractors maintain records which will substantiate use of IPE under rental arrangements only. As a result, utilization records of contractors do not provide the means for CAS personnel to perform tests against minimum use criteria. The requirements of DSAM's 8135.1 and 8300.1 are to determine (a) whether items are being used for purposes authorized by contract, and (b) whether the degree of utilization plus other factors justifies retention of the items. DOD memorandum, May 17, 1965, "Industrial Plant Equipment Utilization," is basically concerned with testing area "b" above. Yet in many cases, silence in the contract for maintenance of such records precludes effective determinations at field level. The prompt and effective reporting to the Defense Industrial Plant Equipment Center of idle production equipment should be stressed. This will greatly enhance the ability of the Defense Industrial Plant Equipment Center to meet the needs of contractors for production equipment from Government resources rather than through additional new procurements for equipment.

(8) Less frequently, but still evident to a sufficient degree even in our limited tests, were the lack of controls in evidence on the part of some very large contractors to properly maintain inventories and usage records of Government-furnished materials. This condition can permit the improper diversion of Government-furnished property during the manufacturing process between various type of contracts and also makes possible the loss of Government material in various ways through poor inventory accounting.

(9) Another interesting point in connection with the reportability of Government-owned equipment involves non-DOD activities. At present, only DOD-owned property is reportable to the Defense Industrial Plant Equipment Center. We found that, at one of the locations included in our review, there was more than \$2 million of items costing over \$1,000 per unit which were purchased or provided under NASA contracts. Many of these items were identical with or similar to the DOD items being reported to the Defense Industrial Plant Equipment Center. In our opinion, it is not in the Government's best interest to limit these equipments to use on NASA contracts. The greatest potential use

and savings would be obtained through similar Defense Industrial Plant Equipment Center treatment of NASA and DOD idle equipment.

BURK O. BARKER,  
Auditor General, DSA,  
Office of the Comptroller.

AUDIT ANALYSIS OF THE MANAGEMENT OF GOVERNMENT-FURNISHED PROPERTY,  
DEFENSE CONTRACT ADMINISTRATION SERVICES REGION, PHILADELPHIA, AS OF  
MARCH 2, 1966

(Report No. 66-67)

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    (b) Physical inventory.  
    (c) Management of plant equipment.

PART I

INTRODUCTION

The Audit General, DSA, has completed the initial phase of an audit of Government property in the possession of contractors and administered by the Defense Contract Administration Services Region (DCASR), Philadelphia. In order to provide requested information to the General Accounting Office (GAO) in phase with GAO reporting requirements explained below, our review was limited to three principal areas:

- Property administrators' producers and controls.
- Inventory verification at contracts' plants.
- Management of plant equipment.

A comprehensive evaluation of property administration would normally also include the following areas:

- Material and equipment acquisition procedures.
- Government property consumption, usage and excess.
- Transfer of material between contracts.
- Plant clearance procedures.

In order to present our evaluation of the above areas and to present the results of any further development of problem discussed herein, we will perform additional audit work and issue subsequent reports.

The General Accounting Office has been requested by a congressional committee to prepare a report on the controls over Government property in the possession of contractors. The GAO report is to be completed in March 1966. Since the DSA Auditor General had the Government property area scheduled for audit, the GAO excluded the DSA contract administration activities from coverage at this time. However, it is the GAO's intention to review and consider the DSA audit results.

We coordinated our visits to contractors' plants with the Defense Contract Audit Agency (DCAA) and, to the extent such were available, we made use of DCAA reports and other data in DCAA files pertaining to control of Government property in possession of contractors.

Generally, it is the Government's policy to designate and use contractors' records as the official property records and not to maintain duplicates. Control of Government property in the possession of contractors is an important function of contract administration. In this regard, the DCASR is responsible for insuring that contractors comply with contract provisions and that the Government's interests are protected. Within the DCASR, Government Property Administrators are appointed for all contracts which involve Government property. The Property Administrators are responsible for determining, on a continuing basis, that contractors' records and procedures are reasonably sound with respect to the status of Government property.

The DCASR, Philadelphia, was established and became operational under DSA on September 1, 1964. In addition to the regional office, which directly administers contracts in the immediate Philadelphia area, district offices are

located in Pittsburgh and Reading, Pa., Baltimore, Md., and Camden, N.J. There are also three plant offices with resident property administrators. Government property is provided under 4,179 contracts and is located in 645 contractors' plants.

## PART II

### SUMMARY

Our review of Government property at the DCASR, Philadelphia, limited to three areas, was conducted at nine contractor locations as well as at the DCASR itself, two district offices and one plant residency. The size of the operations of the contractors selected ranged from small plants with relatively few items and comparatively small dollar values to a large plant having 30,622 live items of equipment, tooling, and materials with an estimated value of \$51 million. In addition to our review of the property administrators' records and procedures, we examined the Government property records maintained by the contractors and made physical observations of property in all mine contractors' plants. Also, we coordinated our review of the foregoing records with a review of selective corresponding records at the Defense Industrial Plant Equipment Center (DIPEC), Memphis, Tenn., which is responsible for maintaining central inventory records for DOD-assigned equipment and the management of assigned plant equipment, including that in the possession of contractors.

As a preface to a summary evaluation of the three principal areas included in this examination, recognition must be given to the many problems involved in the DCASR becoming operational. Many of the problems were inherited from the predecessor military departments and many were the outgrowth of the mass transfer of personnel and records. As the first operational DCASR, Philadelphia, was primarily responsible for the formulation and testing of the overall system adopted by DSA. The DCASR, Philadelphia, was operated as a pilot test region from April 20, 1964 until it became fully operational on September 1, 1964. The problems discussed in subsequent sections of this report, while evidencing need for improvements, are not as relatively serious when considered in the overall dimensions and complications of the areas as they might seem individually. In the light of these factors, our evaluations of the individual areas we reviewed follow.

#### *Property administrators' responsibilities*

Within the area of the property administrators' procedures and controls, our examination disclosed that generally the files maintained by the property administrators contained adequate information to permit effective administration. Surveillance of contractors' property procedures and operations had been accomplished in varying degrees at all contractors' plants included in our review. We believe, however, that improvements are needed in some areas. At one large contractor's plant only token coverage had been given by the property administrator. Also, the extent of coverage should have been greater at three other contractors' plants. For example, at one of these, only 1 of the 10 areas set forth in the DSA manual was covered in 1965 and only a portion of one other area in 1966 to date, with no additional work planned in the near future. In the areas covered, we considered that the coverage given generally conformed to the guidance set forth in the DSA manual, but coverage was needed in the other areas.

#### *Physical inventories*

We found that, generally, Government property in the possession of contractors could be accounted for. Except for the one contractor's plant where we also considered the property administrator's surveys to be inadequate, differences between physical counts and records were minor. With respect to the one contractor, we found major differences only in one of three separate materials areas. We believe action should be taken to require this contractor to improve his control over material receipt documentation and to revise his physical inventory procedures.

#### *Management of plant equipment*

With respect to the overall management of DOD-owned plant equipment, our limited review disclosed a need for increased attention to the area. We found

a significant amount of plant equipment which should have been but was not recorded on DIPEC records. Also, we found instances of plant equipment being retained by contractors without approval.

Only six of the contractors included in our review had plant equipment susceptible to reporting to DIPEC. Of the six, there were problem areas at four. The most common problem was a lack of a system to record use of equipment. In some cases, the need for the equipment could not be ascertained because the amount of use could not be determined. In other cases, amounts of rent due the Government could not be computed accurately because records of use either were not maintained or were only partially maintained.

Another problem involved retention of idle DIPEC reportable items by a contractor. Closer surveillance of the contractor's system by the property administrator could have made the items available for use at other contractors' plants. We also found that test equipment provided under supply contracts was not reported to DIPEC even though the items were of a reportable nature.

Part III of this initial report on property administration contains more detailed discussions of the results of audit. The report was discussed with the Deputy Director, DCASR, Philadelphia, and staff members on February 23, 1966.

BURK O. BARKER,

*Auditor General, DSA Office of the Comptroller.*

### PART III

#### COMMENTS AND CONCLUSIONS

##### (a) *Property Administrators' Procedures and Controls*

Our evaluation of property administrators' responsibilities was divided into five basic areas. Discussion of each of the areas and our conclusions on them are set forth below.

*Maintenance of records.*—One of the initial actions required of a property administrator is the establishment of a ready source of information pertinent to each contract assigned to him for administration. The ASPR and the DSA Manual 8135.1 provide that summary control records be established and maintained to furnish this source of information. Our review of the files covering 164 of the contracts related to the 9 contractors included in our review of the DCASR, Philadelphia, disclosed that the required records were being maintained in a manner which would permit effective administration.

*Approval of contractors' property control procedures.*—The ASPR requires that the property administrator shall, at the inception of each contract, review and approve in writing the contractor's property control system. If a contractor has a number of contracts, the ASPR permits the property administrator to perform the review and give the approval not less often than every 6 months. We found written approvals had previously been granted for the systems of eight of the nine contractors reviewed. The property administrator disapproved the one contractor's procedures because they were not in accordance with ASPR and, as yet, the contractor has not complied with the property administrator's recommendation. In all cases the contractors had continuing contracts and the required approvals had been granted prior to the assignment of administration responsibility to the DCASR, Philadelphia.

*Inspection of contractors' property records.*—The DSA has as general policy, set forth in DSAM 8135.1, that the property administrators will perform surveys of contractors' control systems at least once each calendar year with more frequent surveys when necessary. These surveys are required to be made in sufficient detail to determine the adequacy, completeness and reliability of the contractors' control systems. The surveys should include a review of contractors' property control procedures and practices with respect to acquisition, receiving, records, storage and consumption, utilization, maintenance, physical inventories, subcontractor control, and disposition. We believe that if the surveys described by the DSAM 8135.1 are sufficiently planned and are performed in accordance with the DSAM, there will be reasonable assurance that the Government's property is being adequately controlled.

We reviewed the property administrators' reports and supporting working papers for the nine contractors included in our review. The surveys for five of



the nine contractors were found to have been performed in sufficient detail and depth. The surveys for the other four contractors, who had Government property totaling \$70 million, were in need of expanded coverage. The conditions we found with respect to each are briefly described below.

(1) The property administrator's survey during 1965 for the largest contractor included in our review, who had \$51.7 million of Government property, covered only the area of disposition which is only 1 of the 10 categories required. In 1966, to date, he had covered one to three separate areas of materials. It was pointed out to us by the property administrator that to adequately survey such a large complex contractor's system would require many weeks. We agree and are of the opinion that adequate surveillance would require the full time of at least one property administrator. However, this particular property administrator had the responsibility for an additional 10 locations. In this regard, it is noteworthy that during our review in the DCASR, Philadelphia, and other DCASR's, there were resident property administrators with assistants at contractors having no more Government property than this contractor and with no more apparent complexities. In other words, an imbalance of workload exists which affects performance of assigned duties.

(2) Surveys for all the required categories were completed in a generally satisfactory manner at the plant of the second largest contractor, in our review, who had \$18.9 million in Government property. We noted, however, that the contractor's procedures for reporting of inventory losses did not provide for the reporting for approval of all differences between actual and book inventories when closing out a contract. Although the property administrator's review of the area had not disclosed the weakness, he took prompt corrective action with the contractor when we brought the matter to his attention. Also, the property administrator's survey of this contractor was not in sufficient depth to enable him to assure himself that Government property was used effectively. There was no evidence of any tests being made to determine that the contractor was following the approved procedures.

(3) The survey at another contractor, who had \$297,000 in Government-owned property, was performed in an effective manner; however, we believe the survey was unduly delayed even though some of the delay could be reasonably justified by the organizational problems which were encountered during the establishment of DCASR, Philadelphia. The property administration responsibilities for a contract already in force were assigned to DCASR, Philadelphia, in January 1965 and the first visit to the contractor's plant by the property administrator was in September 1965. At that time the property administrator found that the contractor did not have written property control procedures, nor did he have an established maintenance program, and he was unaware of the DIPEC reporting requirements. When the property administrator cited the deficiencies to the contractor, corrective action was initiated.

(4) At another contractor's plant, which involved \$134,000 in Government property, the property administrator started a survey in August 1965, but upon discovery of a deficiency in the contractor's procedure for reporting receipts of damaged Government property, he discontinued the survey without giving coverage to other required categories. On December 17, 1965, the contractor submitted a revised procedure to correct the deficient area. Our review at this contractor's plant disclosed minor deficiencies in the material receipt procedures. The responsible property administrator advised us that the contractor's system is currently scheduled for review.

*Subcontracts.*—Only three of the nine contractors selected had subcontracts involving Government-owned property. For one of the contractors, the property administrator had not taken steps to assure himself that the contractor had established adequate controls over the property in the possession of the subcontractors. However, our review of the contractor's records disclosed that his procedures for writing subcontracts did provide for the inclusion of the ASPR standard clauses pertaining to Government property. Also, our review of the property records with respect to this area disclosed no discrepancies.

For the second contractor, we found that the property administrator had made an adequate review of the area and had found that the subcontractor had completed work on the subcontract in September 1963 but had not returned the equipment valued at approximately \$16,000 to the prime contractor. The property administrator had advised the prime contractor of the problem in February

1964, followed up on the problem again in February 1965, but as of February 1966, during our visit to the contractor's plant, corrective action was still not complete.

For the third contractor, we believe the property administrator's coverage was adequate. We found that the contractor had been notified of the change in Air Force policy providing that more reliance be placed on the prime contractor to administer Government property on subcontracts and that the property administrator had requested the contractor to give recognition to this change in his written procedures.

*Approval of damage to and loss of Government property.*—The ASPR provides that contractors will be held liable for loss, damage, or destruction of Government-owned property only when it is determined that the cause of such actions was willful misconduct or lack of good faith on the part of contractor management. The losses can be placed in two categories, nonconsumable items such as equipment and tooling, and materials.

During the period July 1, 1963, through December 31, 1965, requests for relief from liability amounting to \$376,000 in losses and damages to Government equipment and tooling were received from three of the nine contractors included in our review. The following table indicates the relationship of losses with the value of equipment and tooling, by contractor:

Contractor	Total cost of equipment and tooling at contractors' plant	Amount of loss and damage	Amount contractor held liable for
(a).....	\$16,177,693	\$343,741	\$6,223
(b).....	47,545,999	30,864	59
(c).....	788,854	2,170	(1)
Total.....	64,512,546	376,775	6,282

1 Action still pending on 1 item valued at \$436.

We selectively reviewed the cases where relief from liability was granted and found that the property administrator involved had reviewed the facts and found no basis for holding the contractor liable. The losses generally involved accidental damage which the property administrators investigated and found that no negligence was involved. For example, at contractor (a)'s plant, of the \$344,000 total, \$243,000 involved one accident in which an item was damaged beyond repair. In the cases where the contractor was held liable, no actual misconduct or lack of good faith was involved but, rather, a third party such as a carrier was deemed to be responsible.

In the materials area, only two of the nine contractors included in our review had requested approval for write-offs. The requests, which totaled \$12,263, were approved by the property administrators, were relatively insignificant in relation to the total value of the materials involved, were within expected loss levels and were therefore approved by the property administrators without question.

#### (b) Physical inventory

We made physical inventory tests at each of the nine contractors' plants selected for our review in the DCASR, Philadelphia. Reportable Government property in possession of the nine contractors, excluding real property, was estimated at \$73.7 million. Of that amount, we tested \$5 million made up of \$4.5 million of plant equipment, \$21,000 of special tooling, and \$485,000 of materials. With one exception, our tests disclosed that generally the property could be accounted for and the contractors' procedures and practices for controlling the property were reasonably sound.

In addition to physically verifying the existence of the property, we considered such factors as the date of the last physical inventory and its results, the inventory methods employed by the contractor, and the extent and adequacy of the surveys made by the property administrators. The results of our review in

this area are set forth separately for equipment, special tooling and material in the following tables, together with notes for those contractors where we found discrepancies.

*Plant equipment*

Contractor	Per contractor		Selected for audit	
	Line items	Value	Line items	Value
1-----	6,986	\$45,906,252	222	\$677,072
3-----	25	296,925	25	296,925
4-----	1	4,000	1	4,000
5-----	5,148	15,342,693	95	1,505,172
6-----	7	1,466,913	7	1,466,913
7-----	235	486,864	40	114,263
8-----	249	788,554	38	244,832
9-----	1	361	1	361
Total-----	12,652	64,292,562	429	4,505,538

<sup>1</sup> Our physical inventory of plant equipment at this contractor's plant disclosed that generally adequate controls existed; however, for reductions in property accountability, the contractor had not made timely adjustments to his inventory records. Our test in February 1966 disclosed 3 items totaling \$63,983 which were still on the inventory records although the items had been shipped from the contractor's plant from 7 to 24 months previously.

<sup>2</sup> Of the 38 items which we selected for verification by physical inventory at this plant, we were unable to locate 4 items with a total acquisition cost of \$805. The contractor's efforts to locate the items also failed and the items were considered lost. Previously, on June 29, 1965, the contractor requested relief for liability on 6 items of plant equipment totaling \$2,170. Four of these items were also considered lost by the contractor. Significantly, the property administrator had disapproved the contractor's property control procedures in November 1964, and as of the date of our audit, approval still had not been granted.

*Special tooling*

Contractor	Per contractor		Selected for audit	
	Line items	Value	Line items	Value
1-----	2,900	\$1,639,747	50	\$14,517
5-----	3,615	835,000	25	6,710
7-----	21	8,280	0	0
8-----	13	300	0	0
Total-----	6,549	2,483,327	75	21,227

<sup>1</sup> At this contractor's plant we statistically selected 50 items for verification by physical inventory. Of the 50 items, we were able to visually verify 10 valued at \$4,218. 1 item could not be located and 39 items were stored in a manner which made verification impractical in the time available. We plan to complete the verification at a later date and our conclusions will be included in a subsequent report.

Materials

Contractor	Per contractor		Selected for audit	
	Line items	Value	Line items	Value
1.....	20,736	<sup>1</sup> \$4,104,426	173 178	<sup>2</sup> \$278,588 69,964
2.....	28	134,181	28	<sup>3</sup> 134,181
4.....	171	104,655	10	2,608
Total.....	20,935	4,343,262	389	485,341

<sup>1</sup> The contractor had three separate material inventories. We performed tests on two of them and found discrepancies in one as shown in footnote 2 below. The third was tested by the property administrator in January 1966. His tests, which we found to be adequate, disclosed no significant discrepancies.

<sup>2</sup> The inventory in this area consisted of approximately 11,000 line items with an estimated value of \$1.5 million. We selected 142 items at random from the inventory records for physical count by contractor personnel and 31 items for verification from the warehouse to the records. We observed the contractor's physical count of the quantities on hand and compared the counts with the recorded balances and in-transit documents.

The test disclosed that for 23 items, or 13 percent of those examined, overages or shortages of \$50 or more existed in the recorded inventory balances. Eleven of the items had overages totaling \$27,209, and 12 items had shortages totaling \$6,029. The discrepancies in the recorded balances were, to a large extent, caused by duplicate posting of receipts and failure to post receipts. We feel that the contractor's own inventory system should have disclosed these conditions. Contractor personnel perform a cyclic inventory on a continuing basis. The conditions had not been disclosed, however, because in our opinion, the contractor's system of taking physical inventory contained weaknesses. The basic weaknesses of the system are that there is no provision to assure that the items are selected in a random manner and the same individual who selects the items performs the counts. Also, new items which come into the system during the year are excluded from selection. The effects of these weaknesses are evident from a comparison of the results of counts based on our random sample and the results of the contractor's counts for calendar year 1965.

Inventory	Line items inventoried	Overages and/or shortages exceeding \$50	
		Number	Percent
Scheduled by contractor.....	4,905	31	0.63
Requested by audit.....	173	23	13.29

<sup>3</sup> The results of the physical inventory at this plant disclosed only one minor discrepancy which involved an item for which no stock record card had been established. The contractor's approved property control procedures require the establishment of stock record cards upon receipt of Government property. In addition, we noted two receipts which had not been posted to the stock record cards.

(c) Management of plant equipment

Contractors who deal with the Department of Defense (DOD) may come into possession of Government-owned plant equipment either by having it furnished directly by a DOD activity or by purchasing it themselves under a contract on a reimbursable basis. Because the Department of Defense owns unknown billions of dollars' worth of equipment located at thousands of widely scattered locations, controls are at the same time both highly necessary and difficult to achieve. At individual contractor locations, the controls are largely the responsibility of designated property administrators and other members of the contract administration team, who, through reviews and tests of contractors' procedures and records, insure that property is used and maintained in manners which protect the Government's interests. At the same time, because of the continually changing nature of DOD needs, an overall control of equipment is needed to minimize purchases of new equipment by redistributing existing equipment among contractors whenever possible. This overall control is the responsibility of the Defense Industrial Plant Equipment Center (DIPEC) which was established in March 1963 in Memphis, Tenn. The DIPEC maintains a central inventory record of all DOD industrial plant equipment items costing \$1,000 or more except for certain special categories of equipment controlled by the military departments.

To determine if both the property administration and DIPEC controls were working, we reviewed property administration of plant equipment, and, also, determined whether or not the required DIPEC coordination had been effected for the six of the nine contractors included in our review which had Government-owned plant equipment. Our reviews were concentrated in two areas and had

two primary objectives. First, we reviewed any available usage records to determine if there was assurance that the contractor needed and was properly using all of the Government equipment in his possession and, second, we determined if equipment was reported to DIPEC when appropriate and if the items were reflected in DIPEC's records.

*Usage of and need for plant equipment.*—Our review disclosed that, generally, contractors maintained minimal records regarding the use of Government-owned equipment. As a result, in some cases, there was no readily available means to determine the number of pieces of similar equipment on hand and, therefore, no means for the contractor or the property administrator to evaluate the need for the equipment. In other cases, it was difficult or impossible to determine the amount of rent due the Government. These and other areas of interest relative to equipment usage are discussed in subsequent paragraphs.

*Need.*—At the two largest contractors included in our review, we found that no detailed usage information was available. Controls existed to limit use of equipment to contracts which specified rent-free use but no records were maintained to indicate the amount of time equipment was used. Our reviews disclosed that equipment was generally issued to work areas, but there was no means of determining if multiplelike items were used sufficiently to warrant retention of the quantities on hand. DCASR personnel at one plant informed us that production control personnel were planning to institute surveillance of the area, but were not yet underway.

A selective review of items located in storage areas at another plant disclosed 22 items, valued at \$48,878 of DIPEC reportable type items, which were idle for periods of as much as a year or more. The contractor maintained that the items were being retained for possible use on follow-on work. In our opinion, the equipment should be reported as idle and it should be the Government which decides whether or not the items could be used elsewhere or whether the potential use by the contractor warranted his keeping the items.

*Rent.*—Contracts at four of the contractors' plants we visited called for payment of rent to the Government under certain specified conditions. Two of these contractors maintained adequate usage data and paid rent in accordance with contract terms. Of the other two contractors, one with Government equipment valued at \$665,000 maintained inadequate usage records and paid no rent even though rent was called for in the contract. The facts relative to the situation were related to the procuring contracting officer by the property administrator in March 1965 but no changes have been effected to date.

The other contractor maintained usage records for and paid rent on Government equipment valued at \$300,000 but maintained no records and paid no rent on equipment valued at \$60,000. Also, the contractor's computation of rent on the equipment on which he paid rent indicated a higher ratio of rent-free use than was indicated by our review of supporting contractual agreements. We computed the total underpayment at approximately \$5,000 for the first 9 months of 1965. During this period, no request for audit of the contractor's records had been made of the Defense Contract Audit Agency (DCAA) or its predecessors. A request was submitted to DCAA in January 1966 for an audit of the contractor's rental computation for the last 3 months of 1965. The results of this audit, when received, should provide a basis for a reasonable settlement for the period requested but, in our opinion, previous periods should also be audited.

*Reporting and screening of plant equipment.*—To determine if items reportable to DIPEC, for the nine contractors included in our review, were actually reflected in DIPEC's records, we requested listings from DIPEC of items recorded as of December 31, 1965. The listings indicated that of the 9 selected contractors, 6 had 1,025 reportable items valued at \$6.7 million. Our review disclosed that with one minor exception, all items on the DIPEC listings were reflected in contractors' records. Also, in comparing records of items at contractors' plants with the DIPEC listing, we found that the records of four of the six contractors with Government property contained no significant items of reportable type property not on the DIPEC lists. However, the records of two contractors contained 376 items with unit values of \$1,000 or more and a total value of about \$5 million which had not been reported. Many of these items were definitely reportable but according to responsible personnel the items were not reported because they were obtained under supply contracts. We were advised by both contractor personnel and the Property Administrator at one location that the responsibility

for reporting items under supply contracts rested with the purchasing officer. Paragraph 13-311, ASPR, provides that items should be reported by the contracting officer at the time they are acquired but does not differentiate between purchasing and administrative contracting officers. In our opinion, in areas where the two responsibilities are distinctly separated as in all contracts under the DCASRs, the reporting can be most readily accomplished by the administrator.

At the other location, we were informed that, in the contractor's opinion, test equipment was not reportable as long as it was being used as a part of special test equipment. In our opinion, any otherwise reportable items should not be excluded from reporting because of the manner in which they are being used and the fact that items are controlled under supply rather than facilities contracts does not justify nonreporting.

Another interesting point in connection with the reportability of Government-owned equipment involves non-DOD activities. At present, only DOD-owned property is reportable to DIPEC. We found that at one of the locations included in our review, there was more than \$2 million of items costing over \$1,000 per unit which were purchased or provided under NASA contracts. Many of these items were identical with or similar to the DOD items being reported to DIPEC. In our opinion, it is not in the Government's best interest to limit these items to use on NASA contracts. The greatest potential use and savings would be obtained through similar DIPEC treatment of NASA and DOD idle equipment.

AUDIT ANALYSIS OF THE MANAGEMENT OF GOVERNMENT-FURNISHED PROPERTY,  
DEFENSE CONTRACT ADMINISTRATION SERVICES REGION, DALLAS, AS OF MARCH  
2, 1966

(Report No. 66-68)

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Part II—Summary.

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PART I. INTRODUCTION

The Auditor General, DSA, has completed the initial phase of an audit of Government property under the administration of the Defense Contract Administration Services Region (DCASR), Dallas. In order to provide requested information to the General Accounting Office (GAO) in phase with GAO reporting requirements explained below, our review was limited to three principal areas:

- Property administrators' procedures and controls.
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- Management of plant equipment.

A comprehensive evaluation of property administration would normally also include the following areas:

- Material and equipment acquisition procedures.
- Government property consumption, usage, and excess.
- Transfer of material between contracts.
- Plant clearance procedures.

In order to present our evaluation of the above areas and to present the results of any further development of problems discussed herein, we will perform additional audit work and issue subsequent reports.

The General Accounting Office has been requested by a congressional committee to prepare a report on the controls over Government property in the possession of contractors. The GAO report is to be completed in March 1966. Since the DSA Auditor General had the Government property area scheduled for audit, the GAO excluded the DSA contract administration activities from coverage at this time. However, it is the GAO's intention to review and consider the DSA audit results.

We coordinated our visits to contractors' plants with the Defense Contract Audit Agency (DCAA) and, to the extent such were available, we made use of DCAA reports and other data in DCAA files pertaining to control of Government property in possession of contractors.

Generally, it is the Government's policy to designate and use the contractors' records as the official property records and not to maintain duplicate records. Control of Government property in the possession of contractors is an important function of contract administration. In this regard, the DCASR is responsible for insuring that contractors comply with contract provisions and that the Government's interests are protected. Within the DCASR, Government property administrators are appointed for all contracts involving Government property. The property administrators are responsible for determining, on a continuing basis, that contractors' records and procedures are reasonably sound with respect to the status of Government property.

The DCASR, Dallas, was established and became operational under DSA on June 1, 1965. In addition to seven plant offices employing resident property administrators, area offices are located at San Antonio and Houston, Tex., and Oklahoma City, Okla. Government property in the DCASR, Dallas, is located in 251 contractors' plants under approximately 1,218 contracts.

## PART II. SUMMARY

At the DCASR, Dallas, we conducted our review of Government property in the hands of contractors at 10 contractors' plants, as well as at the DCASR itself. The property included equipment, special tooling, and material with total values ranging from \$139,571 to \$28,526,580 at the 10 locations. Our review encompassed property administrators' records and procedures, as well as property records maintained by the contractors, and included physical observations of property. Our review also included comparisons between the records maintained by the contractors and records of the Defense Industrial Plant Equipment Center (DIPEC), Memphis, Tenn. The DIPEC is responsible for maintaining central inventory records for DOD assigned equipment and the management of assigned idle plant equipment, including that in the possession of contractors.

To put the results of this review in proper perspective, recognition must be given to the many problems involved in the activation of the DCASR, Dallas, and the short time it has been in existence. Prior to the activation on June 1, 1965, property administration had been accomplished by personnel of the military departments. With the transfer of personnel and contracts to the DCASR, Dallas, for administration, major reassignments of property administrators, and their previously assigned contracts and contractors occurred. In view of these conditions, we believe that reasonable progress had been made toward effective control of the property. In this light, summaries of the three areas we reviewed follow.

*Property administrators' responsibilities.*—Within the area of the property administrators' procedures and controls, the examination disclosed that while files were not complete, progress in assembling required data was evident. The current property administrators for the contractors we visited, except those at two plant offices, inherited a difficult task of familiarization with their newly assigned contracts and with contractors' property control procedures. Progress has been made; however, continuing efforts are needed.

Surveillance of contractors' property procedures and operations had not been accomplished at three contractors' plants included in our review. Where surveys had been performed, we considered that the coverage given generally conformed to the guidance set forth in the DSA Manual 8135.1. Generally, these surveys disclosed only minor discrepancies. At one contractor's plant, we found that neither the property administrator's nor the contractor's controls over inventory adjustments were adequate. However, we noted with particular interest, that the property administrator at this contractor's plant had disclosed significant deficiencies by methods other than the periodic survey.

We attempted to make a determination of the amount of Government property being damaged or lost by contractors and, if the amount was significant, we had planned to make an evaluation of the current policy of assessing liability on the contractors. However, because only 2 of the 10 contractors we selected had requested relief from losses and damages, we were unable to draw overall conclusions with respect to our objectives. However, we were able to determine that appropriate action was taken with respect to the losses and damages of the two contractors.

In the area of special tooling acquired or manufactured for use on Government contracts, we found internal controls lacking in that listings of such tooling re-

ceived from contractors were not given sufficient attention by the property administrators to assure proper accountability.

*Physical inventories.*—Our physical inventory tests disclosed that, with minor exceptions, plant equipment and special tooling were properly recorded and under adequate physical control. Of the 10 contractors selected for audit, 6 contractors had Government-furnished material valued at \$26.9 million. Time did not permit a review of the controls over materials valued at \$4.5 million at one contractor's plant. At the largest contractor's plant, with material valued at \$21.8 million, we found widespread unsatisfactory conditions. The contractor's records did not lend themselves to a ready determination of the item balances and reconciliations between recorded balances and physical counts. Also, the items were not controlled separately by contract. The Defense Contract Audit Agency and its predecessor had reported these deficiencies to the administrative contracting officer in several audit reports and, in at least one instance, had refused to express an opinion as to actual material costs. In our opinion, these conditions evidence a need for immediate corrective action by the administrative contracting officer. At the four other contractors with the lesser amounts, we found controls to be adequate and our tests disclosed no discrepancies.

*Management of plant equipment.*—Our limited review in this area disclosed a need for better controls over the reporting of plant equipment to the Defense Industrial Plant Equipment Center (DIPEC). We found reportable items which were not on DIPEC records, purchases of DIPEC managed items which had not been screened against DIPEC lists of available stocks, and items reported by a contractor in a standby status without proper approval. We also found two contractors who did not have utilization records. At a result, need for the items could not be determined and, in one case, rental fees could not be computed.

Part III of this initial report on property administration contains more detailed discussions of the results of audit. The report was discussed with the Director, DCASR, Dallas, and members of his staff on February 18, 1966.

BURK O. BARKER,  
Auditor General, DSA  
Office of the Comptroller.

### PART III. COMMENTS AND CONCLUSIONS

#### (a) Property administrators' procedures and controls

Prior to activation of the DCASR, Dallas, property administration for the approximately 250 contractors and 1,158 contracts transferred to the DCASR, Dallas, had been accomplished by personnel of the military departments. With the transfer of personnel and contracts to the DCASR, Dallas, for administration, major reassignments of property administrators and their previously assigned contractors occurred. The tenure of property administrators at only 2 of the 10 plant offices we visited was not interrupted by the transfer to the DCASR, Dallas.

Our evaluation of the property administrators' responsibilities was divided into five basic areas. Discussion of each of these areas and our conclusions on them are set forth below.

*Maintenance of records.*—One of the initial actions required of a property administrator is the establishment of a ready source of information pertinent to each contract assigned to him for administration. The DSAM 8135.1 provides that summary control records be established and maintained to furnish this source of information. Our review disclosed that while summary control records had been established for all 10 contractors, records for 2 were incomplete. We determined that required data to complete the records are available in the contracts or prior property administrators' files. Several of the current files were in need of attention to eliminate unnecessary documents or to organize the files. With respect to the foregoing comments, due allowance should be made for the relatively recent personnel and records transfers and changed records requirements.

*Approval of contractors' property control procedures.*—Because of the recent reshuffling of contractors assigned to the property administrators, it is particularly important, in our opinion, that the provisions of the DSAM 8135.1 requiring the property administrator to become thoroughly familiar with the Government property provisions of each assigned contract. Of the eight contractors we selected for which the property administrators were newly assigned, we found that five contractors' property control procedures had been approved by prior



property administrators. The files for three of these contractors, however, included no evidence that the current property administrators had become familiar with the contractual provisions or the property control procedures.

*Inspection of contractors' property records.*—Periodic surveillance of contractors' accountability and responsibility for Government-furnished property is required by the DSAM 8135.1. These surveys, when competently performed, provide the basis for assuring that the contractor has performed his contractual obligations with respect to Government property, or provide the basis for pointing up deficiencies in contractors' operations and practices which require remedial measures. To assist the property administrators in performance of the surveys, which as a general policy are required at least once each year, the DSAM 8135.1 furnishes guidance as to categories, functional areas, and characteristics for coverage.

For the 10 contractors selected for our review, we found that the property administrators had performed 1 or more surveys during the period June 1, to December 31, 1965, at 7 contractors' plants and surveys at 3 plants were scheduled. Coverage in the surveys performed ranged from a single category to all 10 categories listed in the DSAM 8135.1. Generally, our review disclosed that the surveys performed followed the functional areas and characteristics set forth in the DSAM. There were instances where the property administrators had not performed the complete surveys planned, and, in some instances, lot sizes were not shown. These exceptions were of relatively minor significance. However, in view of the unsatisfactory conditions found during our review at one of the contractor's plants, we believe that major exceptions should have been disclosed during the surveillance of this particular plant. The property administrator had performed surveys of five categories at that plant during the period June to December 1965, but his survey summaries indicated that only minor deficiencies were disclosed and that these had been corrected. Yet, during this same period the property administrator had found some of the conditions disclosed by our audit as evidenced by the fact that he had advised the administrative contracting officer in writing of major deficiencies in the contractors' operations such as improper issues of Government-owned material, misuse of Government equipment, and unauthorized requisitioning of equipment.

*Approval of damage to and loss of Government property.*—The ASPR provides that contractors will be held liable for loss, damage, or destruction of Government-owned property in their possession only when it is determined that the cause of such actions was willful misconduct or lack of good faith on the part of contractor management. There are many conflicting views as to the soundness of such a policy. One view is that the Government's interests are not adequately protected under a policy in which it is nearly impossible to find a situation where the contractor can be held liable for loss or damage. Another view is that the losses and damages probably cost less than the increased insurance costs that the Government would have to bear if the policy were changed.

To have some idea as to the extent of the losses being incurred, we determined the total losses and damages reported by the 10 contractors included in our review. During the period July 1, 1963, through December 31, 1965, only 2 of the 10 contractors had submitted requests for relief from losses and damages to Government property. The losses and damages totaling approximately \$60,000 were concerned with aircraft being modified or overhauled and lost plant equipment. The amount of liability assessed the contractors for the reported losses and damages totaled about \$830.

A selective review of the cases, which were well documented, disclosed that the administrative contracting officers, property administrators, and Government technical personnel, when necessary, had reviewed the cases and had taken action after consideration of the facts, the contractual obligations, and the applicable regulations.

*Control over special tooling.*—Under the provisions of paragraph 13-704, ASPR, contractors with fixed-price contracts, if requested, are required to provide lists of special tooling acquired or manufactured for use on the contracts and which the Government is entitled to receive. Only 2 of the 10 contractors we selected had this type of special tooling. Inquiry of the property administrators disclosed that when they receive the listings, they take no action to assure that all tooling is listed or that the listings agree with work orders or authorizing documents. Furthermore, we were advised that no surveillance checks are made

prior to transfer of title to the Government. It is our opinion that the property administrators, to fully accomplish their assigned responsibilities, should perform checks to assure proper accountability for this type of Government property.

(b) *Physical inventory verification at contractors' plants*

We made physical inventory tests at each of the 10 contractors' plants selected for our review in the DCASR, Dallas. The value of reportable Government property in possession of the 10 contractors, excluding real property, was estimated at \$59,375,000. Of that amount, we tested \$3,527,000 made up of \$2,754,000 of plant equipment, \$167,000 of special tooling, and \$606,000 of materials. With one significant exception, our tests disclosed that, generally, property could be accounted for and contractors' procedures and practices for controlling property were reasonably sound.

In addition to physically verifying the existence of the property, we considered such factors as the dates of the last physical inventories and their results, the inventory methods employed by the contractors, and the extent and adequacy of surveillance by the property administrators. The results of our review are set forth separately for equipment, special tooling and material in the following tables together with notes for those contractors where we found discrepancies.

*Plant equipment*

Contractor	Per contractor		Selected for audit	
	Line items	Value	Line items	Value
1-----	25, 715	\$19, 041, 416	287	<sup>1</sup> \$1, 254, 145
2-----	3, 203	3, 863, 700	276	<sup>2</sup> 379, 172
3-----	194	5, 200, 751	42	937, 015
4-----	3	17, 560	3	17, 560
6-----	8	37, 800	2	26, 236
8-----	7	139, 571	7	139, 571
Total-----	29, 130	28, 300, 798	617	2, 753, 699

<sup>1</sup> Of the 287 items selected, 101 valued at \$1,147,000 were major plant equipment items. We were able to account for all of the 101 items. Of the remaining 186 items valued at \$99,620, 95 items valued at \$20,600 could not be located by the contractor.

<sup>2</sup> The contractor had not performed physical inventories of equipment although physical inventories were required by his approved property procedures. In addition, our review disclosed other problem areas that indicate a need for closer review by the property administrator. With respect to the 138 line items included in our review, we found that: 9 items were in excess position; 4 items could not be located; 3 items were not identified as Government property; and 4 were being used without contractual authorization.

*Special tooling*

Contractor	Per contractor		Selected for audit	
	Line items	Value	Line items	Value
2-----	7, 172	\$2, 909, 307	50	<sup>1</sup> \$2, 651
5-----	153	176, 894	40	137, 003
6-----	19	35, 500	1	<sup>2</sup> 10, 000
10-----	308	191, 200	40	17, 000
Total-----	7, 652	\$3, 312, 901	131	\$166, 654

<sup>1</sup> Although we found no discrepancies between our physical counts and the balances shown on the contractor's records, our review did disclose a condition worthy of increased attention by the property administrator. As of Dec. 31, 1965, at the request of the property administrator, the contractor reported 7,172 line items of special tooling valued at \$2,909,307. Although the property administrator accepted this report without question, we found that the report was based on an estimate made by the contractor in 1961 and that no effort had been made to provide an actual current accounting. Our cursory review of the contractor's stock records disclosed that the number of line items of special tooling currently on hand is at least 12,000, or 5,000 more than reported.

<sup>2</sup> In a report requested by the property administrator, the contractor reported 19 line items of special tooling valued at \$35,500 as of Dec. 31, 1965. During our visit to the contractor's plant, it was determined that 6 additional major items of special tooling were on hand which had not been reported. Values for 5 of these 6 items were not available; however, the value of 1 of these line items was determined to be \$62,333.

## Materials

Contractor	Per contractor		Selected for audit	
	Line items	Value	Line items	Value
2	60,783	\$21,753,573	88	1 \$112,349
3	5	67,950	2	49,450
4	176	131,039	6	51,039
7	59	86,290	59	86,290
9	12	321,572	7	307,267
Total	61,035	\$22,360,424	162	\$606,395

<sup>1</sup> The records of this contractor were not being maintained in a manner which permitted a ready determination of either total quantity and value of line items in his possession or the status of individual line items. We selected 88 line items at random in the contractor's warehouses, and with the assistance of contractor personnel, made physical counts of the quantities on hand for each and attempted to verify the quantities counted with the contractor's stock records. 32 of the 88 line items were found to be accurately recorded while 56 contained differences requiring explanation or reconciliation. We expended an inordinate amount of time trying to reconcile the differences for 13 of the 56 line items, and, because of the general confused conditions which we found, we did not attempt to reconcile the other 43 line items.

During the extensive reconciliation process for the 13 line items, which we performed with contractor personnel and the property administrator, we found that items had been issued and received without the preparation of documents, or documents had been prepared but had not been posted to the stock records. Also, we found instances of shop returns and shipments not being posted. We were finally able to account for all the property for 10 of the 13 line items and determined that property valued at \$1,387 for the other 3 line items was missing.

This contractor has 14 contracts involving Government material. The contracts are of various types such as cost plus fixed fee, fixed price, and fixed price with material reimbursable. The ASFR and the contractor's approved property procedures require the Government property to be separately accounted for under each contract. Although we were able to account in total for the quantities applicable to the 10 line items above, we could not take the time needed to reconcile the individual contract quantities applicable to the contracts if they were, in fact, reconcilable. Under such conditions, the misapplication of Government material to other than appropriate contracts is highly possible. There is evidence that the inadequacies of the contractor's property records have existed for some time. On Jan. 28, 1965, the contractor advised the administrative contracting officer, by letter, that a new mechanized system has been installed effective Jan. 1, 1965. The contractor stated where that " \* \* \* The new mechanized system will provide for not only the value of total Government materials in inventory but will provide for the transfer of costs between contracts and well as a source for quick review of the quantity of each item in the inventory \* \* \* "

As of Dec. 31, 1965, at the request of the property administrator, the contractor submitted a report showing the number of line items and dollar value of Government materials on hand. Although it would have been reasonable to expect that the amounts reported had been determined by totaling individual stock records, we determined that the total dollar value was arrived at by multiplying an estimated number of line items by an estimated dollar value per line item. This total was then prorated to the various contracts. Prior to our review the property administrator had accepted this report without question. However, at the time of our review, there was no basis available from which to determine a reasonable estimate of the number of line items or dollar value of material on hand at the contractor's plant.

As of February 1966, the conversion from manually posted records to the mechanized system was incomplete, but receipts and issues were being recorded in the mechanized system for some items even though the balances were still on the manual stock records. Also, although the contractor's procedures call for complete physical inventories, these were not performed during 1964 or 1965. This condition was brought to the attention of the contractor by the property administrator by letter on Aug. 31, 1965, but we found no evidence that action was taken as a result of the letter.

Our review of contract audit reports, directed to or copies of which were furnished the administrative contracting officer, disclosed repetitive qualifications as to the adequacy of the contractor's control over materials. The following excerpt from one of these reports is typical. "In the auditor's review of the contractor's proposed material cost, instances were noted indicative of weakness in the contractor's control of physical movement and cost accounting treatment of direct materials. Instances were noted in which materials had been purchased for and charged to a specific contract yet actually used on other work without any transfer of costs to the using job. On the other hand, instances were noted of materials used on one contract that had been purchased for and charged to some other contract. The proposed material costs (\$1,307,987) of subject contract are affected by this deficiency and, in view of the deficiencies in associating cost with material usage, an opinion cannot be expressed as to actual material cost."

We believe the foregoing warrants immediate action by the administering contracting officer to require the contractor to perform all the provisions of his contracts relating to the proper accounting for Government property in his possession, and, pending such action warrants suspension of payments for materials.

*(c) Management of plant equipment*

Government equipment in the hands of contractors, on an overall basis, is controlled by the Defense Industrial Plant Equipment Center (DIPEC), Memphis, Tenn. On an individual plant location basis, Government equipment, for contracts administered by the various DCASR's, is controlled by property administrators and other members of the DCASR contract administration teams. The purpose of the overall control is to minimize the DOD's total investment in plant equipment by shifting idle Government equipment among contractors to prevent unnecessary purchase whenever possible. The purpose of the controls at individual plant locations is to insure that equipment is properly safeguarded

and used to the Government's best interests at the particular locations and to insure that proper coordination with DIPEC is affected. To perform the overall control, DIPEC is responsible for maintaining a central inventory record of all DOD industrial plant equipment items costing \$1,000 or more except for certain classes of items controlled by the military departments. The control at individual plant locations is maintained by reviews and tests of contractors' records and procedures to insure that the equipment is properly used and maintained. Discussions of problem areas in controlling and reporting plant equipment follow.

*Reporting to DIPEC.*—To evaluate the central controls over equipment and to determine whether the contractors' record agreed with the DIPEC records, we requested listings from DIPEC of all recorded industrial plant equipment as of December 31, 1965 pertaining to the 10 contractors included in our review. Of the 10 contractors included in our review, 6 had 1,214 DIPEC controlled industrial plant equipment items valued at \$14,546,616, according to the DIPEC records. We found that, with minor exceptions, items on the DIPEC records were included on the contractors' records. However, 4 of the contractors' records included a total of at least 88 items of plant equipment valued at \$448,443 which were not on the DIPEC records. As far as we could determine, the primary reason that these items had not been reported was that some contract administrators lacked a clear understanding as to what the DIPEC reporting requirements were.

In addition to the unreported items of plant equipment, we found 37 items of special test equipment valued at \$234,743, which met the DIPEC reporting criterion but which were not reported to DIPEC. We were advised by the administrative contracting officer that no action had been taken to report the items to DIPEC because they were under Air Force bailment control and, in his opinion, should not be reported. Of the 37 items, 16 valued at \$38,140 were purchased after DIPEC screening requirements became effective. Although the purchases were authorized by the Air Force Procuring Contracting Officer, screening of existing DOD stocks was not accomplished and certificates of nonavailability were not obtained from DIPEC. We were able to determine that three items valued at \$10,779 were available for redistribution at the approximate time of the purchases. Paragraph 13-306.4, ASPR, provides that the contracting officer shall screen items with acquisition costs of \$1,000 or more against DIPEC inventories to ascertain whether existing Government property can be furnished. The ASPR does not provide for any exceptions to these screening requirements. In this regard, we found that another contractor had purchased four items costing \$191,964 without first requesting screening at DIPEC.

Another area of reporting to DIPEC concerns the status of plant equipment. We found that at one contractor's plant, 92 items with a value of \$2,291,888 were being reported in a standby status although the items were not installed as a unit and 7 of the items were actually in use. Paragraph 10223, DSAM 4215.1, defines standby equipment as a complement of installed plant equipment maintained intact in a reserve condition. Further, the DSAM provides that the Office of the Secretary of Defense (OSD) approval is needed to retain standby facilities. Evidence of OSD approval was not available in this case. The only basis for retention was a Bureau of Naval Weapons letter, dated September 23, 1963, which stated that approval of the request for standby status was pending.

We also found other cases of unauthorized retention of equipment. One contractor was retaining seven items valued at \$139,571 although utilization of the equipment on DOD contracts was less than the 75 percent minimum utilization requirement set forth in the contract. A recent Defense Contract Audit Agency report, a copy of which was submitted to the administrative contracting officer, included comments pointing out this condition. The administrative contracting officer stated that he had not taken action because of possible increased use of the equipment on DOD contracts. Another contractor retained six items of plant equipment valued at \$10,800 in an idle status from December 1964 to February 1966, without contractual coverage. DIPEC records showed that these items were in short supply during this period.

*Utilization records.*—Utilization records maintained by two of the six contractors with DIPEC controlled equipment were not adequate to insure timely identification and reporting of unneeded equipment. As a result, we were unable to determine whether retention of plant equipment by the contractor was justified. In addition, due to lack of detailed utilization records and basic

agreement documents, a determination as to whether equitable rental fees were being paid could not be made for one contractor. This contractor's volume of commercial business was significant and his inventory included 968 items of Government-owned plant equipment valued at \$8,858,833. Contractor-owned plant equipment in this case was inconsequential; therefore, accurate determination of rental fees should be a primary consideration.

*Control over Government property shipped to a contractor's plant from a military installation or from another contractor's plant.*—Paragraph B, appendix B of ASPR requires in part that "The shipping activity shall furnish the property administrator, who is responsible for the receiving contractor's property account with copies of the documents necessary to permit the property account to reflect the transaction. On receipt of the property the contractor, where required, shall furnish the property administrator with documented evidence of such receipt. The property administrator shall take the action necessary to insure that his records of these transactions are complete." In view of this ASPR internal control requirement, we included a step in our audit program to determine that the property administrators' records of such transactions were complete. We found that the property administrators were complete. We found that the property administrators were not receiving the required copies of documents from the shipping activities. We also noted that appendix H of ASPR, which is the Manual for Military Standard Requisitioning and Issue Procedure (Milstrip) for Defense Contractors, does not provide for a copy of the shipping document to be sent to the responsible property administrator.

Discussion with the property administrators disclosed that they believed an important element of internal control is missing since they do not receive copies of the shipping documents. They generally recognize at the same time, however, that because of the volume involved, space limitations on punch cards, and the need for providing the supplier with additional addressees, the furnishing of copies of all such documents to them is impractical. We believe, however, that additional property administration internal control procedures are needed. The area in DSAM 8135.1 covering acquisition should be expanded to provide for requiring the property administrators to periodically note contractors' open requisitions for subsequent follow up to assure that appropriate supply action and recording is accomplished for the items selected. A recurring test such as this would negate the need for the property administrator's copy of the shipping document.

**AUDIT ANALYSIS OF THE MANAGEMENT OF GOVERNMENT-FURNISHED PROPERTY,  
DEFENSE CONTRACT ADMINISTRATION SERVICES REGION, CLEVELAND, AS OF MARCH  
2, 1966**

(Report No. 66-69)

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Part I—Introduction.

Part II—Summary.

Part III—Comments and conclusions:

- (a) Property administrators' procedures and controls.
- (b) Inventory verification at contractors' plants.
- (c) Management of plant equipment.

**PART I. INTRODUCTION**

The Auditor General, DSA, has completed the initial phase of an audit of Government property in the possession of contractors and administered by the Defense Contract Administration Services Region (DCASR), Cleveland. In order to provide requested information to the General Accounting Office (GAO) in phase with GAO reporting requirements explained below, our review was limited to three principal areas:

- Property administrators' procedures and controls,
- Inventory verification at contractors' plants,
- Management of plant equipment.

A comprehensive evaluation of property administration would normally also include the following areas:

- Material and equipment acquisition procedures,
- Government property consumption, usage, and excess,

Transfer of material between contracts,  
Plant clearance procedures.

In order to conclude our evaluation of the above areas and to present the results of any further development of problems discussed herein, we will perform additional audit work and issue subsequent reports.

The General Accounting Office has been requested by a congressional committee to prepare a report on the controls over Government property in the possession of contractors. The GAO report is to be completed in March 1966. Since the DSA Auditor General had the Government property area scheduled for audit, the GAO excluded the DSA contract administration activities from coverage at this time. However, it is the GAO intention to review and consider the DSA audit results.

We coordinated our visits to contractors' plants with the Defense Contract Audit Agency (DCAA) and, to the extent such were available, we made use of DCAA reports and other data in DCAA files pertaining to control of Government property in possession of contractors.

Generally, it is the Government's policy to designate and use contractors' records as the official property records and not to maintain duplicates. Control of Government property in the possession of contractors is an important function to contract administration. In this regard, the DCASR is responsible for insuring that contractors comply with contract provisions and that the Government's interests are protected. Within the DCASR, property administrators are appointed for all contracts which involve Government property. The property administrators are responsible for determining, on a continuing basis, that contractors' records and procedures are reasonably sound with respect to the status of Government property.

The DCASR, Cleveland, was established and became operational under DSA on August 1, 1965. In addition to the regional office, which directly administers contracts in the immediate area, district offices are located in Dayton and Cincinnati, Ohio. There are also two plant offices with resident property administrators. Government property is provided under 2,146 contracts and is located in 419 contractors' plants.

## PART II. SUMMARY

Our review of Government property at the DCASR, Cleveland, was limited to 3 areas and was conducted at 10 contractors' plants. These plants, geographically spread within the DCASR area, had a total of \$106 million in Government property ranging from \$45,000 at the smallest contractor to an estimated \$88 million at the largest contractor. In addition to our review of the property administrators' records and procedures, we examined the Government property records maintained by the contractors and made physical observations of property in all 10 contractors' plants. Also, we coordinated our review of the foregoing records with a review of selective corresponding records at the Defense Industrial Plant Equipment Center (DIPEC), Memphis, Tenn. DIPEC is responsible for maintaining central inventory records for DOD assigned equipment and for managing assigned idle plant equipment, including equipment in the possession of contractors.

As a result of our review, we concluded that responsibilities pertaining to Government were being performed in a generally satisfactory manner, especially considering that the DCASR, Cleveland, had been in operation for only a short period of time. The transition to a DSA operation was facilitated by seminars held in September 1965 in Cleveland, Dayton, and Cincinnati which served to familiarize former Army, Navy, and Air Force property administrators with DSA procedures. In addition, to the extent feasible, contracts with each military department were assigned to each property administrator to more fully acquaint them with the respective contractual provisions and practices of the services. Six operating instructions pertaining to Government property administration have been published by the DCASR since its inception on August 1, 1965. We recognize the progress that has been made, but there are certain opportunities for further improvement as indicated in the ensuing paragraphs classified by the three areas included in this initial audit.

*Property administrators' responsibilities.*—Within the area of property administrators' procedures and controls, our examination disclosed that, generally, the files met the minimum requirements of ASPR and DSAM 8135.1. Written approvals for contractors' property control systems granted prior to the inception of the DCASR showed no evidence of testing or reviewing the systems at

the contractors' plants prior to giving such approval. We found, however, that adequate testing had been performed for an approval granted after the DCASR was established.

For 7 of the 10 contractors, property administrators' working papers of surveillance inspections showed sufficient planning and performance based on the DSAM 8135.1. One of the remaining three contractors had not been surveyed because he had only recently been assigned. We found a need for improvement in the surveillance inspections for the other two contractors in that documentation to show the work performed was lacking for one and the utilization area was not adequately covered for the other.

*Physical inventories.*—At the 10 contractors' plants in the DCASR, Cleveland, we made physical inventory tests of property totaling more than \$21 million. Our examination showed that responsibilities and controls over Government property were generally carried out in an effective manner. We did observe some discrepancies in the identification of Government property and also noted one contractor in need of improved disposal practices for minor plant equipment. Our tests further disclosed that another contractor with materials in his possession valued at \$41,504 needed to strengthen his controls to insure that issue documents were prepared. At this plant, we found a significant number of differences between material counts and the property records.

*Management of plant equipment.*—In this initial audit, we devoted a significant portion of our effort to a review of utilization and control of plant equipment and to the reporting thereof to the Defense Industrial Plant Equipment Center. We found reportable items which were not on DIPEC records and items on DIPEC records which were not at contractors' plants. We believe that the DIPEC central inventory records should be improved through regularly scheduled comparisons between DIPEC furnished listings and contractors' plant equipment by DCASR property administrators.

We also found a lack of utilization records at a contractor's plant where \$87 million of Government plant equipment was located. At this contractor's plant repetitive unauthorized use of such equipment on commercial work had been disclosed by the property administrator. His disclosures were made on the basis of floor checks; however, because utilization records were not maintained by the contractor, there was no positive method of determining the extent of unauthorized use of Government machines. We believe that where rentals of Government equipment are involved, the need for effective controls over the use of such equipment is essential.

Part III of this initial report on property administration contains more detailed discussions of the results of audit. The report was discussed with the Director, DCASR, Cleveland, and his staff on February 23, 1966.

BURK O. BARKER,  
Auditor General, DSA,  
Office of the Comptroller.

### PART III. COMMENTS AND CONCLUSIONS

#### (a) Property administrators' procedures and controls

We performed our audit of property administrators' responsibilities in five areas. Discussion and conclusions relative to each of the areas follow.

*Maintenance of records.*—One of the initial actions required of a property administrator is the establishment of a ready source of information pertinent to contracts assigned him for administration. The ASPR and DSAM 8135.1 provide that control records containing certain minimum information be maintained. In general, we found that control records provided sufficient information to permit effective administration. We found only one instance where required information was not complete. In this case, when the lack of data was pointed out to him, the property administrator promptly obtained the information.

*Approval of contractors' property control procedures.*—The ASPR requires that the property administrator shall, at the inception of each contract, review and approve in writing the contractor's property control system except that, where the contractor has a number of contracts, the property administrator may perform such review and give such approval not less often than every 6 months. We found that written approvals had been furnished to 8 of the 10 contractors examined. On one contractor without the required approval, the last written approval of his system had been provided in December 1961, in connection with

a Navy fixed-price production contract. An Army facilities contract was awarded in November 1963 and the contractor advised in writing in December 1963 that, subject to Government approval, his system as approved in 1961 was applicable to the new facilities contract. The contractor has never been informed as to whether his old system was acceptable for use under the new facilities contract. Another contractor having contracts awarded in June 1965, furnished the property administrator a copy of his property control procedures in January 1966. As of February 1966, the procedures had not been approved because adequate testing of the procedures had not been made.

With respect to the approvals of four contractors' systems, we noted a lack of supporting evidence showing the extent of testing or review of the property control system prior to approval. These approvals had been given by the property administrators prior to the inception of the DCASR, Cleveland. Subsequent to the inception of the DCASR, approval was granted prior to the renewal of an old contract at one of the four contractors. This approval was granted after tests of the contractor's internal controls had been made as required by the DSAM 8135.1. We believe continued adherence to the DSA Manual guidance in this area will provide the necessary control.

*Deviation in property control procedure.*—One large contractor requested relief from the processing of requests through DIPEC for movements of industrial plant equipment between company locations. In lieu of the advance requests, the contractor proposed to send change notices to DIPEC after each movement. DIPEC granted the waiver eliminating request processing on October 14, 1965. In our opinion, the deviation in DIPEC procedures did not adversely affect controls over industrial plant equipment.

*Inspection of contractors' property records.*—DSAM 8135.1 contains a general policy stating the property administrators will perform surveillance of contractors' property control systems at least once each calendar year with more frequent surveillance when necessary. The manual provides property administrators with guidance relative to major segments of property control systems which normally require testing and provides sizes of samples of items or transactions which should be examined. We believe that the DSAM 8135.1 generally provides the necessity guidance to enable property administrators to adequately plan and perform the surveillance necessary to insure that Government property is adequately protected.

We reviewed surveillance inspections and supporting working papers for the 10 contractors included in our review. Working papers supporting inspections for seven of the contractors showed sufficient planning and performance based on the DSAM 8135.1. No surveillance had been performed at one contractor's plant because his contracts were recently assigned and his procedures had not been approved as of the audit date. An inspection of the files for one of the remaining two contractors showed a need for better documentation of work performed by the property administrator. This contractor had approximately \$54,000 in Government cloth which was provided under terms of a contract awarded in September 1965. The contractor had begun receiving Government cloth for processing on November 29, 1965, and had begun shipping processed cloth on December 27, 1965. Our review in February 1966 showed that considerable effort was required to relate inventory on hand with receipt and issue transactions maintained by the contractor. The property administrator stated in his surveillance report dated December 16, 1965, that he had examined seven segments and found no deficiencies. Required data relative to lots and sample sizes, specific items examined, and the method of selection, were not shown in his supporting papers. In our opinion, working papers detailing the work that was performed should have been kept as evidence to support the property administrator's conclusions.

In his surveillance checks at the remaining contractors' plants, the property administrator had adequately covered all areas except utilization. In the utilization area, the property administrator's tests had disclosed weaknesses but the tests were not designed in a manner which assured complete protection of the Government's interests.

*Approval of damage to and loss of Government property.*—The ASPR provides that contractors will be held liable for loss, damage, or destruction of Government-owned property in their possession only when it is determined that the cause of such actions was willful misconduct or lack of good faith on the part of contractor management. In our review of this segment of property control, we found that only 1 of the 10 contractors included in our review had writeoffs of nonexpendable Government property due to loss or damage. We



examined writeoffs applicable to one contract which involved about \$68 million of the estimated \$88 million in Government property at this contractor's plant. Our examination showed that in the period July 1, 1963, to December 31, 1965, approximately \$137,000 had been written off on the contract and that the liability assessed the contractor totaled \$26,600. Our review of the contractor's procedures and records disclosed that internal control measures were adequate and provided assurance that the contractor was reporting all losses and damages of Government property. Our review of the individual writeoff transactions disclosed that these were reasonable in relation to the total value of property involved and that the property administrators were performing adequate reviews before recommending approval of writeoffs.

(b) *Inventory verification at contractors' plants*

We made physical inventory tests at each of the 10 contractors selected for our review in the DCASR, Cleveland. Reportable Government property in possession of the 10 contractors was valued at \$106 million. Of that amount, we tested \$21.4 million consisting of \$20.4 million in plant equipment, \$804,000 in special tooling and test equipment, and \$284,000 in materials.

In addition to physically verifying the existence of the property, we considered such factors as the date of the last physical inventories and results thereof, the inventory methods employed by the contractors, and extent and adequacy of surveillance by the property administrators. The results of our review are set forth in the following tables together with notes for those contractors where we found discrepancies.

*Plant equipment*

Contractor No.—	Per contractor		Selected for audit	
	Line items	Value	Line items	Value
1.....	4	\$190,822	4	\$190,822
3.....	225	799,182	48	495,691
4.....	102	3,310,843	59	1,650,066
5.....	301	3,520,116	70	2,807,555
6.....	3	3,569	3	3,569
7.....	38	411,745	38	411,745
8.....	4,611	67,937,120	144	14,484,179
10.....	10	777,529	4	332,173
Total.....	5,294	76,950,926	370	20,375,800

<sup>1</sup> 2 contract line items representing 108 wood carriers could not be located. It was determined that they had been disposed of in 1962 without their being recognized as Government property and without the knowledge of the contractor's facilities administrator who, therefore, had not notified the property administrator to obtain proper relief from accountability under paragraph B402.1 of appendix B to ASPR. We believe that the contractor's disposal practices should be strengthened to ascertain whether property is Government-owned prior to disposal and if so, to assure coordination with the property administrator prior to disposal action. The contractor initiated action for relief of responsibility for the wood carriers during our audit. We noted that three other items of plant equipment were also without the required Government identification.

<sup>2</sup> Identification discrepancies were noted on 8 items of plant equipment: 4 items had no tags displaying the Government identification number; 3 were tagged incorrectly with the old identification number after DIPEC had authorized changes to new Army identification numbers; 1 item had only a paper tag.

*Special tooling and test equipment*

Contractor No.—	Per contractor		Selected for audit	
	Line items	Value	Line items	Value
2.....	56	\$774,692	6	\$377,316
4.....	1,096	458,251	21	85,185
5.....	1,040	5,000,000	17	1,278,679
8.....	43,000	12,281,503	64	39,234
10.....	262	55,885	39	23,303
Total.....	45,454	\$18,570,331	147	\$803,717

<sup>1</sup> Our tests were confined to 1 subcontract with special tooling valued at \$836,943. 3 of the items tested had not been identified as Government property. The total value of special tooling at this contractor's plant was furnished to us by the contractor on an estimated basis.

*Materials*

Contractor No.—	Per contractor		Selected for audit	
	Line items	Value	Line items	Value
2.....	1,684	\$37,390	137	\$3,661
5.....	264	2,600,000	12	171,353
6.....	142	41,504	16	117,286
7.....	2	9,172	2	9,164
8.....	20,000	7,835,451	135	28,974
9.....	1	53,551	1	53,551
Total.....	22,093	10,577,068	303	283,989

<sup>1</sup> 12 of the items tested were not in agreement with the physical stocks. The recorded balances were overstated by a net amount of \$3,078. We determined that the lack of control involved employees extracting material from storage areas without preparing issue documents.

*(c) Management of plant equipment*

Contractors who deal with the Department of Defense may acquire Government-owned plant equipment by having the equipment transferred from Government storage locations or from other contractors, or, by purchasing the equipment themselves and being reimbursed by the Government. Because the DOD has very substantial sums invested in plant equipment located at contractors' plants throughout the United States, a central inventory control record was established to aid in achieving maximum use of Government-owned plant equipment, thereby reducing unnecessary purchasing by contractors. The responsibility for this central inventory record, which includes only items costing \$1,000 or more, is charged to the Defense Industrial Plant Equipment Center (DIPEC), Memphis, Tenn. The reliability of the DIPEC control record is largely dependent upon data furnished by contractors.

Of the 10 contractors included in our review, 6 had varying amounts of plant equipment reportable to DIPEC. We compared the plant equipment records of the six contractors with listings obtained from DIPEC and found that four contractors had plant equipment valued at a total of \$845,000 which was not included on the DIPEC listing. For example, we physically inspected two pieces of plant equipment at one contractor's plant which, according to DIPEC records, were in other locations or the location and/or disposition were unknown. Corrections to DIPEC records were made as a result of our comparison. Another contractor had 11 items that were not included on the DIPEC listing. Coordination with DIPEC showed, generally, that these errors involved improper coding by DIPEC and that DIPEC data were not current. One item of plant equipment costing \$6,180 had not been screened against DIPEC's listing of available items before being purchased by a contractor. The contractor stated that he telephoned DIPEC and received oral acknowledgement that the item was not available. We believe that, subsequently, the contractor should have obtained the certificate or have otherwise documented his records as evidence of screening DIPEC for the item.

We also found that one contractor did not have six items of plant equipment which the DIPEC records as of January 15, 1966, indicated were in his possession. Four of the items had never been received by the contractor, one item had been scrapped and the sixth item had been returned to a Government location in March 1965. The inaccuracies in the DIPEC records for these items were caused by erroneous shipment notifications and clerical errors at DIPEC. However, we believe that property administrators could provide a means of insuring that the DIPEC records are up to date by periodically making comparisons between DIPEC furnished listings and contractors' plant equipment. According to DCASR personnel, no such comparisons are presently made except at irregular intervals for some contractors.

Another aspect of the area of management of plant equipment involves control over the use of the equipment, particularly controls to ensure that equipment is used only on authorized projects and to ensure payment to the Government when appropriate. In this regard, at the plant of the largest contractor included in our review who had \$67 million of Government plant equipment, the Property Administrator had disclosed repetitive unauthorized use of Government

property on commercial work without reimbursement. The Property Administrator had performed floor checks in 10 months of calendar year 1965 and each month had found unauthorized use of Government machines on commercial work. During 1965, the contractor was billed \$13,374 for such unauthorized use based on the Property Administrator's floor checks.

Although they were at least partially effective, the Property Administrator's floor checks provided no assurance that substantial additional unauthorized use did not occur. The Property Administrator's method of determining unauthorized use entailed a floor check performed only at month end, during normal working hours. His floor check involved looking for machines in use which had not been included in a listing submitted by the contractor of equipment which the contractor intended to use on commercial work and on which he intended to pay rent. Because records of use were not maintained, there was no positive method of checking possible unauthorized commercial use of Government machines. The floor checks could only show the use of particular machines at particular times and could provide no basis for determining total unauthorized use.

In February 1966, because of the lack of utilization records, we also performed a floor check of 68 of 304 rental machines not on the contractor's rental list. Our test, performed in the middle of the month, was limited to one division which had previously showed repetitive unauthorized use. Of the 68 machines checked, 49 machines were in use. We found that seven or 14 percent were being used on commercial work without authorization.

We believe that when rentals of Government equipment are involved, the need for effective controls on the use of equipment is essential. In this case, where the Property Administrator had found instances where the Government was not properly reimbursed, the need for controls was such that immediate steps were warranted on the part of the Administrative Contracting Officer to bring about corrective action.

## APPENDIX 5

### GAO REPORT ON COST OF SALES OF SURPLUS PROPERTY AND DISPOSITION OF PROCEEDS

#### REPORT ON COST OF SALES OF SURPLUS PROPERTY AND DISPOSITION OF PROCEEDS— DEPARTMENT OF DEFENSE

COMPTROLLER GENERAL OF THE UNITED STATES,  
*Washington, D.C., March 18, 1966.*

B-140389.

The Honorable THOMAS B. CURTIS,  
*House of Representatives.*

DEAR MR. CURTIS: In accordance with your request of July 28, 1965, we have examined into the cost of Department of Defense surplus property sales and into the disposition of proceeds from such sales. Although we did not observe instances where proceeds from sales of surplus property were diverted for purposes which are contrary to law, we did find that established Defense criteria for reimbursing disposal expenses and depositing sales proceeds were not always adhered to.

Our review, which was limited in order to furnish information for use in the 1966 hearings before the Federal Procurement and Regulation Subcommittee of the Joint Economic Committee, disclosed a number of instances in which sales proceeds were retained by the military installations or were used to reimburse certain operating expenses, in conflict with Defense policy. As a result, revenues from surplus sales estimated at approximately \$1 million were not available for return to the Treasury at the end of fiscal year 1965.

Because of the lack of proper accounting methods and the lack of comparability of detailed expense records, as discussed in this report, we have been unable to establish why the ratio of disposal expenses to sales proceeds has progressively increased from 1958 through 1964. However, it should be noted that prior to fiscal year 1960 disposal expenses may have been incurred under appropriations which were not reimbursed because of limitations on the extent of expenses reimbursable from sales proceeds in prior appropriation acts. Further, we were unable to analyze on a comparable basis the costs incurred by the General Services Administration in disposing of surplus property with those incurred by the Department of Defense because costs of the latter include significant charges for preparing material for disposal (such as demilitarization) while costs of the former cover mainly expenses involving the selling process.

We found at an industrial fund activity that proceeds from scrap sales estimated at about \$329,000 had been withheld and used to defray maintenance costs, contrary to Defense instructions. In addition, we estimate that approximately \$630,000 of the expenses of four Navy installations, an Army installation, and two Defense Supply Agency installations were reimbursed out of surplus sales proceeds, which, in our opinion, was contrary to established Department of Defense criteria. These reimbursed costs were incurred in (1) processing industrial fund scrap material, the proceeds of which were retained by the industrial fund activity, (2) performing reclamation work in connection with the disposal process, and (3) transporting and handling unneeded materiel before it entered disposal channels. The implementing instruction of the military services are not always uniform in identifying the types of expenses which are reimbursable from surplus sales proceeds. On July 1, 1965, the Defense Supply Agency issued instructions for correcting the deficiencies noted at its installations.

We also found during our review that there was a need for improvement in (1) the identification of disposal costs and the reporting of disposal operations and (2) the reviews of disposal activities made by internal auditors.

We believe that the condition identified above occurred primarily because the Defense Supply Agency—the organization responsible for managing the Defense-wide disposal program—did not provide adequate guidance in the nature

of detailed policies and procedures, establish and require the implementation of uniform accounting methods, or exercise positive control over the disposal operations of the military services. We believe that, as a result of the lack of effective direction and control of the surplus property disposal program and the accounting and reporting thereof, management officials have not been provided with adequate information to properly appraise the various disposal functions so as to identify conditions warranting corrective action. The availability of reliable management data is particularly important in this program where there is no limitation on the amount of disposal sales proceeds that can be used to finance disposal operations.

Defense Supply Agency officials advised us recently that they had proposed, for the consideration of the Department of Defense and the military services, a uniform cost accounting structure for disposal operations. However, this proposal had not progressed sufficiently to permit our review and appraisal prior to the completion of our work.

We believe that improved management controls over the use of surplus sales proceeds are necessary to provide that only those expenses which are applicable to the disposal program, and which have not been provided for in other appropriations are reimbursed from surplus sales proceeds. Among the more important measures, which in our opinion should be taken to improve operations of the disposal program, are (1) the further strengthening by the Secretary of Defense of the central management role of the Defense Supply Agency to provide more effective direction, supervision, and control over disposal operations of the military services, (2) the early implementation of a uniform cost accounting system that would afford more definitive cost identification, (3) the establishment of an improved reporting system for disposal operations that would provide management with necessary data for appraising the program, and (4) the performance of periodic internal audits to validate disposal expenses which are reimbursed from surplus sales proceeds.

We wish to emphasize that we are not criticizing the objectives of the disposal program, because efficient supply management operations require that unneeded materiel be disposed of in an expeditious and economical manner. However, it is our opinion that proceeds from surplus property sales and the expenses that are reimbursed out of proceeds should be properly identified and recorded to provide agency management and the Congress with necessary data for appraising the disposal program.

In view of the time limitation on reporting to your subcommittee, we were unable to solicit comments on this report from the Department of Defense. However, as agreed, we are sending copies to the Secretary of Defense for his consideration prior to the hearings.

We plan to make no further distribution of this report unless copies are specifically requested, and then copies will be distributed only after your approval has been obtained or public announcement has been made by you concerning the contents of the report.

We trust that this report provides you with the information required. If we can be of further assistance, please let us know.

Sincerely yours,

ELMER B. STAATS,  
*Comptroller General of the United States.*

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## INTRODUCTION

At the request of Congressman Thomas B. Curtis of the Federal Procurement and Regulation Subcommittee of the Joint Economic Committee, Congress of the United States (see app. 5, p. 273), the General Accounting Office examined into selected transactions relating to the disposal of excess and/or surplus personal property by the Department of Defense during fiscal year 1965. As requested, our inquiry has been directed toward the use of sales proceeds to reimburse the military services and the Defense Supply Agency for expenses incurred in disposal operations to determine whether proceeds have been diverted for non-authorized purposes.

We examined records of receipts and disbursements at selected disposal activities of the Departments of the Army, Navy, and Air Force and of the Defense Supply Agency. We also inspected selected disposal facilities, inquired into certain disposal operations, and reviewed reports on disposal actions. Additional information concerning the scope of our review is contained on page 31 (see p. 285) of this report.

## BACKGROUND

The need for a property disposal program within the Department of Defense was recognized during 1951, when a Property Disposal Division was established by the Munitions Board to formulate policy and provide direction to the disposal program. In October 1953, the Office of the Assistant Secretary of Defense (Supply and Logistics) was assigned the responsibility for the disposal function. During 1955 and 1956, this responsibility was vested in a Surplus Disposal Division under the Director of Requirements, Procurement, and Distribution. This division was staffed with merchandising experts drawn from commercial firms to assist in the development of surplus merchandising and sales policies. In 1958 the importance of the property disposal function was downgraded from divisional stature to a branch operation, and by early 1961 a separate organization no longer existed for this function.

Late in 1961, the newly established Defense Supply Agency (DSA) was given responsibility for the administration and supervision of the Defense surplus personal property disposal program. DSA was directed to monitor reporting systems for DOD worldwide excess and surplus materiel and to prescribe techniques and procedures for the preparation and disposal of surplus personal property. To accomplish these objectives, the Disposal Division was established in the DSA Headquarters. The responsibilities of this Division included the developing of policies, plans, and programs for disposal operations; the review and evaluation of these operations; and the initiation of corrective action as warranted.

Because of the enormity of the disposal program, certain responsibilities and functions were delegated to a DSA field activity—the Defense Logistics Services Center (DLSC). This activity compiles and publishes data and develops systems, techniques, and procedures relating to the disposal of surplus. DLSC also controls reported DOD surplus personal property and effects its disposition; maintains DOD centralized listings of prospective purchasers; processes sales offerings; and maintains control over approval, issuance, and dissemination of information on annual bid deposit bonds.

DSA currently operates 12 Defense surplus sales offices (DSSO's) throughout the continental United States as field activities of DLSC to conduct consolidated sales of surplus personal property within assigned geographical areas. The DSSO's conduct these sales for the various military disposal activities within their particular areas. Responsibilities of the DSSO's in conducting surplus property sales include preparing invitations for bid, combining related types of property, conducting bid openings, making awards, and concluding all contractual arrangements.

Depots, supply centers, shipyards, military posts, and bases, as an adjunct of their service mission, generate most of the unneeded materiel within DOD. Property disposal officers, who are accountable for excess and/or surplus property, are located at various military installations. They are charged with the responsibility for receipt, care, handling, accounting, and disposition of such property. Excess stocks of a military service, transferred to the property disposal officers, are reported to DLSC and subsequently to the General Services Administration for centralized reutilization screening to determine whether the unneeded materiel can be used to fill current requirements of other Government agencies, both civil and defense. If no requirements exist, the materiel

is declared to be surplus to the needs of the Federal Government and it then becomes available for disposal. Disposal activities—conducting excess reutilization and surplus disposal functions—are almost entirely financed by proceeds from the sale of surplus property.

*Requirements for controlling and reporting disposal operations*

In order that DSA may exercise control over the disposal program, the military departments are required to report the proceeds from the sale of surplus property and the expenses incurred in the reutilization and disposal process which are reimbursable from sales proceeds. Two statements are submitted quarterly to DLSC—one on proceeds and reimbursements and another on disposal expenses. The services also submit a quarterly report to DLSC entitled "Report of Excess and Surplus Materiel at Disposal Activities" which shows the quantity of property available for disposal and the dispositions actually made during the quarter.

Proceeds from the sale of surplus property are deposited to the DSA deposit fund account 97-6460-5191, from which reutilization and disposal expenses are reimbursed in accordance with section 511 of the Department of Defense Appropriation Act, 1965. This section of the appropriation act authorizes the reimbursement of the operation and maintenance appropriation for all expenses incurred during the fiscal year in the preparation for disposal and the disposal of military supplies, equipment, and material from amounts received as proceeds from the sale of surplus property. The act also requires the Department of Defense to submit a quarterly report of receipts and disbursements under this limitation to the appropriations committees of the Congress. The net amount of the sales proceeds, after reimbursement of expenses incurred by the services and reimbursement of DOD stock funds for a pro rata share of the current year's disposals representing stock fund property, is required to be deposited in the miscellaneous receipts of the Treasury.

The DSA deposit fund account is also credited for 10 percent of the proceeds from sales of industrial fund scrap material and sales/exchange property to provide for selling expenses incurred by DSA. The remaining 90 percent of the sales proceeds from these categories of surplus property is returned directly to the owning service or activity without being deposited in the DSA deposit fund account. The net proceeds from sales/exchange property returned to the owning activity are to be used in the acquisition of property similar to that which was disposed of.

In addition to sales to the public and transfers to other Government agencies, DOD excess/surplus inventories are reduced through donations to schools, public health organizations, and State and local governments and through abandonment and destruction because of the lack of commercial value or because of danger to public health or safety. Since there is little or no direct monetary return to the Government from disposals other than sales, practically all the related expenses incurred in these other disposals of surplus property are also reimbursed out of the DSA deposit fund account for sales proceeds.

According to the Department of Defense, the ratio of reimbursed disposal expenses to total proceeds from sales of surplus property increased progressively from 23 percent in 1958 to 72 percent in 1964; however, in 1965 the ratio decreased to 68 percent, as shown in the following schedule :

Year	Proceeds	Reimbursed expenses	Ratio of expenses to proceeds (approximated)	Acquisition value of material disposed of	Acquisition value closing inventories of excess/surplus property awaiting disposal
	Millions	Millions	Percent	Billions	Billions
1958.....	\$183.0	\$42.5	23	\$6.1	( <sup>1</sup> )
1959.....	215.1	58.1	27	8.6	\$4.0
1960.....	198.5	78.4	40	7.3	4.5
1961.....	168.7	84.6	50	7.8	2.6
1962.....	144.7	77.9	54	5.2	2.0
1963.....	109.9	74.5	68	5.1	2.6
1964.....	111.4	80.5	72	6.9	3.1
1965.....	121.1	81.7	68	6.4	3.7

<sup>1</sup> Not available.

Appendix III on page 37 of this report indicates the distribution of excess/surplus property which was disposed of during the period 1958 through 1965.

The 1958 and 1959 appropriation acts provided limitations on the use of sales proceeds to reimburse the cost of disposal operations. However, the following statement appears on page 48 of the House Report No. 408, 86th Congress, on the Department of Defense appropriation bill, 1960.

"Under title V, 'General Provisions,' section 611 provides that operation and maintenance appropriations may be reimbursed for all expenses involved in the disposal of surplus property from the proceeds of sale of such property. Unlike prior years, the provision this year is without a fixed dollar ceiling. It is the purpose of the removal of the dollar ceiling to encourage more rapid and effective disposition of surplus supplies, equipment and materiel. Testimony indicated that \$26.7 billion worth of material is presently awaiting disposition, and that the ceiling previously imposed was hampering the efforts of the Department. As previously, quarterly reports are required, however, the form of reporting should be revised in view of the appropriation reimbursement feature. It is requested that future reports indicate the appropriation to which reimbursement is made, and the budget program or programs involved within the appropriation. The committee has cautioned Defense officials against disposing of material as surplus when there is a clear need for retaining such material in the military inventories. Defense officials maintained that while some minor mistakes might be made, greater freedom in disposing of surplus will on the whole save large sums."

Defense appropriation acts for 1960 and subsequent years do not establish dollar limitations on the amount of sales proceeds available for reimbursement of disposal expenses.

In this connection, the DOD disposal program manager stated that, prior to 1960, the military services financed many disposal functions through other appropriations. Therefore, he is of the opinion that the congressional action mentioned in the foregoing House report caused the military services to realine their budgetary processes and identify disposal functions with the surplus property disposal program in order that these costs might be reimbursed from sales proceeds.

During 1962, the Secretary of Defense established project 26 relating to the management and operation of the DOD disposal program. A task force was organized under this project to review the program with the overall objective of recommending ways and means of reducing costs associated with the warehousing and disposal of surplus property. In December 1962, this task force submitted a report containing recommendations for improving the program, most of which involved organizational realignments, elimination of duplicative efforts, consolidation of disposal activities, and development of improved management controls. In November 1964, the Deputy Secretary of Defense directed DSA to require reports from disposal activities to reflect actual operations, require the establishment by the services of program elements to reflect the cost of the entire property disposal program and the financial support derived from sales, and require the consolidation within DSA of manpower spaces now used in service headquarters administration functions relating to disposal.

The Deputy Secretary of Defense, at that time, reemphasized DSA's role in the disposal area by stating that DSA was responsible for (1) administering a consolidated holding activity program within the United States with authority to determine the disposal activities required to carry out the program, (2) developing and establishing workload, performance, and cost standards, (3) reviewing and exercising supervision over individual disposal activities at the program level, and (4) developing and recommending to the DOD Comptroller any necessary refinements in the specificity of the expenses authorized to be reimbursed from surplus personal property proceeds.

In December 1965, DSA proposed a uniform DOD property disposal cost accounting structure for the review and consideration of the Assistant Secretary of Defense (Installations and Logistics) and the military services. In this proposal, DSA stated that, since the cost system must be compatible with engineered standards and performance data reporting systems now being developed by the services, it was important that necessary instructions be published and disseminated within the specified time, as any delay would jeopardize DSA's ability to meet the target date of July 1, 1966, for implementing the new cost accounting system.



On the basis of the 1949 Federal Property and Administrative Services Act, it is the responsibility of the General Services Administration (GSA) to sell surplus property; however, disposal authority for materiel owned by the military services was subsequently delegated to the Department of Defense. GSA disposes of surplus materiel owned by the civil agencies of the Government and incurs costs in this process. In this connection, the Congress imposes a limitation on the amount of utilization and disposal expenses that can be incurred by GSA in any particular year. The GSA appropriation act specifies this amount and requires that it be derived from proceeds from the transfer of excess property and disposal of surplus property.

The civil agencies owning the surplus property that GSA disposed of are not reimbursed from sales proceeds for any costs that they may incur in the disposal process.

#### FINDINGS AND CONCLUSIONS

##### *Need to improve the accounting system and cost control for disposal operations*

During our review of selected fiscal year 1965 transactions relating to the disposal of excess and/or surplus personal property by the Department of Defense, we identified the withholding of sales proceeds and the reimbursement of expenses in certain instances which we believe to be contrary to DOD instructions. As a result of the specific situations identified at the installations visited, revenues from surplus sales estimated at approximately \$1 million were not available for return to the Treasury at the end of fiscal year 1965. We believe that this occurred primarily because the Defense Supply Agency—the organization responsible for managing the Defensewide disposal program—did not (1) provide adequate guidance in the nature of detailed policies and procedures, (2) establish and require the implementation of uniform accounting methods, or (3) exercise positive control over the disposal operations of the military services. Further, we believe that adequate reviews of disposal operations have not been performed by the internal audit agencies of the military services.

Although we did not observe instances where, according to authority granted in the Defense Appropriation Act, proceeds from sales of surplus property were diverted for purposes which are contrary to law, we did find that established Defense criteria for reimbursing disposal expenses and depositing sales proceeds were not always adhered to. Because of the lack of proper accounting methods and the lack of comparability of detailed expense records, as discussed in this report, we have been unable to establish why the ratio of disposal expenses to sales proceeds has progressively increased in DOD from 1958 through 1964. However, it should be noted that prior to fiscal year 1960 disposal expenses may have been incurred under appropriations which were not reimbursed because of limitations on the extent of expenses reimbursable from sales proceeds in prior appropriation acts. Also, we were unable to analyze on a comparable basis the costs incurred by the General Services Administration in disposing of surplus property with those incurred by the Department of Defense because costs of the latter include significant charges for preparing materiel for disposal (such as demilitarization) while costs of the former cover mainly expenses involving the selling process.

In our limited audit tests, we found at an industrial fund activity that proceeds from scrap sales estimated at about \$329,000 had been withheld from the deposit fund, contrary to Defense criteria, and used principally to defray major maintenance costs. In addition, we estimate that approximately \$630,000 of the expenses of four Navy installations, an Army installation, and two DSA installations were reimbursed out of surplus sales proceeds, which, in our opinion, was contrary to DOD established criteria. These reimbursed costs were incurred in (1) processing industrial fund scrap material, the proceeds of which were retained by an industrial fund activity, (2) performing reclamation work in connection with the disposal process, and (3) transporting and handling unneeded materiel before it entered disposal channels. The implementing instructions of the military services are not always uniform in identifying the types of expenses which are reimbursable from surplus sales proceeds. On July 1, 1965, DSA issued instructions for correcting the deficiencies noted at its installations.

Although the Defense Supply Agency has the responsibility for managing disposal operations on a Defense wide basis, we find that adequate guidelines have not been developed by DSA to insure uniform accounting treatment of disposal expenses and proceeds from sales of surplus personal property. For the most part, the military services have established their own guidelines in these areas,

causing differences to exist in the accounting and reporting for disposal expenses and proceeds. Consequently, DOD management officials and the Congress have not always been provided with the necessary information relative to disposal operations to adequately appraise the efficiency and effectiveness with which the program has been administered and carried out so that appropriate corrective action can be initiated where and when required. Where, as in this program, there is no limitation on the amount of sales proceeds that can be used to finance disposal operations, it is particularly important that adequate data be made available for evaluation and that cost controls be established to encourage the realization of maximum economies.

A detailed discussion of our findings at selected disposal activities follows.

*Navy shipyard withheld certain scrap sales proceeds from deposits returnable to the Treasury.*—During fiscal year 1965, the Navy's industrial fund retained about \$3.5 million of scrap sales proceeds for use by activities of the industrial fund. On the basis of our tests of \$657,600 of the scrap proceeds retained by the Norfolk Naval Shipyard, we estimate that at least \$329,000, or about half, should not have been withheld from the DSA deposit fund account, according to Defense criteria. On this basis, we estimate that the Navy industrial fund has obtained significant amounts of surplus sales proceeds, reducing the balance of funds that were available in the DSA deposit fund account at year-end for transfer to miscellaneous receipts of the Treasury. The moneys acquired in this manner may have been used to carry out operations normally financed through other appropriations.

Service directives permit the retention by industrial fund activities of 90 percent of the proceeds derived from the sale of scrap material. Ten percent of the proceeds are deposited to the DSA deposit fund account to provide for sales expenses incurred by the Defense surplus sales offices of DSA. However, according to DOD Instruction 7310.1, all proceeds from the sales of scrap material owned by activities other than industrial fund activities must be deposited directly in the DSA deposit fund account. Thus at locations processing scrap of industrial fund as well as nonindustrial fund activities, the determination as to whether the proceeds are retained or deposited in the DSA deposit fund account depends on the classification of the scrap by the installation.

In connection with the accounting treatment for scrap proceeds and related industrial fund expenses, instructions of the Comptroller of the Navy are not consistent with Department of Defense Directive 7410.4. With respect to the withholding of scrap sales proceeds from the DSA deposit fund account, DOD instructions state that only the proceeds from the sale of industrial fund scrap shall be returned to the industrial fund. These instructions describe industrial fund scrap as being short ends, machinings, spoiled material, and similar residue generated and owned by the industrial fund activity. However, Navy industrial fund instructions provide, contrary to DOD instructions 7310.1 and 7410.4, that proceeds from the sale of "rip-out" scrap belonging to its customers will also be withheld from the deposit fund. "Rip-out" scrap is defined as material removed from a vessel that was originally a part of the vessel prior to the start of rehabilitation or modification work. We believe that this practice of withholding, from the deposit fund, proceeds from the sale of such "rip-out" material, which is not the property of the industrial fund, is contrary to the Department of Defense directive.

During fiscal year 1965, the Property Disposal Office (PDO) located at the Norfolk Naval Shipyard, sold almost 22 million pounds of scrap for \$921,500. The shipyard's industrial fund received \$657,600 of the proceeds, and \$263,900 was deposited in the DSA deposit fund account.

In order to determine whether scrap sales proceeds had been properly allocated between the shipyard industrial fund and the DSA deposit fund, we (1) examined records relating to receipts and sale of scrap, (2) identified the shipyard shops and locations which generated scrap, and (3) established ownership of scrap materials.

Shipyard records showed that about 19.8 million pounds of scrap were delivered to the disposal area during 1965. The PDO classified about 17.8 million pounds as industrial fund scrap and 2 million pounds as belonging to other activities. We estimate that 14.7 million of the 17.8 million pounds belonged to other activities. The chief reason for this incorrect classification was that the PDO, as a matter of routine, classified all scrap that came from waterfront locations and shipyard production shops as industrial fund material, regardless of the aforementioned DOD criteria. Almost all the scrap from these locations

represented materials which had been removed from vessels that had undergone overhaul, repair, and modification and therefore did not belong to the industrial fund. Examples of the misclassifications follow.

The shipyard sold over 4 million pounds of cut plates and structural steel as scrap. The PDO classified all but 60,000 pounds of this material as industrial fund scrap. However, we were informed by installation officials that almost 3.8 million pounds, or 90 percent, of the total sold had been removed from vessels being repaired and overhauled. Consequently, of the cut plates and structural steel sold, about 3.8 million pounds actually belonged to other activities and only 358,000 pounds were industrial fund scrap.

In another instance, lead totaling about 1.5 million pounds was classified as being owned by the industrial fund. However, officials informed us that all the lead was from submarine batteries which had been removed while these vessels were undergoing repair and overhaul. Therefore, none of this lead was industrial fund scrap. In addition, we found that about 211,700 pounds of manganese bronze propellers had been similarly treated by the PDO and classified as industrial fund materials, even though these items were all removed from vessels rather than being property of the industrial fund.

As stated above, we estimate that about one-half the proceeds retained by the industrial fund was for materials owned by other activities. These proceeds were not deposited in the DSA fund account. Scrap sales proceeds, treated as other income by the industrial fund, were used to defray major maintenance costs incurred during fiscal year 1965 for such projects as repairing sash, siding, and roofing of buildings; leveling and resurfacing a drydock; and replacing a 30,000-gallon elevated water tank.

*Reimbursement from sales proceeds of expenses not directly related to disposal operations.*—During fiscal year 1965, the Navy claimed costs of about \$24.7 million for disposing of excess and surplus property, which were ultimately reimbursed from disposal sales proceeds deposited in the DSA fund account. We reviewed selected expense transactions at four Navy installations, which accounted for \$2.6 million of the \$24.7 million Navy-wide reimbursements made to the operation and maintenance appropriation, and we identified costs estimated at \$300,000 that did not qualify as reimbursable disposal expenses according to Department of Defense criteria.

In addition, costs totaling more than \$330,000 were incurred at an Army installation and at two DSA installations, which in our opinion did not qualify, according to Defense criteria, for reimbursement from sales proceeds. On the basis of these findings, as well as our findings at other disposal activities, we estimate that the military services have obtained significant amounts of surplus sales proceeds, reducing the balance of funds that were available in the DSA deposit fund at yearend for transfer to miscellaneous receipts of the Treasury.

Our tests at selected disposal sites identified reimbursements to the military services for disposal expenses although these costs were incurred for (1) preparation of scrap material for which sales proceeds were retained by an industrial fund activity, (2) reclamation of usable materiel which benefited the supply system through ultimate reductions in the use of procurement funds, and (3) transfers of excess stocks from supply system inventories to the property disposal office prior to assumption of accountability by the PDO.

Department of Defense Instruction 7310.1 was issued to establish procedures for reimbursing disposal expenses. Guidelines as to the type of expenses chargeable to disposal operations by the Defense Supply Agency at its own activities are contained in DSA Manual 7000.1 and by Navy activities in the Comptroller of the Navy Manual 035480. Air Force guidelines appear in Air Force Manual 177-109, and guidelines for the Army appear in Army Regulation 37-103. Our review disclosed that differences in these instructions often cause inconsistent accounting treatment of expenses subject to reimbursement. Examples of our findings in this connection follow.

*Reimbursement of costs for processing industrial fund scrap.*—Department of Defense Directive 7410.4 requires industrial fund activities retaining proceeds from the sale of scrap to bear the expenses of processing this material through charges to operating costs. Costs incurred in processing scrap owned by activities other than industrial fund activities may be reimbursed from the DSA deposit fund account, as all proceeds from such sales are to be deposited in this account. We found that the industrial fund at the Norfolk Naval Shipyard, while retaining the proceeds from the sale of its scrap, was also being reimbursed from DOD-wide sales of surplus property for the cost of processing its own ma-

terial. This occurred because Navy instructions provide that costs incurred in preparing scrap for sale, other than those for collection and transportation to the property disposal offices, are to be charged to reimbursable disposal expenses rather than to industrial fund operating costs.

During fiscal year 1965, the shipyard incurred costs of \$325,400 in processing scrap owned by the industrial fund and by other Federal activities. These costs were primarily incurred for labor and overhead expenses relating to sorting, cutting, and preparing scrap for sale. Our review of the shipyard accounts showed that the total cost of \$325,400 was reimbursed from proceeds of surplus sales deposited in the DSA deposit fund account.

As stated previously, our review work disclosed that the property disposal officer received 19.8 million pounds of scrap material for processing during fiscal year 1965. Of this amount, we determined that scrap owned by the industrial fund totaled only 3.1 million pounds. The remainder belonged to other Government activities or functions. Records were not available to show the cost of processing the industrial fund material as opposed to the cost incurred for processing the scrap owned by other activities. Therefore, we estimated the cost of processing the industrial fund material on the basis of the ratio of poundage received for processing from all sources. On this basis, costs amounting to about \$52,000 were reimbursed from the DSA deposit fund account for processing industrial fund material. Since the industrial fund retained the proceeds from sales of its scrap materials, the cost of \$52,000 for processing this material should have been borne by the industrial fund, in accordance with DOD criteria.

At the U.S. Army Rocky Mountain Arsenal—the other industrial fund activity reviewed by us—expenses incident to the preparation of scrap were not reimbursed, but rather were charged to operating costs of the activity in accordance with the DOD directive.

The Air Force makes relatively little use of industrial funds for financing activities that generate significant quantities of surplus property.

*Reclamation and modification of usable items.*—Department of Defense Instruction 7310.1 states that the cost of removing parts or other equipment from end items being disposed of may be charged as reimbursable expenses when such action is essential to the disposal process. The Navy Comptroller's Manual states, however, that costs of combined operations involving scrap, salvage, and recovery of usable parts or other equipment are chargeable to reimbursable disposal expenses, without mentioning that such operations must be essential to disposal in order for the costs to be reimbursable from sales proceeds. The desirability of removing usable parts from items to be disposed of is recognized, but the expenses so incurred should be identified and considered in evaluating the effectiveness of the work involved.

We found that the Norfolk Naval Shipyard, the Norfolk Naval Air Station, and the Yorktown Naval Weapons Station had been reimbursed costs of about \$117,000 for certain reclamation and modification work for the purpose of obtaining serviceable materiel for the Navy's supply system. We were informed that the related end items could have been disposed of without incurring the cost for performing this additional work. The practice of reimbursing reclamation and modification costs was also observed at the Toole Army Depot. Examples illustrating the conditions under which reclamation charges were reimbursed from proceeds of DOD-wide surplus sales follow.

(1) In connection with our review at Navy installations, we found that the Norfolk Naval Air Station in July 1964 issued a work request for reclamation of certain usable parts from aircraft engines. This project was a part of the Navy's aviation supply office program for reclaiming usable parts from excess engines in lieu of procurement. The engines were disassembled and certain usable parts were removed and returned to the Navy supply system. The reclamation costs, amounting to about \$49,500, were charged to reimbursable disposal expenses. A representative of the naval air station disposal yard stated that it was not necessary to remove any of the parts in order to dispose of the engines and that the engines could have been disposed of in an "as is" condition.

(2) The Norfolk Naval Shipyard was directed by the Bureau of Naval Weapons to dispose of 15 gun mounts that had been declared excess. The shipyard was also instructed to reclaim from the gun mounts certain usable parts for use in the Navy supply system and to charge the entire cost of this work to disposal operations. As a result of this reclamation, the shipyard salvaged and returned to the Navy supply system usable parts having significant value. The cost of this job—\$11,600—was charged to reimbursable disposal expenses rather than to the benefiting activities. A representative of the shipyard estimated

that, if the gun mounts had been disposed of without recovery of the usable parts, the cost of disposal would have amounted to only about \$700. On this basis, we concluded that the increased cost of about \$10,900 had been incurred primarily for the purpose of acquiring additional inventory for the Navy's supply system.

(3) The Yorktown Naval Weapons Station initiated modification work on 100 units of MK 8-1 explosive-type warheads for the Sidewinder missile that were not excess to Navy requirements. This work, which was performed to acquire a different end item, involved the removal of explosives and the decontaminating, cleaning, painting, and repackaging of the units. After these jobs were accomplished, the units were identified as being the MK 2-0 type, which is an exercise item. These redesignated warheads were returned to the Navy supply system, and the entire cost of the modification, amounting to \$3,800, was charged to reimbursable disposal expenses.

(4) Although Army policy relative to reclamation activities conforms with that of DOD, our review at the Tooele Army Depot, Tooele, Utah, disclosed that expenses in excess of \$210,000 were incurred for the disassembly, reclamation, modification, and reassembly of Air Force bombs. This cost was reimbursed from sales proceeds as demilitarization expense.

We found also that the Air Force directives conformed generally with those of DOD; however, we cannot express an opinion on the extent of Air Force compliance with DOD instructions, because there were no significant reclamation activities at the Air Force installations listed in appendix II, p. 287, which we visited.

The Congress through other appropriations has provided the services with funds to acquire spare parts, supplies, and equipment and to perform modification work.

The reclaiming of usable parts from items being processed for disposal is often desirable when the cost of reclamation or modification is less than the cost to procure new items. Where the cost of removing parts from unneeded materiel is not identified, however, an effective evaluation of the economic feasibility of this work may not be possible. In addition, such reclamation actions would not only reduce surplus sales proceeds by the amount of reimbursed costs incurred in the removal of parts but also may further reduce surplus sales proceeds through decreased sales value of the residue materiel finally disposed of.

*Costs related to transfer of excess materiel to Property Disposal Offices.*—Department of Defense Instruction 7310.1 states that expenses involved in the transportation and handling of materiel, in the act of getting rid of excess surplus property by transfers, donations, sales, abandonment, or destruction, are reimbursable. In implementing this instruction, the services issued conflicting directives covering the reimbursement of expenses which were incurred prior to the time the PDO assumed control and accountability for unneeded materiel.

The Army and Air Force issued instructions which provide that predisposal costs, such as packing and transporting excess property to the PDO, are not reimbursable from disposal sales proceeds. DSA also issued instructions, on July 1, 1965, to correct the practice of reimbursing predisposal costs; however, during fiscal year 1965, two DSA installations were reimbursed costs of about \$120,000 for this purpose. On the other hand, Navy instructions state that reimbursable disposal costs will include recording, reporting, and physical handling of excess materiel, and our tests at three Navy activities identified predisposal costs of at least \$131,000 that were incurred in the identification of excess stocks, in the removal of unneeded items from storage, and in the delivery of such materiel to the Property Disposal Office.

Examples of these reimbursed expenses, which were incurred before the Property Disposal Officer assumed control and accountability of the unneeded materiel, follow.

1. During fiscal year 1965, the storage division of the Naval Supply Center, Norfolk, charged expenses totaling about \$81,000 to disposal operations. Our analysis of these costs showed that about \$64,700 was expended for wages of employees who picked unneeded items from the warehouses and moved these stocks to a loading location for transporting to the property disposal officer. Another supply center division charged additional expenses of about \$21,000 to the PDO operation, representing wages of employees who were transporting excess materiel prior to the time the PDO assumed accountability. We found also that the inventory control and fiscal department of this same Navy activity charged costs of about \$13,800 to the PDO operation for processing listings and recording transactions involving items subsequently declared excess by the installation.

2. At the Naval Weapons Station, Yorktown, we found that the production planning and control division included in reimbursable disposal expenses the

costs for identifying, segregating, and tagging excess materials at supply warehouses and for preparing the release documents to transfer the accountability of such materiel to the PDO. The total amount of these costs charged to reimbursable expenses during fiscal year 1965 was about \$22,600. Our tests at the Norfolk Shipyard also identified costs estimated at \$9,000 which were charged to reimbursable disposal expense for tagging, handling, and loading excess materials for transfer to the PDO.

3. In implementing the Department of Defense Instruction 7310.1, the Defense Supply Agency recently directed that all expenses which its inventory managers and distribution points would normally incur in carrying out their supply functions prior to the transfer of accountability for excess items to PDO's would be excluded from reimbursable disposal costs. DSA has also recommended to DOD that this exclusion be applied DOD-wide. Our review identified reimbursements for these types of expenses at two DSA installations during fiscal year 1965, prior to the issuance of instructions which implemented DOD policy. At the Defense Electronics Supply Center, we observed that costs in the amount of \$55,700 had been incurred and reimbursed for picking, packing, and transporting declared excess property from storage to the property disposal officer. At the Defense Construction Supply Center, costs of about \$64,000 were reimbursed for the same type of services.

In addition to computing requirements, procuring stocks, and maintaining

storage, and distribution systems, supply management responsibilities include identifying excess materiel, removing excess items from inventory, and delivering them to disposal areas. Regular supply personnel perform these services and the cost of these functions is provided for under the operation and maintenance appropriation.

*Need for improvement in the identification of disposal costs and the reporting of disposal operations.*—Our review of selected Department of Defense disposal activities have disclosed that the accounting procedures currently in use do not provide for adequate identification of expenses incurred in the disposal of excess and surplus property. We believe that this condition exists because DOD instructions governing the reporting of expenses do not require full and adequate disclosure of the nature of disposal costs and the disposal program manager (DSA) has not initiated corrective action in this respect. As a result, we believe that congressional and DOD evaluations of the efficiency and effectiveness of the Defense disposal program can only be of limited scope and that this situation can permit reimbursement of expenses properly chargeable to other appropriations.

The current DOD Instruction 7310.1, which provides the basic guidance for recording disposal expenses, requires only that costs be reported to the DOD disposal program manager under the general categories of administration, transportation, demilitarization, scrap segregation and preparation, utilities, storage and maintenance, sales costs, and other disposal costs. Such general expense classifications, in our opinion, do not permit meaningful evaluations of program operations by higher echelons of management; nor do they readily reveal the financing of functions which are not properly related to disposal operations so as to qualify for reimbursement from disposal sales proceeds.

It is congressional policy and intent, as evidenced by the Accounting and Auditing Act of 1950, that Government accounting systems provide full disclosure of the results of financial operations. In our opinion, one of the most important reasons for this requirement is to allow management officials at all levels, and particularly program managers, to compare and appraise financial data in sufficient detail to insure proper discharge of their responsibilities for efficient and economical operations in accordance with applicable laws and regulations. Reports on proceeds and expenses provided to the DOD disposal program manager by the military services do not, in our opinion, meet these requirements for the reasons discussed below.

1. Costs related to the various methods of disposal—sale, redistribution, transfer, donation, abandonment, and destruction—are not readily identifiable in the accounting and reporting systems. Our review disclosed that these expenses were generally commingled in the accounts and reports. Therefore, we could not specifically identify expenditures associated with each of these types of disposal actions.

2. Our review disclosed that costs incurred in the construction of disposal facilities were recorded in expense accounts and reimbursed as utility, transfer,

scrap segregation, sales, or demilitarization costs. For example, at Wright-Patterson Air Force Base, more than \$6,700 of construction costs was reimbursed as utility, storage, and maintenance expenses.

3. Overhead or indirect costs allocated to disposal activities were recorded in a variety of expense accounts by the military services and reported as transportation, maintenance, and utility costs. Our review disclosed also that allocated overhead charged to these accounts for reimbursement from sales proceeds varied from 1 to 300 percent of direct costs and therefore could represent a substantial portion of the reimbursed expenses. In this connection, at one Army depot approximately 37 percent of the costs of local operation and maintenance of facilities was charged to the property disposal officer who handled only 4 percent of the material benefiting therefrom. This same disposal activity was also allocated 37 percent of the costs for administration of rail services even though less than 2 percent of the rail car movements during 1965 related to disposal functions. At Wright-Patterson Air Force Base, indirect charges were 91 percent of direct disposal costs. At the Army Rocky Mountain Arsenal, indirect charges amounted to more than 300 percent of direct disposal costs.

4. Administrative costs relating to intraservice reporting and redistribution of excess property within a military department for its own operating stocks are precluded from reimbursement out of sales proceeds by DOD Instruction 7310.1. The lack of specificity in recording such intraservice costs has permitted improper reimbursements through the commingling with reimbursable interservice costs of the same nature.

5. The Defense Logistics Services Center is reimbursed out of proceeds from disposal sales for costs incurred in the DOD-wide screening of declared excess property reported by disposal activities. This screening is for the purpose of determining whether the unneeded materiel can be used elsewhere within DOD. There is no requirement for the identification of these costs in the reports to DOD or in the reports to the Appropriations Committees of the Congress so that the effectiveness of this operation can be measured in terms of its cost. During 1965 these costs, approximating \$550,000, were reimbursed from surplus sales proceeds.

*Need for more intensive review of disposal activities by internal auditors.*— Although we found that internal audits had been made in recent years at 14 of the installations we visited, our examination of the internal audit reports at these locations revealed that the propriety of the use of sales proceeds was considered in only 4 instances. It is our opinion that in two of these cases the review work did not cover the subject matter in adequate depth as the validity of the more significant disposal costs was not reviewed. In the other two cases, at the Norfolk Naval Shipyard and the Norfolk Naval Supply Center, we found that Navy auditors had previously reported on matters similar to those identified in our report; namely, misclassification of scrap and reimbursement of charges not related to disposal operations. However, responsible management officials did not take corrective action in all instances. We also learned that no comprehensive service-wide reviews of the surplus property disposal program had been made in recent years by the internal audit agencies of the military services. Therefore, we believe that improvement in internal audit coverage is required to identify the full extent of deficiencies in disposal operations and the need for corrective action. Further, we believe that management officials should be required to take corrective action on deficiencies identified in audit reports or to document the reason for not taking such action.

#### CONCLUSIONS

Our limited review of selected transactions relating to the disposal of excess and surplus personal property by the Department of Defense during fiscal year 1965 showed that almost \$1 million in funds accumulated from surplus sales was not available for return to the Treasury at the end of the year. We found that proceeds from scrap sales estimated at about \$329,000 were withheld from the deposit fund by an industrial fund activity and used principally to defray major maintenance costs, contrary to Defense directives. We also identified an estimated \$630,000 of the disposal expenses incurred by the military installations that we visited which, in our opinion, was reimbursed out of surplus sales proceeds contrary to DOD established criteria.

We believe that this occurred because the DOD Disposal Program Manager (DSA) had not authoritatively directed and supervised disposal operations of the military services. We believe also that interpretations limiting DSA's responsibilities to only "administrative" control over the disposal program and

the lack of clarity as to the responsibility of DSA in this regard have to some extent caused management deficiencies such as those identified in this report.

Further, we believe that, because DSA has not developed and prescribed a uniform cost accounting system with detailed expense classifications for providing information relative to DOD-wide disposal operations, management officials cannot effectively appraise various disposal functions so as to identify adverse conditions warranting corrective action. The availability of adequate detailed management data on a timely basis is particularly important in this program where there is no limitation on the amount of proceeds that can be used to finance disposal operations. Such detailed data would identify those cases in which the relationship of reimbursed expenses to the disposal function warrants inquiry. These inquiries may lead to corrective action where costs not related to the disposal program are being reimbursed.

The problems discussed herein are likely to be widespread because of the lack of adequate cost data, uniform accounting methods, and detailed management reporting of disposal sales proceeds and reimbursed expenses. Further, our review of the internal audit function indicated that inadequate consideration was being given to ascertaining the propriety of expenses charged to disposal operations.

We believe that improved management controls over the use of surplus sales proceeds are necessary to provide that only those expenses which are applicable to the disposal program, and which have not been provided for in other appropriations, are reimbursed from surplus sales proceeds. Among the more important corrective measures which, in our opinion, should be taken to improve operations of the disposal program are (1) further strengthening by the Secretary of Defense of the central management role of the Defense Supply Agency to provide more effective direction and supervision of disposal operations of the military services, (2) the early implementation of a uniform cost accounting system that would provide for more definitive cost identification, (3) the establishment of an improved reporting system for disposal operations that would provide management with necessary data for appraising the program, and (4) the performance of periodic internal audits to validate disposal expenses which are reimbursed from surplus sales proceeds. Although Defense officials have advised us recently that certain corrective measures are under consideration and development, these measures have not progressed sufficiently for an appraisal of their effectiveness.

We wish to emphasize that we are not criticizing the objectives of the disposal program, because efficient supply management operations require that unneeded material be disposed of in an expeditious and economical manner. However, it is our opinion that proceeds from surplus property sales and the expenses reimbursed out of sales proceeds should be properly identified and recorded so as to provide agency management and the Congress with necessary data for appraising the disposal program.

#### SCOPE OF REVIEW

In accordance with the request from Congressman Curtis, our inquiry was directed primarily into the adequacy of controls over the use of disposal sales proceeds to reimburse the military services for expenses incurred in the disposal process. Our limited review at selected disposal sites was confined mainly to examinations into costs rather than into the adequacy of receipts. We did not undertake a general evaluation of the DOD personal property disposal program.

In the course of our work, we reviewed policies, procedures, and directives governing the implementation of the disposal program; we examined selected 1965 disposal transactions and inquired into the accounting therefor; we reviewed various reports to DOD management officials on disposal operations; we reviewed the fourth quarter 1965 report of DOD to the appropriations committees of the Congress; we examined selected audit reports prepared by the internal audit agencies of the military services; and we examined disposal facilities and certain disposal functions, such as demilitarization, reclamation, and segregation of scrap material.

Our review work was performed at disposal activities located at five Navy installations and at five Army, three Air Force, and four Defense Supply Centers. We also inquired into the operations of four Defense Surplus Sales Offices and the Defense Logistics Services Center. A schedule identifying the installations visited by us is presented as appendix II.



## [Appendix I]

*Principal officials of the Department of Defense and the Departments of the Army, Navy, and Air Force responsible for administration of activities discussed in this report*

	Tenure of office	
	From—	To—
<b>DEPARTMENT OF DEFENSE</b>		
Secretary of Defense: Robert S. McNamara .....	January 1961 .....	Present.
Assistant Secretary of Defense (Installations and Logistics):		
Paul R. Ignatius .....	December 1964 .....	Do.
Thomas D. Morris .....	January 1961 .....	December 1964.
Assistant Secretary of Defense (Comptroller):		
Robert N. Anthony .....	September 1965 .....	Present.
Charles J. Hitch .....	February 1961 .....	August 1965.
<b>DEFENSE SUPPLY AGENCY</b>		
Director, Defense Supply Agency:		
Vice Adm. Joseph M. Lyle .....	July 1964 .....	Present.
Lt. Gen. A. T. McNamara .....	October 1961 .....	June 1964.
Executive Director, Technical and Logistics Services:		
Brig. Gen. William L. Hamrick .....	July 1965 .....	Present.
Maj. Gen. Francis C. Gideon .....	January 1962 .....	July 1965.
Chief, Disposal Division: Carl O. Sullinger .....	do .....	Present.
<b>DEPARTMENT OF THE ARMY</b>		
Secretary of the Army:		
Stanley R. Resor .....	July 1965 .....	Present.
Stephen Ailes .....	January 1964 .....	July 1965.
Cyrus R. Vance .....	July 1962 .....	January 1964.
Elvis J. Stahr, Jr. .....	January 1961 .....	June 1962.
Assistant Secretary of the Army (Installations and Logistics):		
Dr. Robert A. Brooks .....	October 1965 .....	Present.
Daniel M. Luevano .....	July 1964 .....	October 1965.
A. Tyler Port (acting) .....	March 1964 .....	June 1964.
Paul R. Ignatius .....	May 1961 .....	February 19 4.
Chief Support Services, Services Division, Property Disposal Branch:		
Col. K. T. Smith .....	August 1963 .....	Present.
Lt. Col. R. Goodrich .....	January 1962 .....	July 1963.
<b>DEPARTMENT OF THE NAVY</b>		
Secretary of the Navy:		
Paul H. Nitze .....	November 1963 .....	Present.
Fred H. Korth .....	January 1962 .....	November 1963.
Assistant Secretary of the Navy (Installations and Logistics):		
Graeme C. Bannerman .....	February 1965 .....	Present.
Kenneth L. Belieu .....	February 1961 .....	January 1965.
Chief, Busanda:		
Rear Adm. Herschel J. Goldberg .....	May 1965 .....	Present.
Rear Adm. John Crumpacker .....	January 1962 .....	April 1965.
<b>DEPARTMENT OF THE AIR FORCE</b>		
Secretary of the Air Force:		
Harold Brown .....	October 1965 .....	Present.
Eugene M. Zuckert .....	January 1961 .....	September 1965.
Assistant Secretary of the Air Force (Installations and Logistics): <sup>1</sup>		
Robert H. Charles .....	November 1963 .....	Present.
Joseph S. Imlrie .....	April 1961 .....	October 1963.
Director of Supply Services—AFSSSDA Identification and Disposal Branch Supply Systems Division:		
Lewis W. Wilson .....	April 1963 .....	Present.
Lt. Col. Fred L. Crouse .....	October 1962 .....	March 1963.
McCarthy Nowlin .....	July 1962 .....	October 1962.

<sup>1</sup> Office was known as Assistant Secretary of the Air Force (Materiel) until February 1964, at which time the title was changed to the Assistant Secretary of the Air Force (Installations and Logistics).

## [Appendix II]

## SCHEDULE OF INSTALLATION WHERE REVIEW WORK WAS PERFORMED

## DEFENSE SUPPLY CENTER

Headquarters, Defense Supply Agency, Alexandria, Va.  
 Defense Logistics Services Center, Battle Creek, Mich.  
 Defense Construction Supply Center, Columbus, Ohio.  
 Defense Electronics Supply Center, Dayton, Ohio.  
 Defense General Supply Center, Richmond, Va.  
 Defense Depot, Ogden, Utah.  
 Defense Surplus Sales Offices :  
   Tucson, Ariz.  
   Norfolk, Va.  
   Columbus, Ohio.  
   Ogden, Utah.

## DEPARTMENT OF THE ARMY

U.S. Army Tank—Automotive Center, Warren, Mich.  
 Erie Army Depot, Port Clinton, Ohio.  
 U.S. Army Rocky Mountain Arsenal, Denver, Colo.  
 Tooele Army Depot, Tooele, Utah.  
 Navajo Army Depot, Flagstaff, Ariz.

## DEPARTMENT OF THE NAVY

U.S. Naval Ammunition Depot, Crane, Ind.  
 Norfolk Naval Shipyard, Portsmouth, Va.  
 U.S. Naval Weapons Station, Yorktown, Va.  
 Naval Supply Center, Norfolk, Va.  
 Washington Navy Yard, Washington, D.C.

## DEPARTMENT OF THE AIR FORCE

Luke Air Force Base, Ariz.  
 Hill Air Force Base, Utah.  
 Wright-Patterson Air Force Base, Ohio.

## [Appendix III]

*Types of disposal actions accomplished during fiscal years 1958 through 1965  
 according to the Department of Defense*

[Acquisition value in millions]

Fiscal year	Sales	DOD utilization	Transfers to civil agencies and MAP	Donations	Abandon- ment and destruction
1958	\$5,460	\$213	\$168	\$221	\$62
1959	7,367	485	361	314	99
1960	5,983	666	141	347	118
1961	6,123	975	349	275	44
1962	3,482	1,112	271	258	50
1963	3,446	1,157	188	233	74
1964	4,985	1,325	194	273	117
1965	4,177	1,460	395	282	129

[Appendix IV]

CONGRESS OF THE UNITED STATES,  
HOUSE OF REPRESENTATIVES,  
Washington, D.C., July 28, 1965.

Hon. JOSEPH CAMPBELL,  
*Comptroller General of the United States,*  
*General Accounting Office, Washington, D.C.*

DEAR MR. CAMPBELL: At recent hearings of the Subcommittee on Federal Procurement of the Joint Economic Committee, we had considerable discussion about the sale of surplus property by DSA and GSA. Previously, also, as I recall, your Office pointed out the fact that proceeds from sales have not always been used exclusively for the preparation for and conduct of sales as intended by statute.

On page 28 of the background material, 1965, prepared by the staff for the subcommittee, I noticed that gross proceeds from DOD sales amounted to \$103 million for fiscal 1964 and all costs, including the demilitarization and costs of preparation and selling, were \$77.3 million, or 75 percent of proceeds. This seems to me to be a very high percentage of cost as compared with fiscal years 1958 through 1962. It is my understanding that BOB objection to the transfer of the sales function to a civilian agency has been the matter of economy of operation. On the face of the statistics stated, it is difficult for me to see how the cost could be much higher.

In view of the above, I would like for the GAO to make a study into the costs of the DOD sales, the use of the proceeds to finance the preparation for sales and expenses thereof and the diversion of the proceeds, if any, for nonauthorized purposes. I would like this information for use at next year's hearings.

I might add that I look askance at financing of Federal operations through the use of receipts for other back- and side-door methods inconsistent with strict budgetary-appropriation hearings and procedures. I also believe that receipts should be deposited as contemplated by general statute without delay or reduction into the general fund for reappropriation.

Sincerely,

THOMAS B. CURTIS.

[Appendix V]

CONGRESS OF THE UNITED STATES,  
HOUSE OF REPRESENTATIVES,  
Washington, D.C., August 19, 1965.

Mr. FRANK H. WEITZEL,  
*Acting Comptroller General of the United States,*  
*General Accounting Office, Washington, D.C.*

DEAR MR. WEITZEL: Thank you very much for your letter of August 12, stating that you are beginning a study into the cost of DOD sales, and the use of those funds at my request. I am grateful for your cooperation in this matter.

It is my hope that this study will be guided by the considerations outlined in my July 28 letter to Mr. Campbell, especially "the diversion of the proceeds, if any, for nonauthorized purposes."

Again, I appreciate your help in this matter.

Sincerely,

THOMAS B. CURTIS.

## APPENDIX 6

### GAO REPORT ON USE OF HIGH-PRIORITY REQUISITIONS BY MILITARY ACTIVITIES REPORT TO SUBCOMMITTEE ON FEDERAL PROCUREMENT AND REGULATION, JOINT ECONOMIC COMMITTEE, CONGRESS OF THE UNITED STATES

COMPTROLLER GENERAL OF THE UNITED STATES,  
*Washington, D.C., March 18, 1966.*

B-140389.

Hon. PAUL H. DOUGLAS,  
*Chairman, Subcommittee on Federal Procurement and Regulation, Joint Economic Committee, Congress of the United States.*

DEAR MR. CHAIRMAN: In accordance with recommendations of your subcommittee in July 1965 and discussions with your staff, we have examined into the use of high-priority requisitions by military activities.

On the basis of our review of high-priority requisitions issued by selected Department of Defense installations and filled by the Defense Supply Agency depot at Tracy, Calif., it is our opinion that certain deficiencies in supply management and lack of effective controls over the use of high-priority requisitions have led to the degradation of the high-priority system and the incurrence of significant increased costs for transportation and depot handling.

We examined selected high-priority requisitions issued by five military installations and filled by Tracy Depot and found that about from 70 to 80 percent were designated as high priorities as the result of (1) inadequacies in supply management by the requisitioners and their supply support organizations, and (2) failures of requisitioners to conform to Department of Defense criteria on the relative urgency of need warranting the use of high-priority requisitions. We found also that when transportation personnel, at the depot and at the air terminal located at Travis Air Force Base, Calif., challenged the need for costly, high-speed transportation of large shipments during a 6-month period in 1964, the requisitioners in about 90 percent of the instances agreed to the use of routine transportation for the entire quantity.

In many instances, the urgency of need could have been avoided by utilizing materials already in stock, timely requisitioning of known requirements, and maintaining stocks at levels sufficient to meet programed and recurring requirements. Installation supply officials asserted that restricted operating funds caused insufficient stock levels and the frequent requisitioning of small quantities on an urgent basis. However, in our separate review now in process on frequent, small quantity requisitions, we are inquiring into the extent to which insufficient stock levels actually increase the overall operating costs and affect the supply system.

Also, we found that high priorities were assigned improperly inasmuch as the material was to fill relatively unimportant and routine requirements, such as a stock replenishment, predetermined initial allowances, and administrative needs.

We estimate that the increased costs for high-speed transportation and special depot handling of unnecessary and improper high priority shipments from the Tracy Depot in 1964 totaled about from \$650,000 to \$750,000. Although not a precise estimate, the computation described in our report indicates the approximate financial effect of these actions. The increased costs relate to 102,600 high-priority requisitions filled in a 12-month period by 1 distribution depot. Since the military activities issued 1.7 million high-priority requisitions to all Defense Supply Agency depots within a 6-month period, as well as an undetermined number of high-priority requisitions to other central inventory managers, we believe that the potential savings through improvements in requisitioning practices are very significant and are obtainable without detriment to accomplishment of mission.

We found that the assignment of high priorities was subject to certain controls such as reviews by local administrative and military audit agency personnel and challenges of high-priority requisitions by supply and transportation control offices. In our opinion, these controls, although beneficial, are not effective because they are not designed to identify the basic causes of requisitions being unnecessarily designated as high priority to fill urgent requirements.

A Department of Defense study group recently completed an evaluation of the priority system. The study group's report, dated October 1965, has been submitted to the Secretaries of the military departments for comment. Copies of the report were made available to us informally.

According to the study group's report, the present priority system is basically sound and no fundamental changes are necessary. However, this study group proposed certain procedural changes to strengthen the priority system and to facilitate the identification of competing demands. Although we have not fully evaluated the study group's proposals, they seem to represent measures which, if properly implemented, should improve performance under the priority system. However, the supply management deficiencies disclosed by our review do not appear to be covered by the proposed changes.

In our opinion, correction of these problems requires that the Department of Defense develop a management control system which would provide a means of measuring the extent and financial effect of the use of high priorities by requisitioning activities in order to provide a basis for identifying and correcting unnecessary, as well as improper, use of high-priority requisitions.

In view of the time limitation on reporting to your subcommittee, we were unable to solicit comments on this report from the Department of Defense.

Pursuant to arrangements with your staff, copies of this report are being sent today to the Secretary of Defense for his information. We plan to make no further distribution unless copies are specifically requested, and then copies will be distributed only after your approval has been obtained or public announcement has been made by you concerning the contents of our report.

We trust that our report provides you with the information required. If we can be of further assistance, please let us know.

Sincerely yours,

ELMER B. STAATS,

*Comptroller General of the United States.*

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### REPORT ON USE OF HIGH-PRIORITY REQUISITIONS BY MILITARY ACTIVITIES, DEPARTMENT OF DEFENSE

#### INTRODUCTION

In accordance with the request of the Subcommittee on Federal Procurement and Regulation, Joint Economic Committee, in its report on the "Economic Impact of Federal Procurement, July 1965," the General Accounting Office has examined into certain aspects of the use of high-priority requisitions by selected Department of Defense installations.

In its July 1965 reports, the subcommittee stated its concern that repetitive requisitions for the same item and the tendency to place high priorities on requisitions were degrading the priority system, delaying other requisitions, and burdening the supply system. It recommended that the General Accounting Office review the requisitioning procedures and practices used by military activities to obtain common-use items from the Defense Supply Agency and the General Services Administration. Our examination into the use of frequent requisitions for small quantities of material is in process, and a separate report will be submitted at a later date.

Since the procedures used by the military installations for requisitioning from the General Services Administration would likely be the same as those used in connection with the Defense Supply Agency and in view of the need to report our findings to the subcommittee promptly, we did not review transactions involving shipments by the General Services Administration. Statistics obtained on high-priority requisitions received by the General Services Administration from military installations indicated the percentage to be less than that received by the Defense Supply Agency.

Our review of high-priority requisitions was directed primarily toward (1) identifying the circumstances leading to the need for material on an urgent, rather than a routine, basis, (2) ascertaining whether the requisitioner's stated urgency of need complied with the established Department of Defense criteria on relative importance of competing requests for material, and (3) identifying premium costs for special depot handling and high-speed transportation of high-priority shipments.

Our review was confined to high-priority requisitions filled at the Defense depot at Tracy, Calif. (Tracy Depot), a principal distribution depot of the Defense Supply Agency. We identified costs incurred at that depot in calendar year 1964 for handling and transportation of material, excluding medical supplies and material consigned to Vietnam, under high priority, rather than routine priority, requisitions. We selected for examination at the requisitioning installation all the high-priority requisitions, excluding requisitions for medical items, filled by Tracy Depot in the 2-week period ended September 3, 1964, for the Sacramento Army Depot, the San Francisco Naval Shipyard, and the McClellan and Travis Air Force Bases in California and the Hickam Air Force Base in Hawaii. At these five locations, we reviewed the pertinent stock records and discussed the requisitions with the originators and other responsible persons to determine the circumstances of need and to evaluate the bases for the assignment of high priorities. We also reviewed procedures used by transportation personnel at Tracy Depot and air transportation control officers at Travis Air Force Base in challenging urgency of need when large-volume requirements were assigned high priorities.

We excluded requisitions for medical items from our review because we believed that high-priority requisitions from medical supplies involve circumstances which vary from circumstances involved in requisitions for other items.

#### BACKGROUND

The Department of Defense (DOD) developed the uniform materiel movement and issue priority system (UMMIPS) to permit uniform recognition and processing of competing demands for supply system assets and transportation services. DOD Instruction 4410.6, revised November 12, 1962, and August 20, 1964, provides criteria to insure that materiel requirements are processed in accordance with priorities on the basis of relative importance. The requisitioning activity shows the degree of priority by assigning to the requisition a priority designator, a two-digit code ranging from 01 through 08 for high priorities normally requiring special handling and high-speed transportation and 09 through 20 for less important needs permitting routine handling and cost favorable transportation.

The priority designator is determined by combining the importance of mission of the using activity (force/activity designator) and the urgency of its need or end use (urgency of need designator). The force/activity designator (FAD) is assigned by the Joint Chiefs of Staff, or by each military service under delegation of responsibility from the Joint Chiefs. It is expressed as one of the Roman numerals I through V and signifies the relative order of importance of the requiring activity. Using the criteria of DOD Instruction 4410.6, as implemented by the military services, the requisitioning activity determines the urgency of need designator. It is expressed as one of the letters A through D and signifies

the relative order of importance of the requirement, ranging from items without which the activity is unable to perform assigned operational missions to items required for stock replenishment.

For example, a requisitioner would properly assign an O2 priority designator to a requisition if material for emergency repair of a mission-essential vehicle warranting an urgency of need designator A was needed by an activity maintained in a state of readiness for immediate combat and therefore assigned a FAD II. If, however, the same activity needed the material to replenish backup inventories warranting an urgency of need designator D, a 17-priority designator would be properly assigned to the requisition.

The priority designators are categorized into priority groups 1 through 4 to provide supply and transportation personnel with maximum standard processing and delivery time from date of the requisition to receipt of the material by the consignee. The following table shows the time allowed for high priorities, priority groups 1 and 2, compared with routine priorities, priority groups 3 and 4.

*Delivery requirements set by UMMIPS*

Priority designator	Priority group	Within continental United States (days)	Overseas (days)
High priorities:			
01 through 03.....	1	5	7
04 through 08.....	2	8	15
Routine priorities:			
09 through 15.....	3	20	45
16 through 20.....	4	30	60

To insure appropriate assignment of priority designators, the DOD instruction requires commanding officers of requisitioning activities, or an individual authorized in writing, to personally review all requisitions with priority designators 01 through 08 within 24 hours after issuance of the requisitions.

The Defense Supply Agency (DSA) has the responsibility for providing to the military activities effective and economical support of common supplies and services. During the 6-month period ended December 31, 1964, military activities issued to DSA about 7.4 million requisitions, including 1.7 million with high priorities. The DSA warehousing system, which consists of seven principal distribution depots, four specialized support depots, and numerous other direct supply support points, is based on the positioning of stocks close to concentrations of military installations and ports of embarkation in the United States. The defense depot at Tracy, Calif., located about 50 miles east of San Francisco, is one of DSA's seven principal distribution depots. During calendar year 1964, Tracy Depot processed 855,400 requisitions, including 102,600 with high priorities.

The DOD instruction requires that requisitions assigned priority designators 01 through 08 be processed on a 7-day workweek, 24-hour workday basis and that high-speed transportation be the method of delivery. These urgent demands are to be satisfied on time without operating and transportation costs becoming an overriding factor. For large volume shipments, however, requisitioning activities are to be communicated with to confirm, or challenge, the urgency of need.

For urgent overseas deliveries, Tracy Depot utilizes the military air transport terminal at nearby Travis Air Force Base. During the period covered by our review, the eligibility of large volume shipments for overseas air transportation was challenged by air traffic coordinating officers at Travis Air Force Base, acting as representatives of the individual military services. This responsibility was subsequently transferred to the Military Traffic Management and Terminal Service, a single manager agency operating under the Secretary of the Army.

The premium costs for the special depot handling and high-speed transportation of high-priority orders are not charged to the requisitioner. The supplying agency absorbs the depot's increased processing cost. Transportation costs are financed centrally by each military department by publishing open allotment account numbers and authorizing designated activities to charge the central accounts without limitation.

The principal officials of the Department of Defense, the military services, and the Defense Supply Agency with responsibility for the administration of activities discussed in this report are listed in appendix I.

## FINDINGS

*Improved management control system required to achieve proper and economic use of high priorities*

Our review of high-priority requisitions issued by selected Department of Defense installations and filled by the Defense Supply Agency depot at Tracy, Calif., disclosed that certain deficiencies in supply management and lack of effective controls over the use of high-priority requisitions have led to the degradation of the high-priority system and the incurrence of significant increased costs for transportation and depot handling. On high priority shipments from Tracy Depot in 1964, we estimate that costs approximating \$650,000 to \$750,000 were incurred, which in our opinion could have been avoided without detriment to accomplishment of mission.

We examined selected high priority requisitions issued by five military installations and filled by the distribution depot during 1964 and found that about from 70 to 80 percent were designated as high priorities as the result of (1) inadequacies in the supply management by the requisitioners and their supply support organizations, and (2) failures of requisitioners to follow the DOD criteria on relative urgency of need warranting the use of high-priority requisitions.

When transportation personnel at the depot and at the air terminal located at Travis Air Force Base, Calif., challenged the need for costly, high-speed transportation of large shipments during a 6-month period ended in June 1964, the requisitioners in about 90 percent of the instances agreed to routine transportation for the entire quantity. In other instances, the challenges resulted in diversion of part of the requisitioned quantities to routine transportation. Thus, it seems evident that the urgency of need had generally been overstated by requisitioners and that substantial additional cost would have been incurred if the need for high-speed transportation had not been challenged.

Our inquiries and limited tests disclosed little evidence that effective control existed at the requisitioning level or that the challenges of supply and transportation agency personnel identified the basic causes for requisitions having been unnecessarily designated as urgent requirements.

*Transportation and depot handling costs significantly increased.*—In 1964 Tracy Depot filled 102,600 high-priority requisitions. On the basis of data obtained from the pertinent records and documents furnished by responsible depot personnel, we estimate that premium costs for transportation and depot handling, excluding the costs incurred for medical supplies and material consigned to Vietnam, totaled about \$1 million. These costs consisted of (1) air freight exceeding the cost for surface freight to continental and overseas destinations by about \$865,000, (2) air parcel post exceeding ordinary mail cost by about \$85,000, and (3) depot personnel overtime and travel expense to expedite material issue and delivery to air transport locations exceeding routine handling costs by about \$50,000.

During our sample period, August 21 through September 3, 1964, Tracy Depot filled 4,037 high-priority requisitions. We selected one overseas installation and four continental installations for which we reviewed all the depot's high-priority shipments to military activities. During the 2-week period, Tracy Depot filled 258 high-priority requisitions issued by these installations. We were able to determine from records and discussions with responsible personnel at the installations that 181 of these requisitions had been unnecessarily or improperly assigned high priorities—priority designators 01 through 08. Of the remaining 77 requisitions, 42 were proper and not reasonably avoidable. Sufficient information was not available at the requisitioning installations to determine conclusively whether the high priorities had been properly assigned to 35 requisitions. Thus, in our limited sample of 258 high-priority requisitions, those unnecessarily or improperly designated as high priorities ranged from a minimum of 181, or about 70 percent, to a maximum of 216, or about 80 percent.

Projecting the results of our limited sample period to the premium costs incurred for shipments from Tracy Depot in 1964, we computed costs ranging from \$650,000 to \$750,000 that could have been avoided by reasonably adequate supply management and by adherence to DOD's established criteria on relative importance of material requirements. The basis for our computation is described in appendix II. The increased costs relate to 102,600 high priority requisitions filled in a 12-month period by one distribution depot. Since the



military activities issued 1.7 million high priority requisitions to all DSA depots within a 6-month period, as well as an undetermined number of high priority requisitions to other central inventory managers, we believe that the potential savings through improvements in requisitioning practices are very significant.

The circumstances and specific causes for misuse of high priorities and examples of individual instances are identified in the following sections of this report.

*Urgency of need could have been avoided by improved supply management.*—We found 129 instances where the needed material could have been obtained on a routine basis if the management of supply support had been effective at the requisitioning installation. The use of high priorities could have been avoided by reasonable care in utilizing materials already in stock, timely requisitioning of known requirements, and maintaining stocks at levels sufficient to meet programmed and recurring demands by requisitioning on a routine basis. The types of supply management deficiencies and examples are as follows:

**Nonutilization of materials already in stock:** In 14 instances installation supply organizations could have avoided ordering materials from DSA on an urgent basis by utilizing acceptable substitutes or identical materials that were already on hand available for issue from stock.

For example, on August 13, 1964, the base supply office at McClellan Air Force Base ordered 100 units of an indented, butt-type conductor splice—Federal Stock No. (FSN) 5940-232-5209—for replenishment of bench stock in the base aircraft maintenance unit. The supply office assigned to the requisition an 05 priority designator requiring delivery within 8 days, because its stock of the item was depleted. At the requisition date, however, its stocks included more than 350,000 units of a similar indented, butt-type conductor splice—FSN 5940-840-0139. The supply officer's Federal Stock Catalog showed that this item was a suitable substitute for the item requisitioned. In fact, DSA filled the high priority requisition by expediting shipment of 100 units of the substitute splice, an item which was already in long supply at McClellan.

In another instance, the San Francisco Naval Shipyard on September 1, 1954, issued a high priority requisition for 100 feet of flat steel needed to modify an aircraft carrier. The requisition was assigned an 03 priority designator requiring delivery in 5 days. At the requisition date, however, material in stock at the shipyard included 483 feet of the identical flat steel. Since the urgent requirement apparently could have been met by utilizing materials already in stock, we questioned the persons responsible for initiating the requisition. We were told that they did not utilize the available material because they wanted to build up the inventories. This objective should have been accomplished by routine stock replenishment requisitions.

**Delay in requisitioning known requirements:** In 46 instances requisitioning activities did not order material within a reasonable time after needs were known. The untimely requisitions were consequently assigned high priorities to meet using activity requirements.

At the San Francisco Naval Shipyard, for example, the outfitting section of the supply office on April 13, 1964, received an allowance parts/equipment list showing that a pipe-threading tap was needed to outfit a ship for sea trials. About 4 months later, on August 17, 1964, the outfitting section issued the requisition. To insure receipt of the item by September 1, 1964, the scheduled time for sea trials, the requisitioner called for delivery within 8 days by assignment of an 07 priority designator. The maximum standard time for routine handling and delivery within continental United States is 20 to 30 days. Had the requisition been issued within a reasonable time after receipt of the parts list, it could have been assigned a routine priority.

In another instance, a work order for installation of certain equipment in a new telephone exchange at the Sacramento Army Depot was approved on July 21, 1964. Even though the post engineer office had completed a bill of materials in June 1964 showing a need for 48 electrical connection boxes, it did not initiate a requisition to obtain the boxes until August 20, 1964. The requisition was assigned an 08 priority designator requiring delivery within 8 days or no later than August 28, 1964. Issuance of the requisition to DSA by the post supply office was further delayed until September 1, 1964, 4 days after the required deliver date. Since the maximum standard time for routine delivery is from 20 to 30 days, the requirement could have been met by initiating and issuing a routine priority requisition within a reasonable time after approval of the work order.

**Maintaining insufficient stock levels:** At the Air Force installations reviewed, we found that supply support organizations did not stock sufficient quantities

of material needed by their customers for repetitive, operating requirements. Consequently, direct support inventory was frequently depleted and the central inventory manager was regularly requested, by assignment of high priorities, to expedite the processing and delivery of the needed material.

The low level of stocks maintained by direct-supply support organizations resulted not only in increased reliance on the central inventory manager for high-speed delivery to meet customers' urgent requirements but also in numerous orders for small quantities of material needed for routine replenishment of the local supply support inventories. The limited number of requisitions reviewed at Army and Navy installations did not involve deficiencies in maintaining stock levels. As the subject of our separate review of frequent requisitions for small quantities of material, we are inquiring at Army and Navy as well as Air Force installations into the extent to which insufficient stock levels for low-cost items preclude the requisitioning of economic order quantities and affect overall operating costs.

In this review, we found 69 instances where requisitions were assigned high priorities because (1) the authorized stock levels for low-cost, slow-moving items of from 150 to 390 days were reduced to 60 days, and (2) routine replenishment requisitions were not issued despite depleted inventories of items needed for customers' recurring demands.

At Travis Air Force Base, for example, in a 6-month period from April to September 1964, the base supply office issued to DSA 16 high-priority requisitions and 5 routine requisitions for a total of 9,650 quarts of lube oil. In April 1964, a stock level of 8,000 quarts had been established in accordance with Air Force Manual (AFM) 67-1. The base supply office, however, did not replenish its stock even though its supply of the item was almost constantly depleted. Instead, it filled its customers' recurring orders by repeatedly assigning urgent priority designators to requisitions for small quantities of lube oil. At the end of August 1964 when the base supply office did order a quantity sufficient to fill its customers' small orders from stock, it assigned an 05 priority designator requiring delivery within 8 days.

In our opinion, the Travis base supply office was, in effect, using DSA to discharge its own supply support responsibility for prompt delivery of repetitive, small quantities. The supply officials agreed that the frequent requisitioning of small quantities on an urgent basis was the result of insufficient stock levels. They told us that the basic cause was a restriction in fiscal year 1964 on the availability of operations and maintenance funds. Our separate review, now in process, of reduced stock levels and uneconomic replenishment orders indicates that the directly related increase in expenditures to process a greater number of repetitive, small quantity requisitions exceeds the cost of maintaining adequate stock levels.

In reviewing the extent to which maintaining insufficient stock levels may cause uneconomical ordering of small quantities, we noted at the McClellan Air Force Base supply office that in January 1964 its stock records showed that the foreseeable, recurring demand for spools of wire, a DSA-managed item, was 12 spools for the current year. Since each spool of wire cost \$2, the annual dollar demand was under \$25. For this low-dollar value, AFM 67-1 prescribed a stock level of 390 days, providing for the requisitioning of operating requirements for 270 days in addition to a reorder level of 120 days. Thus, the stock level for this item should have been 13 spools. In August 1963, however, the Air Force Logistics Command directed that the maximum stock level would be 60 days for DSA-managed items and other items financed by local operations and maintenance funds (base-funded items). Accordingly, McClellan's implementation of AFM 67-1 for this item was suspended and the base supply office established the stock level at 2 spools and the reorder level at 1 spool. Under these circumstances the on-hand inventory was frequently depleted, and McClellan in 1964 issued five routine requisitions and four high-priority requisitions to DSA for spools of wire. Had the 390-day level been retained, 1 routine requisition for 13 spools, valued at \$26, would have sufficed and avoided issuance of 4 routine requisitions as well as the 4 high-priority requisitions.

*Requisitions assigned high priorities contrary to DOD criteria for determining relative urgency of need.*—We found 135 instances where high priorities were assigned to requisitions contrary to the uniform materiel movement and issue priority system (UMMIPS) criteria for determining the relative importance of competing demands. It should be noted that 83 of these instances involved requisitions which were also included in the 129 instances described as avoidable

in the preceding section of this report. In these 83 instances, not only did the supply management deficiencies result in a requirement for expedited shipment but the high priority designated upon issuance of the requisition was not warranted by DOD criteria on relative urgency.

In all the instances described in this section, the high priorities—priority designator 01 through 08—were assigned improperly because the requisitions involved relatively unimportant and routine needs such as stock replenishment, predetermined initial allowances, and other nonessential purposes. Examples of the deviations from DOD's criteria for determining relative urgency are as follows:

High priorities used for stock replenishment: In 70 instances we found that high priorities were assigned to requisitions for material needed to replenish stocks. UMMIPS requires that stock replenishment be assigned an urgency of need designator D which, when combined with the highest FAD, results in a routine priority. If the routine priority delivery date will not meet the activity's needs under certain conditions of urgency, UMMIPS provides that an earlier required delivery date may be assigned to the requisition. It does not permit, however, the assignment of an urgent priority designator.

At Hickam Air Force Base, for example, the petroleum, oil, and lubricating officer assigned an 03 priority designator to a requisition for 16,008 quarts of lube oil needed for recurring demands. This quantity represented 120-day needs. The stock records at the date of the requisition, July 31, 1964, showed that 7,176 quarts, a quantity equal to expected demands for 54 days, were on hand and available for issue. A priority designator 03 results only when a FAD III—designating either a force maintained in a state of readiness to deploy for combat or an activity essential to combat forces—is combined with an urgency of need designator A—used for items without which the unit is or shortly will be unable to perform its operational mission.

In this instance, however, UMMIPS required assignment of an urgency of need designator D. If the urgency of need designator D were combined with a FAD III, the requisitioner could not properly have assigned an urgency greater than priority designator 18 which calls for maximum standard delivery within 60 days. This may not have been adequate to meet deployment or other scheduled needs of Hickam's customers since the on-hand supply could cover expected demands for only 54 days. Hickam Air Force Base personnel told us that, since DSA had not been used previously as a supply source for oil, the time required to fill a requisition was unknown and, therefore, the priority designator 03 was used. It appears that, under the DOD instruction, it would have been appropriate for Hickam to assign priority designator 18 showing a required delivery date within 54 days, whereas it was a violation of the priority system for Hickam to assign the 03 priority designator showing a priority delivery date within 7 days.

The urgency priority designator called for high-speed, air transportation of the entire quantity requisitioned—16,008 quarts weighing 35,351 pounds. UMMIPS requires confirmation of urgency of need for large volume shipments. In this instance a challenge by personnel at the military air transport terminal resulted in diversion of part of the requisitioned quantity to surface transportation and in shipment on September 1, 1964, of 9,090 quarts by air transportation.

High priorities used for initial stocking: UMMIPS provides that orders for the initial stocks of an item are to be assigned routine priorities unless supported by a more urgent need. In 49 instances, however, requisitions for initial stocks were assigned high priorities even though not supported by urgent need.

For example, the allowance parts/equipment list for a ship undergoing modification at the San Francisco Naval Shipyard showed a need to obtain a wrench. The item was to be used for damage control but was not required until a reasonable time before November 17, 1964, the date of first sea trial. The requisition was issued on August 7, 1964, and carried an 07 priority designator requiring delivery within 8 days. We were told by the supply officer that the high priority was used to insure delivery by the required date. A priority level greater than routine, which in this instance called for a standard delivery time of 30 days, was in our opinion not supported since delivery of the wrench was not required for a period of approximately 3 months.

High priorities used for other nonessential purposes: Under the DOD criteria, high priorities may be assigned only for essential needs such as operational capability and protection from serious personal hazard. In 16 instances, however, high-priority requisitions were used to obtain material for administrative and other nonessential purposes.

For example, at McClellan Air Force Base, a requisition initiated by maintenance personnel and issued on August 15, 1964, was assigned an 02 priority designator to obtain rapid delivery for 6 gallons of wax. This priority designator should result only when combining a FAD II, generally reserved for forces positioned and maintained in a state of readiness for immediate combat, and an urgency of need designator A, generally reserved for items needed for emergency repair of primary weapons and without which the force is or shortly will be unable to perform its assigned operational mission. Maintenance personnel told us that the wax was ordered for polishing an airplane assigned to the base and used by high-ranking personnel. They informed us that the waxing was done for special trips and that the use was primarily for improving the appearance, rather than the protection or operational capability, of the aircraft.

*Existing controls on assignment of high priorities.*—Our review of the circumstances under which the high-priority requisitions were issued disclosed only limited controls on the assignment of high priorities. As described in the following sections, these controls included local administrative and military audit agency reviews and supply and transportation agency confirmation of requisitioners' urgency of need.

Administrative and audit review at the requisitioning installations: At the five installations visited, we found that the monitoring of high-priority requisitions varied. Generally, administrative reviews and surveillance were concerned primarily with the number of high-priority requisitions issued and the percentage relationship to total requisitions issued. Controls included discussions at staff meetings of the percentage of high-priority requisitions and the establishment of requirements for passing priority requisitions over a designated desk. At one activity, we found that the requisitioner was required to certify on the back of the requisition that the materials requested were for high-priority needs. The locally responsible officials recognized that the large number of urgent requisitions stemmed from indiscriminate and improper assignment of priority designations. The Air Force audit agency, in reporting on this condition in July 1963, had advised that 88 percent of the high-priority requisitions used by base activities were in disregard of the priority system and that "This was a 'way of life' \* \* \* to assure quick delivery regardless of the urgency of need."

Although certain corrective actions were taken, including reinstruction of personnel concerned with the initiation of requisitions, we did not find provision for effective review to identify and correct the local supply support inadequacies causing the repeated reliance on high-speed delivery of material from DSA and other central inventory managers.

Challenges by supply and transportation control offices: Since requisitions in priority groups 1 and 2 (01 through 08) must be processed on a 7-day workweek, 24-hour workday basis, and high-speed transportation is the method of delivery, UMMIPS restricts use of high priorities to quantities needed to fill urgent requirements. It provides that shipping and transportation control offices will contact requisitioning activities to confirm the need for priority designators 01 through 08 on large volume requirements.

Our review showed that continental United States (Conus) requisitioners were contacted by Tracy Depot transportation personnel prior to shipment of large volume, high-priority requisitions, whereas overseas requisitioners were contacted by the military departments' air transportation control officers at Travis Air Force Base—the air transport terminal. According to the transportation personnel at Tracy Depot and Travis Air Force Base, there was no established size which required challenge. We were told that, generally, challenges were based on judgments in consideration of factors including excessive quantity and weight, backlog of orders awaiting air shipment, and freight costs exceeding \$100. They told us that by communicating with requisitioners to obtain consent to change shipments from air transportation to routine surface transportation, they effected savings estimated at about \$10 million in fiscal year 1964. The requisitions challenged at Travis Air Force Base included shipments from numerous supply organizations, other than Tracy Depot, serviced by the terminal. Agency personnel estimated that the savings for Tracy Depot shipments were about \$400,000 on overseas requisitions and about \$100,000 on Conus requisitions.

In connection with Conus shipments, for example, Tinker Air Force Base, Okla., in July 1964, issued a high-priority requisition for about 23 tons of sodium. The airfreight required by the urgent priority designator would have cost \$6,930. However, when Tracy Depot transportation personnel questioned the need for high-speed transportation of this large quantity of materials, the

requisitioner retracted the requirement for air transportation and authorized transportation by routine rail freight. The diversion of this one shipment from air transportation to routine surface transportation resulted in a cost of only \$731, a reduction of \$6,199.

*DOD study group evaluation of the present priority system.*—On April 30, 1965, the Assistant Secretary of Defense (Installations and Logistics)—OASD (I. & L.)—initiated a comprehensive study of UMMIPS. The study was prompted by recent overloading of airlift capabilities resulting from a high volume of Issue Priority Groups 1 and 2 shipments and by the fact that there had been no overall review since 1962.

Under the chairmanship of an OASD (I. & L.) representative, the study group consisted of representatives of the Joint Chiefs of Staff, Army, Navy, and Air Force, and of the Defense Supply Agency, the Military Traffic Management and Terminal Service, and the General Services Administration. During the period May through September 1965, the group (1) identified major problem areas by discussions with personnel in fields of procurement, inventory management, and transportation, and by Army Inspector General evaluations, (2) reviewed questionnaires completed by the services, and certain field commands and activities including inventory control points, stock points, and using activities preparing requisitions, and (3) visited certain of the field activities.

The study group's report, dated October 1965 and titled "Performance Evaluation Report—Uniform Materiel Movement and Issue Priority System (UMMIPS)," has been submitted to the Secretaries of the military departments for comment.

According to the report, the consensus of the study group and the activities visited is that the present priority system is basically sound and that no fundamental changes are necessary. The study group proposed certain procedural changes and revisions to DOD Instruction 4410.6 to strengthen the priority system and to provide requisitioners and suppliers with a more useful tool to identify competing demands. Of 30 major recommendations, the following ones seem to be most directly related to the requisitioner's excessive use of high priorities.

(1) To minimize latitude for interpretation by the requisitioner and to permit more effective review and policing of the assignment of high priorities, DOD Instruction 4410.6 should furnish more specific criteria for assigning Urgency of Need Designators and military service implementation should tailor the DOD criteria to the specific nature of their operations.

(2) When a requisition is assigned an Urgency of Need "A" on the basis of inability to perform assigned operational missions, the need should be supported by a report of equipment casualty in accordance with established equipment readiness information systems.

(3) Urgency of need should be determined on the basis of specific item essentiality, and military service programs to disseminate item essentiality data should be accelerated to minimize assignment of one priority designator to all requisitions for a project.

(4) The use of Urgency of Need Designator "A" by a requisitioning activity should be approved before the fact by the commanding officer or other commissioned officers designated in writing.

(5) Service schools training enlisted personnel and officers should give greater emphasis to the proper determination of Urgency of Need Designators.

Although we have not performed a complete evaluation of the feasibility or merits of the study group's proposals, the proposals seem to represent measures which, if properly implemented, should improve performance under UMMIPS. In our opinion, however, additional measures are needed. The study group proposes, for example, that the use of Urgency of Need Designator "A" be approved before the fact by the requisitioning activity's commanding officer or other commissioned officers designated in writing. This should tend to result in more proper assignment of priority designators in those instances where the local officials are not aware of UMMIPS abuses. Our report shows, however, that officials at the requisitioning level were aware that urgent priority designators were used indiscriminately and improperly as a substitute for reasonably adequate supply management.

We discussed this matter with the study group participant representing DSA on January 18, 1966. We commented that the study group had reported that a DOD-wide trend away from routine stock replenishment requisitions was influenced by "the establishment of minimum essential inventory levels at operating activities, resulting in a large volume of requisitions for smaller quantities," but it had made no recommendation to correct the condition. We were told

that the study group did not confront this problem because it involved complex supply management matters and military service responsibilities. According to the DSA representative, the study group, in its visits to field activities, did not include verification of the conditions leading to urgent needs. In his opinion, our findings at requisitioning activities on the effect of poor supply management supplemented the study group's findings.

### Conclusions

It is evident that a large number of the high priorities used by requisitioners at the five installations could have been avoided by more adequate management by the military department supply support organizations. On the basis of the results of our limited tests of orders filled in 1964 by one Defense Supply Agency depot and the results of challenges by air traffic control officers of the need for high-speed transportation from one air terminal, we estimate that about from 70 to 80 percent of the high-priority requisitions, excluding medical supplies and emergency requirements such as for the Vietnam buildup, would be routine if the military activities used reasonable care in managing their requirements for materiel and exercised closer surveillance over adherence to DOD's Uniform Materiel Movement and Issue Priority System.

We recognize that substantial savings result from the challenging by transportation control officers of the need for high-speed transportation of large volume shipments. The procedures being applied to large volume shipments represent a reasonable technique for effecting significant savings with a minimum of effort. Challenges of the more numerous smaller high-priority shipments do not appear to be practical. However, effective procedures are needed which will provide for the identification and correction of the basic reasons for the unnecessary or improper assignment by requisitioning installations of high priorities to small, as well as large, shipments.

We believe that the priority system changes proposed in October 1965 by the Department of Defense study group will, if properly implemented, tend to improve performance in certain problem areas. However, our review has disclosed deficiencies in supply management that do not appear to be covered by the proposed changes. We believe that correction of these problems is essential to minimize reliance on high-priority requisitions. In our opinion, the Department of Defense should develop a management control system which would provide a means of measuring the extent and the financial effect of the use of high priorities by requisitioning activities in order to provide a basis for identifying and correcting unnecessary, as well as improper, use of high-priority requisitions.

### [Appendix I]

#### *Principal officials of the Department of Defense responsible for the administration of activities discussed in this report*

	Tenure of office	
	From—	To—
Department of Defense:		
Secretary of Defense: Robert S. McNamara.....	January 1961.....	Present.
Deputy Secretary of Defense: Cyrus R. Vance.....	January 1964.....	Do.
Assistant Secretary of Defense (Installations and Logistics):		
Paul R. Ignatius.....	December 1964.....	Do.
Thomas D. Morris.....	January 1961.....	December 1964.
Department of the Army:		
Secretary of the Army:		
Stanley R. Resor.....	July 1965.....	Present.
Stephen Alles.....	January 1964.....	July 1965.
Under Secretary of the Army:		
David E. McGiffert.....	November 1965.....	Present.
Vacant.....	July 1965.....	November 1965.
Stanley R. Resor.....	April 1965.....	July 1965.
Vacant.....	December 1964.....	March 1965.
Paul R. Ignatius.....	March 1964.....	December 1964.
Vacant.....	January 1964.....	February 1964.
Assistant Secretary of the Army (Installations and Logistics):		
Dr. Robert A. Brooks.....	October 1965.....	Present.
Daniel M. Luevano.....	July 1964.....	October 1965.
A. Tyler Port (acting).....	March 1964.....	June 1964.
Paul R. Ignatius.....	May 1961.....	February 1964.
Commander, Army Supply and Maintenance Command:		
Maj. Gen. Frank A. Osmański.....	January 1966.....	Present.
Lt. Gen. Jean E. Engler.....	April 1964.....	January 1966.

*Principal officials of the Department of Defense responsible for the administration of activities discussed in this report—Continued*

	Tenure of office	
	From—	To—
Department of the Navy:		
Secretary of the Navy: Paul Nitze.....	November 1963.....	Present.
Under Secretary of the Navy:		
Robert H. B. Baldwin.....	July 1965.....	Do.
Kenneth E. BeLieu.....	February 1965.....	July 1965.
Paul B. Fay, Jr.....	February 1961.....	January 1965.
Assistant Secretary of the Navy (Installations and Logistics):		
Graeme C. Bannerman.....	February 1965.....	Present.
Kenneth E. BeLieu.....	February 1961.....	February 1965.
Chief, Bureau of Supplies and Accounts:		
Rear Adm. H. J. Goldberg.....	May 1965.....	Present.
Rear Adm. John Crumacker.....	May 1961.....	April 1965.
Commanding officer, Fleet Material Support Office:		
Capt. Paul F. Cosgrove.....	August 1965.....	Present.
Capt. Edward E. Brighton.....	July 1962.....	August 1965.
Department of the Air Force:		
Secretary of the Air Force:		
Dr. Harold Brown.....	October 1965.....	Present.
Eugene M. Zuckert.....	January 1961.....	October 1965.
Under Secretary of the Air Force:		
Norman S. Paul.....	October 1965.....	Present.
Brockway McMillan.....	June 1963.....	September 1965.
Assistant Secretary of the Air Force (Installations and Logistics): Robert H. Charles.....	November 1963.....	Present.
Commander, Air Force Logistics Command:		
Lt. Gen. Kenneth B. Hobson.....	August 1965.....	Do.
Gen. Mark E. Bradley.....	July 1962.....	July 1965.
Defense Supply Agency:		
Director:		
Vice Adm. Joseph M. Lyle.....	July 1964.....	Present.
Lt. Gen. Andrew T. McNamara.....	October 1961.....	June 1964.
Deputy Director:		
Maj. Gen. Francis C. Gideon.....	July 1964.....	Present.
Rear Adm. Joseph M. Lyle.....	January 1962.....	June 1964.

## [Appendix II]

**BASIS FOR COMPUTATION OF INCREASED COSTS FOR TRANSPORTATION AND DEPOT HANDLING OF HIGH-PRIORITY SHIPMENTS FROM THE DEFENSE DEPOT AT TRACY, CALIF., IN 1964**

In projecting the condition disclosed by our limited review to all overseas and continental high-priority shipments from Tracy Depot, excluding shipments to Vietnam, we took into consideration the facts that (1) at the one overseas installation reviewed, requisitioners had unnecessarily or improperly designated as high priority about 90 percent of the requisitions in our limited sample, and (2) requisitioners had agreed to routine transportation for the entire quantity requisitioned in about 90 percent of instances where agency transportation personnel challenged the need for premium transportation.

The diversion from premium transportation to routine transportation on requisitions challenged by agency transportation personnel resulted in cost savings of about \$500,000 for shipments from Tracy Depot. We assumed that the remaining 10 percent of the requisitions challenged, which were confirmed in total or in part, were proper and represented premium costs of about \$55,000.

Our computation is summarized as follows:

Total premium costs, excluding costs incurred for medical supplies and material consigned to Vietnam.	\$1, 000, 000.
Less, estimated premium transportation cost for high-priority shipments challenged and confirmed by transportation personnel.	\$55, 000.
Net premium costs, excluding transportation costs incurred after challenge and confirmation of need.	\$945, 000.

- Approximate percentage of requisitions unnecessarily or improperly assigned high priorities. 70 to 80 percent.
- Approximate amount of increased costs for high-speed transportation and special depot handling of shipments unnecessarily and improperly designated as high priorities. \$650, 000 to \$750, 000.



## APPENDIX 7

DIGEST OF GAO REPORTS ON UNNECESSARY RETENTION OF HIGH-VALUE LAND  
B-146988, April 22, 1965.

### UNNECESSARY RETENTION OF HIGH-VALUE LAND, FORT GORDON, GA., DEPARTMENT OF THE ARMY

Approximately 258 acres of expensive land valued at about \$1.9 million is being unnecessarily retained by the Department of the Army at Fort Gordon, Ga., principally to provide an 18-hole golf course for personnel stationed there. We believe that the retention and utilization of this valuable land known as the Oliver area, primarily for recreational purposes, is contrary to Department of Defense policy.

We reported this matter to the Secretary of Defense in October 1964, and proposed that the land be declared excess and disposed of, in accordance with normal Government disposal procedures, and be made available for its best use.

The Deputy Assistant Secretary of the Army (Installations) commenting on our findings and proposals has stated that: (1) the golf course facility is providing essential morale and recreational support that otherwise would not be generally available to military personnel and dependents residing in the Augusta area; and (2) the release of this facility before suitable accommodations are available at Fort Gordon would have a serious impact on already overtaxed facilities and would have an extremely adverse effect on troop morale.

We question that the retention of the golf course is a major morale factor in view of the fact that only about 1.4 percent of the military personnel assigned to the installation are members and since a 9-hole golf course at Fort Gordon and two 18-hole public golf courses are available in the Augusta area. Also, 3d U.S. Army officials have advised us that a new 18-hole golf course will be constructed at Fort Gordon. This construction is to be financed entirely from nonappropriated funds.

The Deputy Assistant Secretary stated further that our evaluation of the property at \$1.9 million appears overly optimistic, particularly in view of the fact that in 1961, the Army released 58.10 acres in this area which sold for an average of \$2,084 an acre. Actually, we found that the average price of the land sold in 1961 was \$2,716 an acre, after allowing for 13.5 acres that were transferred to the Richmond County Board of Education.

Land in the Oliver area has appreciated significantly since the sale of the Government land in 1961. For example, about 10 acres of the Government land sold at public auction in June 1961 for \$2,246 an acre was resold by its owner in January 1964 for \$4,128 an acre. Our \$1.9 million estimate was based on a review of recent sales in the area and the opinions of two local realtors. We, thus, believe that \$1.9 million is a reasonable approximation of the current value of the land. It is recognized, however, that in the event the Oliver area is declared excess, public agencies can acquire the property at 50 percent of the fair market value provided it is used as park and recreational facilities, or at no cost if it is used for educational purposes.

We believe that it should not be necessary to delay disposal of the bulk of the Oliver area until the proposed 18-hole golf course and clubhouse at Fort Gordon are completed, particularly in view of the existing 9-hole course at the installation and the availability of two 18-hole public golf courses in the Augusta area. However, we recommended that, if it is determined that replacement of the facility is required to maintain necessary recreational facilities, the Secretary of Defense require the Department of the Army to dispose of the Oliver area at an early date consistent with replacement of the facilities involved on the less valuable land available at Fort Gordon. Further, in order to give impetus to the construction of any needed replacement facility, we suggested that a firm date be established for the disposal of the Oliver area.

We also recommended that the Secretary of Defense establish policies and procedures for his Office to review the utilization and retention of real property used by the military departments for recreational purposes so that prompt disposal action can be initiated when a valid requirement no longer exists for such land.

E-135295, April 28, 1965.

UNNECESSARY RETENTION OF HIGH-VALUE LAND FOR RECREATION, RESERVE FORCES TRAINING AND MILITARY HOUSING PURPOSES AT FORT DERUSSY, WAIKIKI BEACH, HAWAII, DEPARTMENT OF THE ARMY

The Department of the Army is unnecessarily retaining 72 acres of land on Waikiki Beach in Hawaii, which is worth more than \$65 million and no longer required for national security purposes.

This land, designated by the Army as Fort DeRussy, is located on one of the most famous beaches in the world and is virtually surrounded by high-rise hotels and tourist attractions. Since being converted from a coast and anti-aircraft artillery post after World War II, Fort DeRussy has been used principally as a recreation center for military personnel and their dependents. However, more than adequate recreation facilities are available on the island at the numerous other military installations and at public parks and beaches and commercial establishments.

An area of about 20 acres of the highly valuable land at Fort DeRussy is used as training facilities for Army Reserve units on the premise that the Army requires a centralized location for such training. We found that the Reserve organizations of the other military services, as well as the National Guard, have all located their training facilities on much less valuable land elsewhere on the island and have found their locations to be sufficiently centralized.

Also, there is presently some doubt as to how many of the Reserve units now training at Fort DeRussy will be retained after a pending Reserve reorganization plan is implemented and consolidation with the Army National Guard is completed. To the extent that Army Reserve units now training at Fort DeRussy will not be eliminated in this reorganization, we believe that consideration should first be given to training these units either (1) at National Guard armories which are not being fully utilized or (2) at one or more of the many other military installations on the island. If existing military facilities, other than those at Fort DeRussy, prove to be insufficient to accommodate the reorganized Hawaii National Guard, consideration should then be given to requesting authorization to construct additional armory facilities on less expensive land elsewhere on the island.

Another area at Fort DeRussy of about 4 acres, valued at almost \$5 million, is used as a site for nine family housing units. These units are all more than 42 years old and are expensive to maintain because of their age and condition. The 9 obsolete housing units represent an insignificant portion of the more than 1,100 Army-owned family housing units on the island. Consequently, their disposition would not seriously affect the housing situation and would allow the release of highly valuable land.

It seems apparent that, because Fort DeRussy is no longer used for national security purposes and because the services it provides can be obtained elsewhere on the island, there is no valid need for retaining this highly valuable property. Therefore, we recommended that the Secretary of Defense take steps to: (1) close all recreational facilities at Fort DeRussy, including transient living quarters; (2) transfer the training of Army Reserve units to other inadequately utilized training facilities or to a less expensive area on the island; (3) close the existing nine obsolete family housing units; and (4) set in motion a comprehensive program leading to the early disposal of the land and improvements.

The Department of the Army has informed us that it believes Fort DeRussy should be retained for utilization substantially as now constituted and that congressional approval should be sought from time to time for the replacement of obsolete facilities. However, the House Committee on Interior and Insular Affairs, which has responsibilities in the area of land utilization by the Government, has taken the general position in the past that the continued use of valuable urban property by the military is justified only when national security clearly makes such control and use essential.

Furthermore, both the Senate and House Committees on Armed Services took the position in 1962 that the Department of Defense should dispose of marginal installations, or those which serve no defense purpose, and that replacement of eliminated facilities where needed at other locations should be requested through the normal budget and appropriation process. Consequently, because there is a conflict between positions taken by the Army and congressional committees and because there is no longer a valid national security purpose for retaining the highly valuable land at Fort DeRussey, we reported our findings to the Congress.

## APPENDIX 8

### CONTRACT ADMINISTRATION SERVICES <sup>33</sup>

ASSISTANT SECRETARY OF DEFENSE,  
*Washington, D.C., February 8, 1966.*

Hon. THOMAS B. CURTIS,  
*House of Representatives,*  
*Washington, D.C.*

DEAR MR. CURTIS: This is in reply to your letter of January 13, 1966, to Capt. John F. Ryder, Special Assistant to the Deputy Director, Contract Administration Services (DCAS), Defense Supply Agency, in which you requested data concerning a breakdown of the dollar amounts of categories of contracts indicating those administered by the Defense Supply Agency and those administered by the military departments. Captain Ryder, in his interim reply of January 21, 1966, advised that because the information you desired covered Department of Defense-wide activities, a reply would be made by the Office of the Secretary of Defense.

It is the policy of the Department of Defense that all field performance of contract administration will be by DCAS, except that the Assistant Secretary of Defense (Installations and Logistics) may assign specific plants to the military departments or may assign field performance to a military department by category of contract. In any event, regardless of whether performance in any given plant is by DCAS or a military department, a contractor has to deal with only one Department of Defense contract administration services office.

Common contract administration procedures are currently being developed for use by all Department of Defense contract administration services components. Implementation of such procedures will result in a more effective and efficient relationship between the Department of Defense and its contractors.

Enclosure 1 is a list of plants specifically assigned to the military departments. Enclosure 2 lists types of contracts set aside for performance by the military departments and other types under consideration for possible assignment to the military departments. Performance of contract administration at all other plants and on all other categories of contracts is by DCAS.

We do not have specific figures on the dollar amounts by categories of contracts but believe that the estimates contained in enclosure 3 will furnish a reasonably good indication of the overall scope of the total Department of Defense contract administration services effort as well as a breakdown of that portion administered by DCAS offices and that portion administered by the military department offices.

Sincerely,

J. M. MALLOY,  
*Deputy Secretary of Defense (Procurement).*

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<sup>33</sup> See also app. 4, re adequacy of controls over Government-owned property in the possession of contractors.

**CATEGORIES<sup>1</sup> OF CONTRACTS WHICH HAVE BEEN EXCLUDED FROM DEFENSE CONTRACT ADMINISTRATION SERVICES, DSA, ADMINISTRATION OR ARE BEING CONSIDERED FOR EXCLUSION**

**A. Categories of contracts assigned to the military departments and others by Assistant Secretary of Defense (Installations and Logistics) (ASD (I. & L.)) :**

<i>Category</i>	<i>Assigned to—</i>
(1) Contracts for military and civil construction (except contracts for construction supplies are administered by DCAS).	Army and Navy.
(2) Basic research and other contracts at educational institutions. (Basic research contracts at all other institutions and plants are administered by DCAS, except in plants individually assigned to Military Departments by ASD (I. & L.))	Navy.
(3) Contracts for subsistence items (except that DCAS performs inspection on certain non-perishable items).	Defense Personnel Support Center, DSA.
(4) Contracts for coal-----	Defense Fuel Supply Center, DSA.
(5) Contracts for headstones and gravemarkers--	Army.
(6) Contracts for shipbuilding, repair and overhaul.	Navy.
(7) Secondary administration of contracts at Air Force test sites and at Air Force missile site locations.	Air Force.

**B. Categories of contracts currently being performed by the military departments which are under consideration for assignment determination :**

- (1) Contracts for airlift (MATS).
- (2) Contracts for sealift (MSTS).
- (3) Contracts for stevedoring.
- (4) Contracts for flight training.
- (5) Contracts for operation, support, and maintenance of SAGE, DEW-LINE, and BMEWS.
- (6) Contracts for services of industry technical representatives and consultant support services.
- (7) Air Force contracts for communication services, air charting and information, and spacetrack sensors and relays.

*Statistical estimates indicating scope of contract administration services within DOD—Broken down to show that portion performed by DCAS, DSA field offices, and that portion performed by military department CAS field offices*

	DSAC	Military departments	Total
Number of contractors' plants being administered.....	34,000	<sup>2</sup> 825	34,825
Number of personnel performing CAS.....	20,500	21,500	42,000
Number of contracts requiring majority of contract administration services.....	1 127,000	15,000	1 142,000
	<i>Billions</i>	<i>Billions</i>	<i>Billions</i>
Face value of contracts being administered.....	\$25	\$75	\$100
Undelivered balance of contracts being administered.....	\$8	\$12	\$20

<sup>1</sup> Does not include 90,000 procurements requiring inspection only and 10,000 others requiring minor CAS effort.

<sup>2</sup> Includes plant locations listed in summary listing below, plus approximately 300 colleges, 150 commercial shipyards, and 200 construction contractor locations.

<sup>3</sup> All categories listed herein are currently being administered by the military departments.

SUMMARY LISTINGS OF DEPARTMENT OF DEFENSE PLANT COGNIZANCE ASSIGNMENTS  
OF THE ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS) AS  
OF JANUARY 1, 1966

*I. Plants assigned to the Department of the Army*

<i>(a) Systems plants:</i>	<i>Date assigned</i>
Bell Helicopter Co., Fort Worth, Tex., and facilities at Hurst, Saginaw, Richland Hills, and Arlington, Tex.	Nov. 20, 1964
Chrysler Corp., U.S. Army Detroit Arsenal, Warren, Mich.	Do.
Hiller Aircraft Co., <sup>1</sup> Palo Alto, Calif.	Aug. 25, 1964
Ling-Temco-Vought Aerospace Corp., LTV Michigan Division, and Chrysler Corp. Missile Division, Michigan Army Missile Plant, Warren, Mich.	Nov. 20, 1964
Martin-Marietta Corp., Orlando, Fla.	Do.
Ratheon Co., Andover, Mass.	Do.
Rohm & Hass Co., Redstone Division, Huntsville, Ala.	Do.
Sperry Utah Co., Salt Lake City, Utah.	Do.
Thiokol Chemical Corp., Alpha Division, Huntsville Plant, Huntsville, Ala.	Do.
<i>(b) Basic research, systems management/technical direction plants: Bell Telephone Laboratories, Inc., Whippany, N.J.</i>	May 25, 1965
<i>(c) Ammunition and chemical plants (GOCO):</i>	
Alabama Army Ammunition Plant, Olin Mathieson Chemical Corp., Childersburg, Ala.	Sept. 29, 1965
Badger Army Ammunition Plant, Olin Mathieson Chemical Corp., Baraboo, Wis.	Do.
Burlington Army Ammunition Plant, Kennedy Van Saun Manufacturing & Engineering Corp., Burlington, N.J.	Do.
Cornhusker Army Ammunition Plant, Grand Island, Nebr.	Do.
Holston Army Ammunition Plant, Holston Defense Corp. (Eastman Kodak Co.), Kingsport, Tenn.	Do.
Indiana Army Ammunition Plant, Olin Mathieson Chemical Corp., Charlestown, Ind.	Do.
Iowa Army Ammunition Plant, Mason & Hanger-Silas Mason Co., Inc., Burlington, Iowa.	Do.
Joliet Arsenal, U.S. Rubber Co., Joliet, Ill.	Do.
Kansas Army Ammunition Plant, National Gypsum Co., Parsons, Kans.	Do.
Lake City Army Ammunition Plant, Remington Arms Co., Inc., Independence, Mo.	Do.
Lone Star Army Ammunition Plant, Day & Zimmerman, Inc., Texarkana, Tex.	Do.
Longhorn Army Ammunition Plant, Thiokol Chemical Corp., Marshall, Tex.	Do.
Louisiana Army Ammunition Plant, Sperry Rand Corp., Shreveport, La.	Do.
Milan Army Ammunition Plant, Harvey Aluminum Sales, Inc., Milan, Tenn.	Do.
Niagara Falls Army Chemical Plant, Machelor Maintenance & Supply Corp., Niagara Falls, N.Y.	Do.
Newport Army Chemicals Plant, FMC Corp., Newport, Ind.	Do.
Radford Army Ammunition Plant, Hercules Powder Co., Radford, Va.	Do.
Ravenna Army Ammunition Plant, Ravenna Arsenal Inc., Ravenna, Ohio.	Do.
Riverbank Army Ammunition Plant, Norris-Thermador Corp., Riverbank, Calif.	Do.
Scranton Army Ammunition Plant, Chamberlain Corp., Scranton, Pa.	Do.

<sup>1</sup> Temporary assignment.

*I. Plants assigned to the Department of the Army—Continued*

(c) Ammunition and chemical plants (GOCO)—Continued	<i>Date assigned</i>
St. Louis Ordnance Plant, Olin-Mathieson Chemical Corp., St. Louis, Mo.	Sept. 29, 1965
Sunflower Army Ammunition Plant, Hercules Powder Co., Lawrence, Kans.	Do.
Twin Cities Army Ammunition Plant, Federal Cartridge Corp., Minneapolis, Minn.	Do.
Volunteer Army Ammunition Plant, Atlas Chemical In- dustries, Inc., Chattanooga, Tenn.	Do.
Wabash River Army Ammunition Plant, Olin-Mathieson Chemical Corp., Montezuma, Ind.	Do.

*I. Plants assigned to the Department of the Navy*

(a) Systems plants:	<i>Date assigned</i>
Aerojet-General Corp., Von Karmen Center, Azusa, Calif., and corporate offices at El Monte, Calif.	Sept. 29, 1965
Bendix Mishawaka Division, 400 South Beiger St., Mishawaka, Ind.	Do.
Boeing Co., Vertol Division, 100 Woodland Ave., Morton, Pa.	Do.
Douglas Aircraft Co., aircraft group facilities at Long Beach, Torrance, and Palmdale, Calif.	Do.
General Dynamics/Pomona, Naval Weapons Industrial Reserve plant, 1675 West 5th Ave., Pomona, Calif.	Do.
General Electric Co., Ordnance Department, Defense Electronic Division, Pittsfield, Mass.	Do.
Goodyear Aerospace Corp., facilities at Akron and Wing- foot Lake, Ohio, and Goodyear Tire & Rubber Co., Plant C, Akron, Ohio.	Do.
Grumman Aircraft Engineering Corp., plants at Beth- page and Calverton, Long Island, N.Y., and Stuart Field, Fla.	Do.
Gyrodyne Corp., St. James, Long Island, N.Y.-----	Do.
Ling-Temco-Vought, Inc., LTV Research Center, and LTV Data Processing Center, Dallas, Tex.; LTV Military Electronics Division, Arlington and Garland, Tex.	Do.
Ling-Temco-Vought Aerospace Corp., LTV Aeronautics Division, LTV Astronautics Division, and LTV Range Systems Division, Dallas, Tex.	Do.
Lockheed Aircraft Corp., Lockheed-California Co., plants A1, B1, B5, B6, unit 32, unit 33 at Burbank, Calif.; plant B4, Palmdale, Calif.; plant 2, Saugus, Calif., and ware- house No. 1, Los Angeles, Calif.	Do.
McDonnell Aircraft Corp., St. Louis, Mo.-----	Do.
North American Aviation, Inc., Columbus Division, 4300 East 5th Ave., Columbus, Ohio	Do.
Pratt and Whitney Aircraft Division, United Aircraft Corp., facilities at East Hartford, Southington, North Haven, Conn., West Palm Beach, Fla., and UAC Research facility, East Hartford, Conn.	Do.
Sikorsky Aircraft Division of United Aircraft Corp., facili- ties at Main Street, Stratford, Conn., and at South Ave- nue, Bridgeport, Conn.	Do.
Sperry Gyroscope Co. Nassau facility, Great Neck, L.I., N.Y.; the Sperry Polaris facilities at Syosset, L.I., N.Y.; the McArthur facility, McArthur Field, L.I., N.Y.; the Carle Place facility, Carle Place, L.I., N.Y.; and the Sperry Gyroscope Archives, Sperry Repair facility, and Sperry Naval Training facility, New Hyde Park, L.I., N.Y.	Sept. 20, 1965
Westinghouse Electric Corp., Defense and Space Center, Baltimore, Md., including Aerospace Division, Surface Division, Underseas Division, Systems Operations Divi- sion at Baltimore; and Products Support Equipment De- partment at Cockeysville, Md.	Nov. 20, 1964

*I. Plants assigned to the Department of the Navy—Continued*

(b) Basic research, systems management/technical direction plants:	<i>Date assigned</i>
Applied Physics Laboratory and Vitro Laboratories, Silver Spring, Md.	Dec. 4, 1964
(c) Depot Maintenance Plants (IRAN):	
Aero Corp., Lake City, Fla.....	June 7, 1965
Hayes International Corp., Napier Division, Dothan, Ala.	Do.
Intercontinental Engine Service, Brownsville, Tex..	Do.

*I. Plant assignments to the Department of the Air Force*

(a) Systems plants:	<i>Date assigned</i>
AC Spark Plug, General Motors Corp., Milwaukee, Wis...	Nov. 20, 1964
Aerojet-General Corp., Sacramento plant, Sacramento, Calif.	Nov. 12, 1964
Allison Division, General Motors Corp., Indianapolis, Ind.	Nov. 20, 1964
AVCO, Lycoming Division, Stratford, Conn.....	Do.
Boeing Co., corporate offices, Seattle, Wash., Aerospace Division and Industrial Products Division, Seattle, Wash., and Airplane Division, Renton, Wash. (Does not include plants under the CMO, Seattle, Wash.).	Do.
Boeing Co., Airplane Division, Wichita, Kans.....	Do.
Boeing Co., AF Plant No. 77, Hill Air Force Base, Utah...	Do.
Douglas Aircraft Co., Inc., Missile and Space Systems Division facilities at Santa Monica, Culver City, Huntington Beach, and Sacramento, Calif., test site.	Do.
General Dynamics, Plant 4, Fort Worth, Tex.....	Do.
General Electric Co., Evendale, Ohio.....	Do.
General Electric Co. facilities, Syracuse, N.Y.....	Do.
Hercules Powder Co., Bacchus Works, Magna, Utah....	Nov. 12, 1964
Hughes Aircraft Co. and Hughes Tool Co., Culver City, Calif., complex, and Tucson, Ariz., facility. Culver City complex to include Fullerton, Calif., complex and Newport Beach, Oceanside, and Santa Barbara sites.	Nov. 20, 1964
Lockheed-Georgia Co., Marietta, Ga.....	Do.
Martin-Marietta Corp., Denver Division, Denver, Colo..	Do.
Martin-Marietta Corp., Martin Co. Division, Middle River, Md., including the RIAS facility, Baltimore, Md.	Do.
North American Aviation, Inc., Autonetics Division, facilities at Anaheim, Downey, El Segundo, and Fullerton, Calif.	Do.
North American Aviation, Inc., Los Angeles Division, facilities at Los Angeles, Crenshaw, and Palmdale, Calif.	
Northrop Corp., Corporate Offices, Beverly Hills, Calif., and Norair Division facilities at Hawthorne, Palmdale, and El Segundo, Calif.	May 25, 1965
Rocketdyne Division, North American Aviation, Inc., facilities at Canoga Park, Van Nuys, and Inglewood, Calif.; and test locations at Edwards Air Force Base, Calif., Santa Susanna, Calif., and Reno, Nev.	Nov. 20, 1964
Thiokol Chemical Corp., Promontory, Utah.....	Do.
United Technology Center, Sunnyvale, Calif., and United Technology Development Center, Coyote, Calif.	Dec. 4, 1964
(b) Basic research, systems management/technical direction plants:	
Aerospace Corp. facilities at El Segundo and San Bernardino, Calif.	Oct. 2, 1965
ARO Inc., Arnold Air Force Base, Tenn.....	Do.
AVCO Corp., Wilmington, Mass.....	Dec. 4, 1964



*I. Plant assignments to the Department of the Air Force—Continued*

	<i>Date assigned</i>
(b) Basic research, etc.—Continued	
Bendix Radio Division, Bendix Corp., Oxnard, Calif.-----	Oct. 2, 1965
Federal Elect. Corp., Vandenberg Air Force Base, Calif.-----	Do.
Lear Siegler, Inc., Vandenberg Air Force Base, Calif.-----	Do.
Massachusetts Institute of Technology, Lincoln Laboratory, Lexington, Mass.-----	Do.
MITRE Corp., Bedford, Mass.-----	Do.
Pan American World Airways, Patrick Air Force Base, Fla.---	Do.
Rand Corp., Santa Monica, Calif.-----	Do.
System Development Corp., Santa Monica, Calif.-----	Do.
Vitro Services, Eglin Air Force Base, Fla.-----	Do.
(c) Depot Maintenance Contracts (IRAN) :	
Aerodex Corp., Miami, Fla.-----	Jun. 25, 1965
Aerospace Service, Inc., Oakland, Calif. (canceled Oct. 9, 1965).-----	Jun. 7, 1965
Air International, Miami, Fla.-----	Jun. 25, 1965
American Airmotive Corp., Miami, Fla.-----	Oct. 2, 1965
Dallas Airmotive Inc., Dallas, Tex.-----	Jun. 25, 1965
Fairchild-Hiller Corp., Crestview, Fla.-----	Do.
Fairchild-Hiller Corp., St. Augustine, Fla.-----	Do.
Fairchild-Hiller Corp., St. Petersburg, Fla.-----	Do.
International Aerospace Services, Inc., Charleston, S.C.-----	Jun. 7, 1965
Ling-Temco-Vought Electrosystems, Inc., Greenville, S.C.-----	Do.
Lockheed Aircraft Service Co. (New York), a division of Lockheed Aircraft Corp., Jamaica, Long Island, N.Y.-----	Do.
Lockheed Aircraft Services, Lake Charles, La.-----	Oct. 9, 1965
Propeller Services, Inc., Miami, Fla.-----	Jun. 25, 1965
Southwest Airmotive Corp., Dallas, Tex.-----	Do.

## CONGRESSIONAL BRIEFING ON CONTRACT ADMINISTRATION SERVICES ACTIVITIES

Briefing officer: Capt. John F. Ryder, USN, special assistant to the deputy director for CAS, Defense Supply Agency.

Present: Senator Len B. Jordan and Representative Thomas B. Curtis.

Also present: Ray Ward, Douglas Frechtling, and Donald A. Webster, staff members of the Joint Economic Committee; William T. McInarnay and Wayne Thevanot, staff members of the Senate Select Committee on Small Business; Robert Vastine, economic assistant to Representative Curtis; Edmund C. Burnett, Daniel Varley, and Cyril D. V. McLaughlin, representatives of the Defense Supply Agency.

Captain RYDER. Congressman Curtis, members of the staff of the committee.

Today I am going to talk about the Contract Administration Services (CAS) organization and about the training involved in this organization.

The briefing will present (1) what Contract Administration is; (2) what is excluded from Contract Administration Services; (3) something on the consolidation; and mainly (4) the training of personnel for the conversion process during the consolidation and subsequent to it.

Contract Administration Services is defined as: "All those actions which are accomplished for the benefit of the Government which are necessary to the performance of a contract or in support of buying organizations."

Representative CURTIS. Let me ask this. When you say "performance," does that include the actual work that goes into getting the contract?

Captain RYDER. No, sir.

Representative CURTIS. So this is after the contract.

Captain RYDER. This is after the contract.

Representative CURTIS. I see.

Captain RYDER. These are the things that are excluded from Contract Administration Services:

1. All those functions assigned to the buying offices. These are the procurement contracting officers or office organizations. We are called the administrative contracting officers or office organization.

2. Also excluded are those contractors' facilities which have been assigned to military departments by the Secretary of Defense for contracts for weapons systems or major components of weapons systems. Some aircraft plants would be an example.

Representative CURTIS. Would this be like the old BARS?

Captain RYDER. Yes, sir; the old BARS with their type of organization. They are called Bureau of Weapons Representative (BuWeps Rep) today.

Representative CURTIS. Then do you have charge of the change orders or does the buying office?

Captain RYDER. The change orders can be issued by two organizations, depending upon the magnitude and the kind of change involved. If it is a change involved in the delivery schedules or if it is a change in the basic contract, it must be originated at the buying office level.

Representative CURTIS. How about a change in design?

Captain RYDER. This would be at the buying office. The change order would be issued there and distributed.

Representative CURTIS. Do you then take charge of the inspection?

Captain RYDER. Yes, sir. We do all the inspection on those that are assigned to us. As you said, the old BARS, the Bureau of Aeronautics representatives, had this too. We do all the inspection—we do the paying today. We did not used to—at least in the Navy—do the paying. We do the paying of all contractors today on those contracts that are assigned for contract administration to the Defense Supply Agency.

3. Excluded are contracts in specified categories designated by the Secretary of Defense. There are only a few of these but they are specifically excluded by the Secretary of Defense.

Representative CURTIS. Are they numerous or are they real exceptions?

Captain RYDER. There are about 10 or 12 categories of these. These are such things as the obtaining of aircraft for airlift by MATS or obtaining ships for sealift by MSTs—posts, camps, and stations.

Representative CURTIS. How about petroleum, for example?

Captain RYDER. No, sir. Petroleum is contracted for and we actually inspect.

Representative CURTIS. So you would say they are really exceptions. These exceptions are not so many.

Captain RYDER. Oh, yes, sir; and they are in very definite categories of exceptions.

Mr. WARD. Percentagewise, what are excluded under 2 and 3 of the total?

Captain RYDER. I don't have any figures on the percentages of these but in this particular category are the plants. We have a list of all the plants that are assigned to the Army or the Navy or the Air Force for contract administration. There are a number of these—mostly big engines; that is, jet engine or propeller-type engine manufacturers. Airframe manufacturers are included in this particular category.

Representative CURTIS. What about your breakout contracts on some of these components? Might you follow the breakout?

Captain RYDER. We would administer many of the subcontracts that come from the prime contractors.

Representative CURTIS. Even though it were part of the weapons?

Captain RYDER. Yes, sir.

Representative CURTIS. Very good.

Captain RYDER. Even though those go down to maybe three, four or five tiers, if Government inspection or other administration is required.

Representative CURTIS. Very good.

Captain RYDER. Of course, it must be remembered the contractor himself is responsible for the kind of equipment he gets on the subcontracts and may not require Government inspection at all.

Representative CURTIS. Yes.

Captain RYDER. It is those that require Government inspection that we would get involved with.

For the moment, I will comment a little bit on why training was necessary. First of all, the Army, the Navy and the Air Force, and some of the offices of DSA, had different operating procedures for performing contract administration and, secondly, their personnel operated under concepts different from those they were going to operate under in this new organization. These personnel had been trained in their technical specialties and in their services' operating procedures. They would continue the training scheduled for them by their own organizations. In addition, they would be trained in CAS operational procedures as soon as such procedures were developed. This was the status of personnel training at the commencement of planning for consolidation.

When the Defense Supply Agency was given the responsibility for consolidating the Contract Administration Services organizations, the National Planning Group was organized, charged with the responsibility for developing a plan, for converting the field offices and then for operating the new organization.

During the development of this particular plan (National Implementation Plan), we made arrangements with the NASA people for whom we do a lot of contract administration work. We had an understanding with them, a signed agreement, on what we were going to perform on their contracts, what we were going to do specifically for them. We now have, as a matter of information, NASA representatives at our Headquarters at Cameron Station and at each one of our regional offices throughout the country.

The plan was completed at the end of December 1964 and was approved by the Secretary of Defense. The activation schedule for the 11 regions across the country was as follows:

I want to point out that Philadelphia became part of DSA on September 1, 1964, before the plan was completed. The reason for this was that it had been set up as a pilot test region under the Assistant Secretary of Defense, Mr. Morris, on April 20, 1964. And on September 1, the management of that particular organization was passed over to the Director of the Defense Supply Agency.

Subsequent to the approval of the plan, Detroit then became operational on April 1, 1965; Dallas on June 1; two regions, Cleveland and Boston, on August 1;

Chicago, St. Louis, and Atlanta, on October 1; New York, the 1st of November; and very recently, Los Angeles and San Francisco, on the 1st of December.

This is chart 1 and, although it is a little bit small for you in the back of the room, you do have this chart in your handout. It is a breakdown of the country into 11 regions. It depicts on it the regional headquarters' sites and the cities in which subordinate offices are located. It also breaks it up by the smaller lines into districts and geographical areas.

# DCASR BOUNDARIES AND COMPONENTS

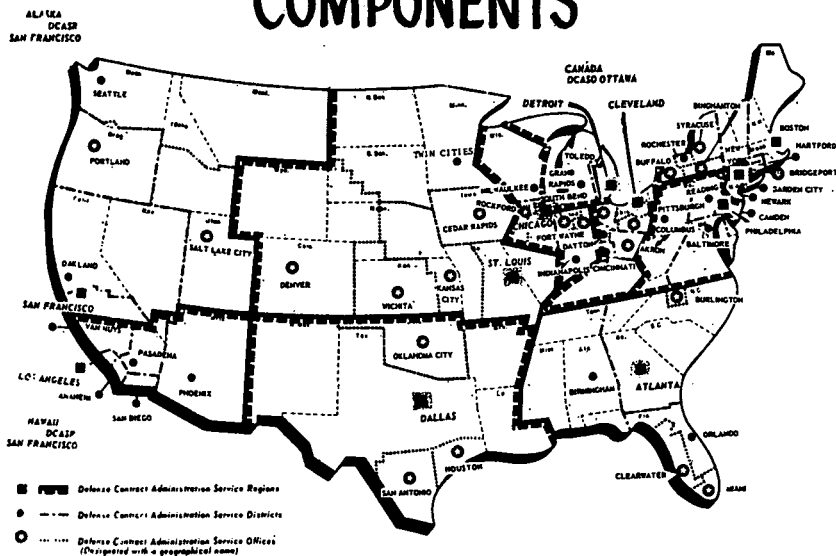


CHART 1

What were the manpower resources? These are the manpower resources at the end of fiscal year 1965 that were identified to the Contract Administration Services. The Army provided 7,005; Navy, 4,996; Air Force 7,215; from the Defense Supply Agency and the Office of the Secretary of Defense, 834, for a grand total of 20,050 manpower spaces.

These resources devoted to contract administration services had been budgeted for by the organizations just mentioned. Future savings made will represent a reduction from this 20,050 figure. The number of personnel on a specific date could be less than the resources identified.

While the planning group was working on the implementation plan, two projects were established concerning training.

Project 43 had to do with training for conversion. This had to be planned concurrently with the planning of the consolidation, and the training had to go on at the same time.

This long-range training plan, Project 63, had to do with looking back to see what training had been accomplished and what we had to accomplish for the long-range future.

Now, we early gave recognition to the fact that training was a vital part of our consolidation process and was also vital to having a high esprit de corps, having a viable organization and a very competent organization, having people proud of what they were doing. And we attempted to do this by keeping people informed.

While planning, we had to consider where people were, the geographical dispersion of personnel throughout any one region; we had to recognize that some of the skills of the people had to be realigned: there would be greater demand for some skills and lesser demand for some of the other skills. And we had to prepare for the shifting in the skill realignment.

We had to recognize, also, that personnel were accustomed to one concept of operation, one set of operational procedures, and they were going to have to become familiar with a completely new organization, a different way of doing things.

We were particularly concerned with the morale of personnel involved. It was vital that we keep them informed of the planning process: the progress of it; where we stood; what were the problems that we were trying to solve for the people themselves; how we were taking care of their own personal situations. We tried to let each and every one of our people know that they were being thought of and that we were taking care of them individually as well as collectively.

We also had to recognize one very fundamental fact: that was that each of the military departments and DSA had charged their field organizations with certain responsibilities. These had to continue despite all the effort that was going into the consolidation process and yet, at the same time—though we couldn't interfere with what they were doing—we had to train them for the new organization to meet the conversion date.

Now at the same time, while we kept our personnel informed by thinking constantly of them and trying to see to it that they got the complete picture, we had to orient the procuring contract officers, the PCO's, of the buying offices. I mentioned them a little bit earlier. This orientation was accomplished by conference teams being sent to the buying offices of the Army, Navy, Air Force, DSA, and NASA. In Washington, we had conferences with all the major buying activities. We then had conferences held in Philadelphia for buying activities that were in the field. You will notice here that NASA is also included. We briefed NASA, not only here in Washington but at each one of their centers, so that they would be completely informed on what we were going to do and how our operations would affect them.

Representative CURTIS. Let me make an obvious statement, but I do it for emphasis and just to be sure that it is so. I am sure it must be. Coordination between your group and the buying officers is a very basic and essential thing.

Captain RYDER. It is a fundamental platform upon which we base our efforts.

Representative CURTIS. Yes.

Captain RYDER. We are here only to serve the buying officers.

Representative CURTIS. And you have to feed back information to them just as they must feed information to you.

Captain RYDER. Absolutely essential.

Representative CURTIS. Very good.

Captain RYDER. They cannot operate without us and we cannot proceed without them.

In the orientation of the DOD personnel who were going to come to CAS, who were going to work with us, how did we keep them informed? Partly by personnel information letters. We sent out five letters from DSA headquarters, each giving the then current status of the planning process; the status of the planning for the individual personnel themselves, what was going to happen to them personally, and any other information that would be useful to them in planning their own lives, knowing full well there might be permanent changes of station, there might be movement within a region from one office to another.

Then we also sent out a task force from our headquarters at Cameron Station to all the field activities involved in contract administration, so that we would have an intensified person-to-person get-together with each one of these separate offices, telling them what we were doing and then taking their questions and translating them into information for them, so they could then think clearly and proceed with their own planning toward the ultimate goal of consolidation.

These actions provided a settling influence and helped instill a positive attitude in personnel toward accomplishing consolidation. We were highly successful in this.

Conversion training was accomplished in three steps. I talked previously about the first one, the orientation of the buying offices of the services and the field contract administration offices that we went out to by task force.

Secondly, we had to train our people in the new operational procedures. In order to do this, we had three steps: First of all, we selected instructors for their capability and trained them in the new operational procedures in each one of the functional areas. We then took these people and put them through what we call instructor technique training. Many of these people didn't need this but some of these people did need technique training and we wanted to make sure we put the point across. The next step was to take these trained instructors, break them up into small groups, send them out into the regions where the personnel were located and then train the rest of the people in the region, on a functional basis, in the operational procedures of their function.

In order to accomplish this, a third step was necessary; namely, the preparation of operational procedures manuals, lesson plans that went with those manuals, and then development of the various training aids to help in the training process.

This is an example of a conversion training plan within a particular region. We chose Cleveland; it is about an average size region. It was converted last summer. The training period was between February 23 and July 23, 1965. We had 65 instructors taking technique training. They had 1,560 man-hours of training for an average of 24 hours per instructor. There were some 57 instructors who get operational procedures training in their own functional areas, and a total of 2,028 man-hours of instructional training planned. They had an average then of 35.6 man hours in operational procedures training. There were 1,462 people left in the region to be trained. We planned 80 classes for them, for a total of 33,176 man-hours of training.

Actually, 67 instructors received 24.8 man-hours of technique training and 65 instructors received 19.5 man-hours of operational procedures training; 1,742 people received 25,579 man-hours of training for an average of 14.6 per person trained.

You will note there were 280 instances in which individuals were trained in more than one functional area. There were 1,462 people in the region and there were 1,742 instances of training because of training in more than one function.

In addition to the above, 560 man-hours were devoted to training instructors from other regions later in the activation schedule. This was important to us so that we would have uniformity in the interpretation of operational procedures. We trained one region and, while we were doing it, we would bring in instructors from other regions and they would go back with the same story and train other people. This chain of events was continued until we got through training San Francisco and Los Angeles personnel.

There was other training going on in Cleveland also. We had briefed the contracting officers, the PCO's of the buying offices, to keep them informed on the plan development and how it would affect them. We did the same thing with the contractor's themselves in the field.

We had contractors' representatives in Cleveland—1,040 of them—who received a 3-hour briefing on what was going to happen; what were the changes that were going to affect them.

Also, we took the industrial security part of the training and took the contractor representatives, who are the special group of industrial security specialists in the contractors' plants, 225 of them received 1 full day—8 hours—of briefing in how the new industrial security procedures would affect them.

Now, the total cost for travel and per diem for conducting all this training in Cleveland was \$21,719.50.

Subsequent to conversion, we had to go into an intensive postconversion training program—remembering now that these people had not been together or working together as a group before. For 60 days after conversion date, we planned and executed intensive on-the-job training to increase their proficiency and develop efficiency. It was absolutely vital to accomplish this training to get the organization rolling.

We also instituted what was known as interface training. Within CAS we define "interface" as that point at which one function comes in contact with another function in the processing of an action. People were new to each other; they had to find out how the people around them were working, what the other

people were doing in other areas, and what kind of support they could receive from other functional elements in the regional organizations to help execute their own mission.

Representative CURTIS. What had they been doing before—operating under other commands? How would that be?

Captain RYDER. Using a Navy organization as an example, because I used to run them, in the inspection of naval material, the INSMAT organization operated under Navy procedures. Now the procedures that we developed in the Defense Supply Agency were different from the ones the Navy had been operating under previously. Also, when they came in to sit down at their desks, they found people from Army, Air Force, and DSA surrounding them.

Representative CURTIS. Yes.

Captain RYDER. They weren't with their own people at all.

Representative CURTIS. Yes.

Captain RYDER. They were unfamiliar with the new organization. They had had the training, they knew the subject matter, but they had not had the actual material in front of them and the papers they were now working with; also, they had not processed them from one person to another and then to someone else—this was the major problem. Also, they had to know the relationship of the pieces of paper they had to other actions taking place throughout the regional headquarters and district and other office organizations. This was something they had been told about but they had to get intensive training to get a real feel for it. We had special briefings to tell them about the detailed organization, not only in their own regional headquarters but district offices, plant offices, and area offices. We told them who the key people were, pointed them out on the platform, and told them where their desks were physically located, so they would know where the top managers and intermediate supervisors would be.

We had to tell them what internal and external reporting was required, because everything they did would wind up at some designated place in the reporting system.

In the Data and Financial Management area, what were the requirements personnel were going to contribute? Data and Financial Management organization was brand new. None of the services had had an organization like this before.

In the preparation of forms, some people prepared whole forms; some prepared parts of the forms. They had to recognize what they individually had to do on the forms and why it was done in relationship to other operations, and they had to know what each support element could do for them in the total process of performing contract administration.

Finally, we had extensive supplemental training in the Data and Financial Management area, since this was a new organization that had not existed before. It is a paying office and it is a reporting office: it has to get input from everywhere and then make the reports and pay the contractors.

Coming back to personnel training, this was Project 63 I mentioned earlier. This DSA policy is "to insure availability of an effective work force to accomplish its missions."

Our long-range training program concerns itself with the provision of a developmental base and a career progression ladder for both the civilian and military sides of the house, and we try to see to it that those with managerial capability can get trained and get into more responsible positions throughout the CAS organization.

Following is the total training program and outline of the responsibilities of each one of the directors of a DCAS, Defense Contract Administration Services Region.

They provide orientation for all their new personnel and reorientation on a periodic basis for all the old hands as well as the new hands.

(Senator Jordan enters.)

Captain RYDER. Good afternoon, Senator, I am Captain Ryder, Special Assistant to the Deputy Director for Contract Administration Services. If you want to follow the script, we are starting about here [indicating on manuscript given to Senator Jordan]. I was describing the responsibilities of the directors of our regional offices in the overall continuing training program.

As I told them, we were providing orientation for all new personnel and reorientation for everyone to keep them up to the minute on new developments in their own particular specialties, as well as anything that came in that affected the

whole regional organization. We encourage self-development. This is one thing we paid particular attention to, to see that individuals are encouraged to improve themselves. We have had to implement training programs and provide developmental opportunities for all our people. This has to be looked at by all the supervisors, to see that we pick the right people and that we don't leave anybody out. We had to provide on-the-job training; this is a continuing objective in all offices. We arrange for onsite training. This is bringing the mountain to Mahomet, if you will; that is, bringing the trainers from other organizations into the headquarters organization, or into the field offices to train, rather than sending our individuals out. This saves time of personnel and in a large measure conserves funds, because it involves travel for a few people rather than a lot of people. The directors are directed to provide for the development of supervisors and those who indicate supervisory capability, so we can have an ever-growing group of people getting into the managerial area. We make staff personnel available to conduct training. This is not only done in the regional offices but throughout the CAS organization, utilizing the best skilled people we have. We provide for executive development so we can move our people up the ladder into the top jobs—into the higher grades. We utilize the current career management programs that are established by the Defense Supply Agency. In utilizing non-Government facilities, we do it only in accordance with the approved policies of the Defense Supply Agency and the Department of Defense.

Representative CURTIS. On that, what do you mean by "facilities"? Contractors office? Or do you mean a training program of a university?

Captain RYDER. A program of a university would be a typical example or a contract with some organization like Harbridge House, which has training programs with the Department of Defense.

We would also utilize the technical and professional societies for specialized training. Quality assurance would be a typical example here. We participate in their meetings and programs constantly.

Establish cooperative education programs: This is the kind of program where two individuals in effect occupy one manpower space. One individual performs in that space and another individual is going to school in a college or university for a short period of time, perhaps one quarter of schoolwork. Then he comes back and the other fellow goes to university for training. This swapping back and forth may go on for as long as 6 years, until the training program has been completed. During this time, while they are not working for the Government but are actually in school, they are not paid by the Government and they do not receive any of the school costs provided to them. They provide their own schooling.

Representative CURTIS. What is the theory behind that?

Captain RYDER. We keep two people available; we are training two people but paying only one individual.

Representative CURTIS. I am thinking from the standpoint of the individual. Isn't this something we should be encouraging.

Captain RYDER. Yes, sir.

Representative CURTIS. They don't even get a tax reduction for their training expenses. This is a tragedy of our tax laws. This is why we want to get the tax laws amended, so that they do. But how about this from the standpoint of getting people into it? Is it the fact they do better themselves?

Captain RYDER. Yes, sir. They get a higher grade early.

Representative CURTIS. And this is enough?

Captain RYDER. That is the incentive. They can get up there rather rapidly—as a matter of fact, much more rapidly than those who don't have their education and training.

Representative CURTIS. But, of course, that is right. They do have their base of payment, so they can sort of spread their income over their training period. Is that right?

Captain RYDER. Well, they are only paid during the time they are actually in the office.

Representative CURTIS. I understand that.

Captain RYDER. They have to spread that over the double period.

Representative CURTIS. I see, they can do that.

Captain RYDER. And they know they have a job when they get through.

Representative CURTIS. I see. For a minute I couldn't see the economics of it, but I see it now.

Senator JORDAN. Is there any shortage of applicants or do you have men waiting in line?



Mr. McLAUGHLIN. No, sir. It is not a case of a shortage of applicants. It applies mainly to the engineers and scientists. As there is need for the program, based on our kind of organization, we can get applicants.

Captain RYDER. This program is beginning to roll reasonably well. Of course, we are just starting on this in our capacity, but it is a program that has been around for some time.

We must evaluate all our training. By this I mean, do we accomplish our training objectives? What does it cost us? Do we have to do retraining? What else must we do to better our training program?

The regional directors must develop annual installation training plans. This is in order to budget properly for the future for our training requirements and, also, to obtain school spaces for our future needs. We don't want to get to the point where, when we want to train somebody, we find there is no school space allocated for him. So this installation training plan is a very important part of the director's responsibilities. Obviously, each director must maintain his own records of the expenses and costs of doing the training. And he must submit prescribed reports. I will get to this in a minute.

Representative CURTIS. I want to ask you a question. How many jobs in all of the Defense Department did this program wipe out?

Captain RYDER. Do you mean the consolidation?

Representative CURTIS. Yes.

Captain RYDER. To date we have no jobs wiped out, and I checked it this afternoon; 74 people are still excess to the needs of CAS. This is out of some 20,000 spaces. But we are taking care of those on a daily basis.

Representative CURTIS. The people that held those jobs previously now report to you.

Captain RYDER. That is right.

Representative CURTIS. You don't mean the jobs were wiped out. You mean they were removed from the Army, Navy, and Air Force.

Captain RYDER. And came to us. Those jobs that they had were wiped out from those three departments and new jobs were created in the Defense Supply Agency.

Representative CURTIS. So, actually, you didn't wipe out any jobs at all, yet you did save money.

Captain RYDER. We have not lost jobs but have lost people due to retirement, transfers to other Government organizations, marriages.

(Amplification for the record.)

"DSA was required to make job offers to all personnel identified to DSA for CAS. Such job offers were made to all identified personnel. Due to deaths, retirements, transfers to other Government agencies, and resignations, many job offers were not accepted. Therefore, the numbers of people who actually transferred to CAS were less than the resources identified to CAS. We have taken no jobs away from people."

Representative CURTIS. How many people have moved with these jobs?

Captain RYDER. As of the 3d of December 1965, we had 17,603 civilians and 479 military. We have an authorization of 18,985 civilian spaces and 518 military spaces as of the 3d of January 1966.

Representative CURTIS. So you are down to 18,000 from 20,000. But then, also, I imagine there has been a stepup in activity.

Captain RYDER. There has been a very large increase, Congressman, due to the southeast Asia heavy buying. Of course, this is immediately reflected in what we have to do.

Representative CURTIS. So the 18,000 now are really doing a heavier workload than the 20,000 did.

Captain RYDER. Yes. We have had some real savings here but they are hard to identify in hard dollars.

Representative CURTIS. Oh, sure. I like to put it in terms of a productivity increase.

Captain RYDER. We are doing much better productively and, of course, if this training program is as successful as it is assumed it is going to be, we will be even better off than we were before. We are going to have people doing more things in an area than two or three people were doing previously.

Representative CURTIS. Of course, the thing we are after is quality production, and I could imagine, hopefully, that the quality here would be increased tremendously.

Captain RYDER. And there are several reasons for the increase in quality: One, where you had three separate organizations in one contractor's plant inspecting the product for quality, each in its own way, inspecting in a little different way, now you have one requirement for that quality. Of course, we can train our people more effectively in one way than we can train them in three separate ways. So we are getting better productivity.

Representative CURTIS. I know this will be covered. But I would like to mention it now. One of the key things that Secretary McNamara had in mind was the development of esprit de corps, which bears on the quality aspect.

Captain RYDER. Well, this esprit de corps is something this education helps provide, and they know they are doing a better job now. They know they are all for one, instead of vying with each other for something. I think we are much better off under the new way of doing than the way of doing things previously.

Representative CURTIS. Are your officers in uniform?

Captain RYDER. We are all different services—Army, Navy, and Air Force. General Veal, Air Force Major General Veal, is Deputy Director for Contract Administration Services. We have as assistant deputy director an army colonel, selected for brigadier general. I am special assistant to General Veal. I am the senior Navy officer on board in this organization. We have others all the way down through the organization and we have senior civilians from all the three services right with us.

Representative CURTIS. On what do promotions depend within CAS?

Captain RYDER. We really haven't had a chance to find this out yet about the promotion program. So far as the civilian side is concerned, we can work that, but so far as the military side—

Representative CURTIS. Yes, you have got a problem. But what is the breakdown of the 18,000 between those in uniform and those in civil service?

Captain RYDER. I gave you only the civilians on this one.

Representative CURTIS. I see.

Captain RYDER. Of the military, they had onboard the 3d of December 1965, 479; on the 3d of January 1966, we were authorized 518. That is clear across the country, including headquarters.

Representative CURTIS. What was the previous figure related to the 20,000?

Captain RYDER. I don't have that figure. We can get that figure for you. We will supply you with that figure.

(The information supplied follows: Q. What was the previous figure related to the 20,000? A. 630 military and 19,420 civilians, for a total of 20,050.)

On the Personnel Training Reports, two reports are required from our directors: (1) An annual report which is submitted during the month of July, subsequent to the fiscal year termination, and (2) a midyear updating of that report immediately after the beginning of the calendar year, done during the month of January. These reports are in two parts: (1) Accomplishments and (2) Installation Training Plan.

In Accomplishments, we require that the director tell us what the on-station training and development consisted of; then the training that was done at other Government facilities outside of the station; that done in non-Governmental facilities; data on individuals receiving this training, so we can update their records; and a summarization of the training programs utilized, making sure that the directors do utilize all the programs that are provided to them.

In the second part, the Installation Training Plan, they must give an on-station training plan. This includes on-the-job training and any other kind of training that takes place at the station; that at other Government facilities; at non-Government facilities; and any miscellaneous training—under this would be included such things as emergency planning training. Then, do they need assistance from Headquarters, DSA? They must record this and ask for it specifically here.

This mid-year plan reviews the training for the 6 months, July through December, updates the current fiscal year training plan and, also, includes in it the next fiscal year training plan, the one starting the following July and for the whole year. This helps us in our budgeting process and scheduling of personnel to attend schools.

Here are some examples of procurement-type courses used to develop our personnel; these are all approved by the Defense Procurement Training Board: Defense Procurement Management; Contract Administration; Art and Technique of Negotiating Contract Modifications; Industrial Property Adminis-

tration; Production Management; Termination Settlement and Negotiation; Defense Procurement Executive Refresher Course; and Industrial Security Courses which are conducted at Fort Holabird.

Representative CURTIS. Now under "Termination settlement and negotiation," would that include work in renegotiation?

Captain RYDER. No, sir. We are talking here in terms of terminating a contract for the convenience of the Government and we have to negotiate the termination settlement.

Representative CURTIS. I understand that. Is there an area of renegotiation in which your people would become involved?

Captain RYDER. It is the buying office's function to redetermine price.

Representative CURTIS. Let us dwell on this just a bit, because of course, to my regret, the renegotiation office is separate, but the area of renegotiation you put in your own contract is a very fine thing. I think they use a term other than renegotiation.

Mr. McLAUGHLIN. Congressman, I believe you are talking about the contract modification—negotiating contract modification.

Representative CURTIS. It could be under contract modification. Indeed, it could.

Mr. McLAUGHLIN. It is a post-award action.

Representative CURTIS. So you would have it under the "Art and Technique of Negotiating Contract Modifications" category.

Mr. McLAUGHLIN. Yes, we would.

Representative CURTIS. Oh, I get it. Yes. But your people would be involved. And I would think, in some ways, your people would be involved more than the original procurement people because you are following the contract.

Captain RYDER. It depends upon the area of negotiation and the area of modifications. Some modifications we can do and other modifications we cannot perform or provide. The buying offices must.

Representative CURTIS. Because here you are dealing with an item upon which there is no experience, and you are in effect saying, after we have had experience we will go back and look at it. But where does the experience come from? From your people. Again, this is probably one of these very closely coordinated areas between your people and the buying offices.

Captain RYDER. We also provide recommendations to the buying offices. They ask us for specifics in any particular area, so they can negotiate, but it is their prerogative.

Representative CURTIS. I was thinking you need a joint team on this. I am very interested in the Renegotiation Act. The whole argument I have against this, renegotiation board technique is that you have people with no experience in the contract itself, and I much prefer to see the agencies involved which do, which are the Army, Navy, or Air Force. In other words, I would have the people who have actually written the contract and then have watched the production, do the renegotiating, because we are talking about honest people. That is the assumption.

Captain RYDER. We must assume this.

Representative CURTIS. We have to assume this. So we are talking about, I would argue, who is the most capable of renegotiating. That is why I dwell on the point of how the CAS personnel fit in this. Even though you say it is their area, I would say you would have to have a joint team almost every time between CAS and Procurement on renegotiation.

Captain RYDER. Well, we provide them information as required. We talk to them on the telephone; we write them letters on a continuing basis. They talk to the contractors and we talk to the contractors in the areas we are authorized to talk to them on. There are some delegations of authority which I didn't dwell on but perhaps I should mention at this point. Each of the several services has delegated certain authorities to Contract Administration Services in the performance of administration on the contracts. These are the normal authorities. There are some optional authorities which they can delegate to us in the performance on a contract. The delegations that are given to us include negotiating contract modifications of certain varieties.

Representative CURTIS. I see.

Captain RYDER. The procuring activities are pretty tightfisted when it comes to giving away money and we can only pay the money or funds that have been obligated for the specific purpose.

Fort Holabird is at Baltimore, for those who don't know it, and that is where the industrial security school is maintained.

Representative CURTIS. Would you turn back to that page just once?

Captain RYDER. Yes, sir.

Representative CURTIS. Simply because this is uppermost in my mind, I went out yesterday to one of these trade fair kind of things with one of our St. Louis computer manufacturers. Of course, these people are trained in computer use and so forth. Has there been any formal consideration to be sure that at certain levels every one of your people are familiar with the possibilities of the computer?

Captain RYDER. Yes, sir. We have, in the data and financial management area, computers and we have people who are particularly skilled who went to school at IBM and Honeywell. We have used the two varieties. They have been trained in programming. We have our own programmers.

Representative CURTIS. Let me restate this in another way. This has caused me a great deal of worry ever since this was mentioned to me. I am on the board of trustees at Dartmouth College. The president of the college said: "We feel and recommend to the board that no one should get an AB degree or be considered educated unless they at least know the limitations and potentials of computers and, henceforth, all seniors must have at least this knowledge because otherwise they are not educated", thereby meaning every member of the board of trustees is uneducated. That has been burning in me ever since, but the wisdom of this has been borne out to me every day that I look into the potentials of computers as well as their limitations. That is why I asked the question.

Captain RYDER. From that viewpoint, all our people aren't that skilled. However, in that part of the training program that I referred to a little while ago, we briefed them on the data and financial management side. This was to get some of this pervading through the people of the importance of this machine they are feeding all the time. So I think they understand they have got to feed this machine and they know what comes out of it. Some of them have a real feel that it can do more for them.

Representative CURTIS. That is why I say you have to recognize the limitations as well as the potentials. Certainly, your top people ought to know enough about the potential, so they know where they can really store the data collected and utilize it in their operations.

Captain RYDER. We are very concerned with this because our reporting is based on this computer operation.

Representative CURTIS. Yes.

Captain RYDER. We are watching it very closely. We have a monthly look at the reports to see if we can't make the computer do better for us, without increasing the labor that goes into providing the information.

Examples of quality assurance-type technical training, including requirements for NASA. This includes the following: Ammunition; petroleum; electronics; medical—they must have completed appropriate medical supply courses before they can inspect medical items; mechanical/electrical; vehicles; chemicals and drugs—here again this is associated with chemicals; nuclear; space systems; lifesaving and survival equipment; specialized soldering—this is a particular requirement of NASA—we must get people through specialized soldering because it is critical on space systems.

In summation, I have explained the status of training preconversion, training to go on concurrently with the planning; we talked about converting a number of regions and the postconversion training program; then, finally, the DSA career management training program which is a long-range program.

Now, among your handouts in the folders, there are some manuals on the career management program.

This concludes my briefing on the training and contract administration, but I would be happy to answer any questions that I can for you at this time.

Representative CURTIS. I think you have answered this but I want to have it restated. First, let me say this is splendid and is just the kind of updating I was looking for. But will you restate where it is the head of your group, CAS, now sits? I want to see what his prestige is. This is most important to the esprit de corps. Who is the head of it now? What is his position in DSA?

Captain RYDER. Coming from the top down (referring to DSA organization chart), Vice Admiral Lyle is the head of DSA; his deputy is an Air Force major general; then another deputy, Major General Veal, Air Force, is the head of contract administration services.

Representative CURTIS. Well, you have got him right up there.

Captain RYDER (referring to DSA organization chart). Admiral Lyle, director; General Gideon, deputy director; directly down from him is another deputy director, specifically for contract administration services. Then you come down one notch further and you are into the executive directors at the level in the central staff and the operating part of DSA as well as in the CAS structure.

Representative CURTIS. So you have really got status for your new group.

Captain RYDER. Yes, sir. Deputy Director General Veal is right here and under him the executive directors for production, quality assurance, and contract administration—these three (again referring to DSA organization chart).

Representative CURTIS. May I turn this (DSA organization chart) over to the stenographer for the record?

Captain RYDER. Yes, sir. (See p. 326.)

Representative CURTIS. Thank you so much for the briefing.

Captain RYDER. It was nice to give the briefing to you.

Representative CURTIS. Well, we still have to see the full potential, but it looks very good at this stage.

Captain RYDER. We are in the process of trying to analyze where we are and how we can get better at this time but, since our last two regions just became operational on December 1, it is still a little bit too early to tell very much.

Representative CURTIS. Does the staff have any further questions?

Mr. WARD. May I ask, was this set up under the McCormack-Curtis amendment?

Representative CURTIS. The power to perform the consolidation.

Captain RYDER. I can't answer that question directly, sir, because I don't honestly know, but it was done at the direction of Mr. McNamara.

Representative CURTIS. He was in consultation with several of us.

Captain RYDER. I am sure he was, and this had a long genesis, as you probably know.

Representative CURTIS. Of course when I first even heard of such an idea my own view was that this was most essential. In fact, I would make an added comment, that this whole business of where the Government deals with the civilian sector—which is probably one of the big aspects of procurement—this is an area to which we have got to devote a great deal of attention, and continually so. This seems to me to be desirable for many reasons, beyond the actual dollars and cents that will be saved and the increased quality of materials. It points the way to how we can do a better job of relating these two sectors in our economy, the governmental and the private. Hopefully, I again might say, I hope to get the Government more and more out of the actual business aspects of procurement, but, if we are going to do it, we have got to beef up this area of relationship between the Government that procures and the private sector. Among other things, I worry about how we can get the money to finance this operation, and I felt the technique of developing procurement officers and contract administrators will help the Government get the kind of return for its dollar that it must, otherwise the Government will have to handle the production itself.

Captain RYDER. That is right and our relationship with the contractor has to be so solid that he performs well.

Representative CURTIS. Well, if the contractors realize this, the private sector will give a tremendous boost to what you are doing, otherwise it could lead to a decision that we had better not mess with the private sector. We had better set up a little agency to do the entire job ourselves which will be more responsive to command.

Mr. WARD. How many million dollars' worth of contracts are administered?

Captain RYDER. The last report we had, which goes back to the 20th of November on our fiscal report here, we had an obligated dollar value—this is on the basis of contracts—of \$27,631,900,000. Now the unliquidated balance—that which is yet to be delivered—is \$5,484,600,000. This is what we are still working on. This is only for 9 of the 11 regions. We don't have any data on Los Angeles and San Francisco.

Representative CURTIS. What was the figure you spent on training that you gave us?

Captain RYDER. That was only one region—\$21,000.

Representative CURTIS. \$21,000 in one region. I just wanted to spell that out, because this is significant here in terms of a few thousand dollars with which we are trying to administer a tremendous area where we are dealing in billions.

Captain RYDER. That is right, sir. Of course, we must remember that most of these people are skilled in their own particular function to start with. So our particular training here was to reorient their thinking in their way of doing the things they know. We know the long term cost is the schooling that needs to go on, which is on a continuing basis.

Mr. WARD. Now to go back, what part of the total contract package is not included in the \$27 billion?

Captain RYDER. This \$27 billion includes the face value of the prime contracts only. Now, why eliminate secondary contracts? Secondary contracts are always paid at the prime office, so whatever moneys are there are obligated on the prime contract.

Mr. WARD. I was trying to get the total overall contract package for the Department of Defense. If there are \$27 billion and a half—

Captain RYDER. Out of nine regions.

Mr. WARD. Then how many billion dollars' worth of contracts handled by the services, are included in their package?

Captain RYDER. I don't have that figure, sir, but we will certainly be happy to try to get it for you.

Mr. WARD. Would it be \$5 or \$10 billion?

Captain RYDER. I would hesitate because you are getting into weapons systems and they are very expensive.

Mr. WARD. I am thinking that about a year ago Secretary McNamara gave us an overall figure of something like \$27 billion.

Captain RYDER. I might explain this a little differently. This was the face value of these contracts, that \$27 billion. The \$5 billion is the unliquidated balance. This goes over a period of time. This could be several years, in some cases. So it is not a too meaningful figure taken by itself.

Mr. WARD. That is the face value of the actual contracts.

Captain RYDER. Yes, sir.

Mr. WARD. Percentage-wise, how much is for DSA and how much for Army, Navy, and Air Force?

Captain RYDER. I don't have those figures.

Mr. WARD. Roughly, is most of this more DSA?

Captain RYDER. No, sir. I can't back this up but I would say this is mainly for the three military services. Of course, the general broad base of supply is DSA, but the items peculiar—of which there are a great many—are in the individual military departments. But I don't have the exact figures on this and I would hesitate to come out with a positive statement.

[Letter from Congressman Curtis, dated January 13, 1966, addressed to Capt. John F. Ryder, requested information which includes the questions asked by Mr. Ward. This letter has been passed to the Office of the Secretary of Defense for reply.]

Mr. WARD. Do you have any idea of what the impact of this has been on the contractors, that is, the reduction in the amount of space he has to make available, personnel, and expenses?

Captain RYDER. I have no exact figures there but, as you indicated, we certainly will have less space devoted to Government personnel because, instead of having perhaps three separate offices in one plant, we will now have one; it may be larger than any one of the three but we will have one. There is another advantage; the contractor spends less money on you.

Mr. WARD. But you haven't developed what the impact is on this?

Captain RYDER. No, sir. I would guess it would be a full year out before we will have real meaningful figures on that. Perhaps we can never really get it, because the contractor never really tells you how he is evaluating and what his savings are.

Representative CURTIS. Of course, the Government will always save the markup on what they pay for.

Mr. WARD. Another question. We were up at Philadelphia when the test was being run. I asked General Stanwix-Hay at that time whether or not his people were permitted to sit in with the contracting people during the time they make

the contract, and he said, no, but it would be desirable. Has there been a change in that situation?

Captain RYDER. None that I know of. However, CAS has and would participate when requested to do so by the contracting officer.

Mr. WARD. Don't you think they should sit in, so they can be familiar with what is going on, in order to properly manage the contract?

Captain RYDER. As to whether or not it would be more desirable to have the ACO group of people present with the PCO people while they are doing their contracting, I honestly don't know, but it would take a lot of time and a lot of travel to do it.

Mr. WARD. I don't mean all, but I think it would be more than just coordinating. What was the word you used—team?

Captain RYDER. To the best of my knowledge, nothing has been done. Although I have talked to General Stanwix-Hay on a number of occasions, he never happened to mention that. This is the first I have heard of it.

Mr. WARD. Another point that Congressman Curtis raised: How does this relate to the Audit Agency?

Captain RYDER. The Defense Contract Audit Agency is fully operational now, and some of the functions that contract administration used to perform are now performed by the Audit Agency. However, this is a team effort in any event. The Contract Audit Agency and the DCAS office work together on any contract. Sometimes the auditor is the team leader; sometimes the ACO is the team leader. These are spelled out in Defense Procurement Circular No. 34. It has been out 6 months or more.

Mr. WARD. The services have been pulled together similarly to what has been done here. That is separate.

Captain RYDER. In many cases, the auditors are actually physically sited at the same installation with the CAS organization.

Representative CURTIS. How about the General Accounting Office people?

Captain RYDER. They are not with us. I suppose that—

Representative CURTIS. I know that—but go ahead.

Captain RYDER. I was going to say that I don't know whether it had been thought of, but I haven't recently heard any comments made as to whether or not the General Accounting Office would be coming in. They sort of look on top of us.

Representative CURTIS. Yes, they sort of oversee and spotcheck.

Captain RYDER. The auditors and contract administrators, of course, work very closely on preaward surveys. A contractor submits a bid and we want to find out if he is responsive. Then the CAS organization in the field makes the examination of the contractor's capability; the auditor examines the contractor's accounting system in the event the contract type will require examination of the contractor's financial records during the course of contract administration.

Representative CURTIS. CAS will do that?

Captain RYDER. Yes, sir. The auditor inspects the books and he makes a recommendation regarding the contractor's accounting system.

Representative CURTIS. Incidentally, Ray, I think this might help the record, because I want to see this published for the information of Congress; if there would be included a little narrative of what the actual job of a contract administrator is. For instance, I was not quite aware—I see now why they would—that CAS would look into a contractor's capability before the contract was signed.

Do you think you could give a little narrative to be submitted for the record?

Captain RYDER. Yes, sir.

Representative CURTIS. A sort of little general job description in this area.

Captain RYDER. I would be happy to do that. (See p. 327.)

Representative CURTIS. It would be helpful in reading the record.

Mr. WARD. There was another question in regard to the contractor inventory. I know this has been a tough problem in the past. But do the contract managers get a good picture of the extent of the Government's inventory that is in the hands of the contractor? Are they able to keep on top of that now?

Captain RYDER. I don't know whether I understood you specifically, but we have property officers in each of our contract administration services offices, and they are responsible for all Government property in a contractor's plant. This would be the raw materials that go to make up the product or it could be the product itself as it comes down the production line. It would include spoilage.

Representative CURTIS. Would it include machine tools?

Captain RYDER. Yes, sir. It includes machine tools which the Government either owns or lends or has an interest in.

Representative CURTIS. Or a computer the Government might own.

Captain RYDER. Yes, sir.

Mr. WARD. Defense inventory stock.

Captain RYDER. Yes, sir. Every time stock is brought into the system and the Government has paid for it, as Government-furnished material, yes, that is all accounted for.

Mr. WARD. They keep account of it against the stock issued.

Captain RYDER. If it is Government furnished, we must. But, generally speaking, the contractor will go out and buy his own material and then we just pay him off for the product he delivered. But, when we are furnishing him materials, we must account for all the materials furnished and find out how he is using them; that there isn't a lot of waste involved. He might waste Government material but not his own.

Representative CURTIS. Or what might get wasted might turn out to be the Government's and not his.

Captain RYDER. So that is what the property administrators do in large measure, that is, keep track of all the property.

Mr. McLAUGHLIN. And see that it is not misused.

Captain RYDER. That is another aspect, to see that they don't convert it to some other objective.

Representative CURTIS. One other thing, and this is something you may not want to respond to. Has GSA watched what you are doing, with an eye to doing the same? What about this?

Captain RYDER. I don't honestly know, Congressman. This is something I haven't looked into. I am sure they have an interest in what we are doing.

Representative CURTIS. They haven't been auditing your courses.

Captain RYDER. Not to my knowledge.

Representative CURTIS. I would like to direct their attention to this, Ray. If they want to do a more adequate job, this is exactly the way to do it.

Captain RYDER. I am completely unfamiliar with anything GSA is now doing in this area.

Representative CURTIS. Of course, they do a lot of procurement and I am hopeful they will do more for the Military Establishment.

Captain RYDER. They do a great deal of it right now.

Representative CURTIS. That is what I am getting at. There ought to be some standardization to the extent there can be on the CAS aspect of what they are doing. We need to explore that.

Mr. WARD. Maybe you know. Are there some plants where they have their people in at the same time your people are in there?

Captain RYDER. I doubt it, sir. I can't say positively this does not happen, but it would not conform to the CAS concept.

Mr. WARD. I remember a number of years ago we made a study at the Bureau of the Budget involving a lot of these contractor representatives. The Federal agencies were all in there—to what extent this has been corrected or reduced, I don't know.

Mr. McLAUGHLIN. There was transfer to GSA of items like paint. We had it at one time.

Representative CURTIS. Make an inquiry to the Bureau of the Budget.

Mr. WARD. Yes, sir.

Representative CURTIS. Keep this in mind.

Do you have any questions?

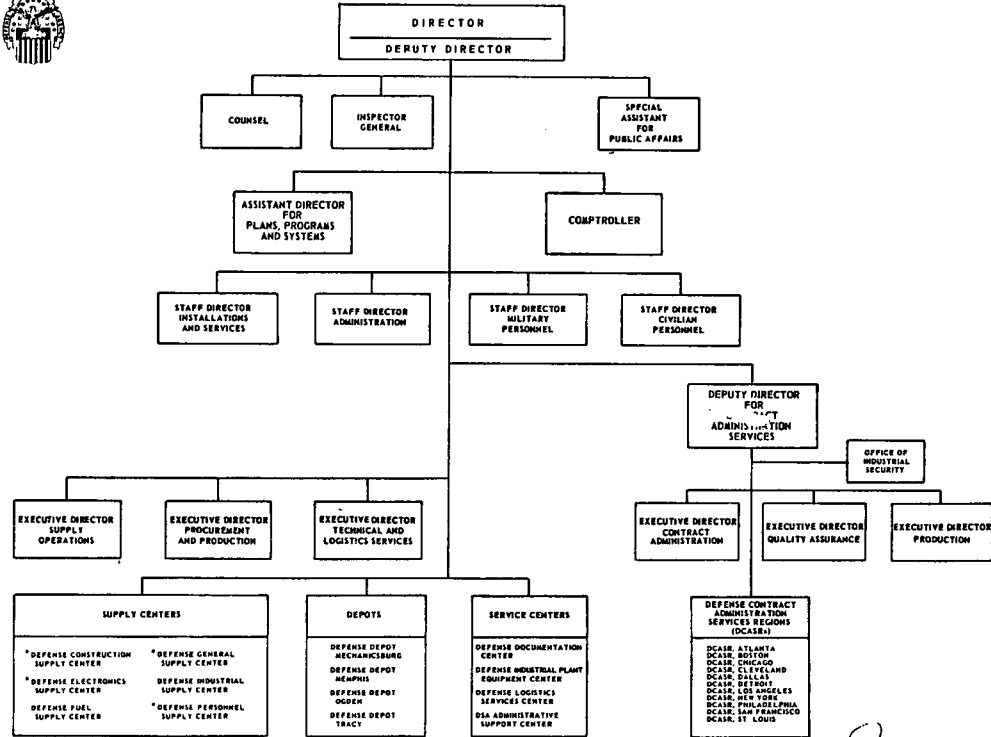
Thank you very much for a fine job.

Captain RYDER. Thank you, sir.





# DEFENSE SUPPLY AGENCY



\*Centers with Depot Operations

APPROVED: \_\_\_\_\_

J. M. LYLE  
 Vice Admiral USN  
 Director  
 1 December 1965

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Optional Form 6 July 1954 U. S. CIVIL SERVICE COMMISSION Chapter P2, Federal Personnel Manual W-5-103  <b>POSITION DESCRIPTION</b>		1. Check one: Dept <input type="checkbox"/> Field <input checked="" type="checkbox"/>	2. Official headquarters: DCASR	4. Agency position No. RCA-55		
		3. Reason for submission: (a) If this position replaces another (i. e., a change of duties in an existing position), identify such position by title, allocation (service, series, grade), and position number New		5. C. S. C. certification No.		
6. Date of certification		7. Date received from C. S. C.				
8. CLASSIFICATION ACTION (b) Other (specify)						
ALLOCATION BY	CLASS TITLE OF POSITION	CLASS			INITIALS	DATE
a. Civil Service Commission		Service	Series	Grade		
b. Department, agency, or establishment						
c. Bureau	Contract Administrator	GS	1102	11	FBJ	
d. Field office						
e. Recommended by initiating office						
9. Organizational title of position (if any)				10. Name of employee (if agency, specify V-1, S, P, or I)		
11. Department, agency, or establishment Defense Supply Agency				a. Third subdivision Operations Division		
a. First subdivision Defense Contract Administration Services Region				d. Fourth subdivision Commodity Branch		
b. Second subdivision Directorate of Contract Administration This is a complete and accurate description of the duties and responsibilities of my position  _____ (Signature of employee) _____ (Date)				e. Fifth subdivision  12. This is a complete and accurate description of the duties and responsibilities of this position  _____ (Signature of immediate supervisor) _____ (Date)		
13. Certification by head of bureau, division, field office, or designated representative  _____ (Signature) _____ (Date)				14. Certification by department, agency, or establishment  _____ (Signature) _____ (Date)		
Title:				Title: Position Classification Specialist		
15. Description of duties and responsibilities <b>JOB SUMMARY</b> Serves as a Contract Administrator with signatory authority in a Commodity Branch and is responsible for administering a group of fixed price, call, facility, and bailment contracts and a few more complex types such as incentive, redeterminable and cost-plus-a-fixed-fee contracts.						
<b>JOB CONTROLS</b> Receives general supervision from the Branch Chief. Accomplishes assignments on own initiative and responsibility. Occasionally confers with supervisor who provides advice and guidance by discussing interpretations of regulations and policies and citing of similar cases. Completed work receives spot check review for compliance with policies, regulations and procedures and for soundness of decisions and judgments made. Regulatory controls consist of applicable regulations and directives of higher authority as well as locally developed policies and procedures.						

If more space is required, use the other side and additional pages when 2 x 14 1/2

MAJOR DUTIES

1. Assures that the interests of the Government are protected at all times and that the contractor fulfills the contractual agreements. Makes necessary investigations and determinations and approves or disapproves all matters and/or requests of the contractor. Performs such functions as: Approves contractor's progress; approves progress payments; approves contractor's property, purchasing and fiscal accounting systems, policies and procedures based upon recommendations of various specialists; acts as team captain, and in this capacity obtains

technical and specialized investigations, advice and/or data from such personnel as auditors, price analysts, Q.A. representatives, industrial specialists, property administrators, etc.; coordinates contractor requests for deviations with buying activities, and makes recommendations regarding acceptance; negotiates price adjustments and delivery schedules; prepares determinations and findings of fact in cases of disputes between contractor and the Government; personally and without direction from any individual, initiates and signs correspondence, vouchers, memorandums, reports and other documents which are binding on the Government; reconciles previously obligated funds and issues provisioning order obligating documents, etc.

2. Performs a variety of functions as may be required based on types of contracts assigned: (a) Reviews contractors' price schedule and negotiates and approves the pricing of spare parts, in connection with provisioning of spare parts; (b) reviews contractors' proposals for price redetermination, negotiates price revisions, and executes the supplemental agreement; (c) negotiates, formalizes, and distributes facility lease contracts; (d) reviews, analyzes, and definitizes production lists on call contracts; (e) develops actual overhead rates acceptable to all services of the Department of Defense; and (f) in connection with cost-type contracts, reviews and approves or disapproves such matters as—expenditures incurred as cost-reimbursement contracts, estimates of percentage of completion for payment of fixed fee, special advance payment bank accounts and countersigning bank checks in connection therewith, overtime requests, fairness and reasonableness of salaries and wages paid to contractors' employees, subcontracts and purchase orders, etc.

3. Attends meetings, conferences, and negotiations: Confers with contractors' executive personnel and officials to adjust or clarify conflicting interpretation of the contract, contractual obligations, disallowable items of cost, etc., to assure that the interests of the Government are adequately protected and that the contractor receives what is justly due under the terms of the contract. Negotiates forward-pricing agreements for the establishment of forward-pricing rates of material, labor, overhead, G&A, engineering expense, and subcontract expense. Administers subcontracts issued by administrative contracting officers located in other geographical areas. Exercises, within areas delegated, the same responsibility as the prime ACO.

Performs other duties as assigned.

DEFENSE SUPPLY AGENCY, HEADQUARTERS, CAMERON STATION,  
*Alexandria, Va., January 21, 1966.*

Hon. THOMAS B. CURTIS,  
*House of Representatives,*  
*Washington, D.C.*

DEAR MR. CURTIS: This is an interim reply to your letter of January 13, 1966, wherein data is requested concerning a breakdown of all categories of contracts by their function, indicating the dollar amount of each, and an indication as to those contracts under the Defense Supply Agency, Contract Administration Services (DSA, CAS) administration and those which are administered by the military services.

Since the data desired covers Department of Defense-wide activities, arrangements have been made with the Office of the Secretary of Defense to reply directly to you. That response will include data on those contracts assigned to DSA, CAS.

The transcript of the presentation on January 12, 1966, has been edited and is forwarded herewith. We have included in the record a job description of a typical contract administrator (GS 1102-11 Contract Administrator) position.

Sincerely,

JOHN F. RYDER,  
*Captain, U.S. Navy,*  
*Special Assistant to the Deputy Director,*  
*Contact Administration Services.*

APPENDIX 9

1. EVALUATION OF A CONTRACTOR'S QUALITY PROGRAM

QUALITY AND RELIABILITY ASSURANCE

**HANDBOOK**

**H 50**

Superseding  
Quality Control and Reliability  
Handbook (Interim) H 110  
31 October 1960

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**EVALUATION OF A CONTRACTOR'S  
QUALITY PROGRAM**



**23 APRIL 1965**

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE  
(Installations and Logistics)  
Washington, D. C. 20301

(329)



INSTALLATIONS AND LOGISTICS

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE  
WASHINGTON, D. C. 20301

April 23, 1965

## Evaluation of a Contractor's Quality Program

H 50

Quality and Reliability Assurance Handbook H 50, developed by a Department of Defense Task Group composed of representatives from the Departments of the Army, Navy and Air Force, and the Defense Supply Agency, is approved for printing and distribution.

This handbook provides guidance for a uniform and adequate evaluation of contractors' quality programs established in accordance with MIL-Q-9858A, "Quality Program Requirements." The handbook shall not be referenced in purchase specifications nor shall it supersede any specification requirements.

H 50 will be reviewed periodically for completeness and accuracy. Users are encouraged to report errors and recommendations for changes to the Commanding General, U.S. Army Materiel Command, ATTN: AMCQA, Washington, D.C. 20315.

GEORGE E. FOUCH

Deputy Assistant Secretary of Defense  
(Equipment Maintenance and Readiness)

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## INTRODUCTION

Quality and Reliability Assurance Handbook H 50 provides guidance to personnel responsible for the evaluation of a contractor's quality program when Military Specification MIL-Q-9858A is invoked in his contract. MIL-Q-9858A, "Quality Program Requirements," requires contractors to establish a quality program which will assure compliance with the requirements of their contracts.

Users of this handbook are cautioned that MIL-Q-9858A supersedes MIL-Q-9858 and contains such extensive changes that it must be treated as an entirely new specification, rather than as a revision. Among the far reaching new concepts in MIL-Q-9858A are requirements for Quality Programs, Quality Program Management, Initial Quality Planning, Costs Related to Quality, Facilities and Standards, Advanced Metrology Requirements, Manufacturing Control (involving work instructions) and other new or expanded requirements.

MIL-Q-9858A is intended for use in contracts involving the more complex types of military hardware and systems, while MIL-I-45208A is the specification pertinent to less complex items. A decision as to which of these specifications to invoke in a contract must be made by the technical and procurement personnel who specify the other technical or contractual requirements. Whichever specification is used, the contractor is not absolved from his responsibility for the quality and reliability of the product he delivers to the Government.

Proper and efficient use of this handbook and the specifications mentioned above require that the reader become familiar with Sections VII and XIV of the Armed Services Procurement Regulation; with MIL-I-45208A, "Inspection System Requirements" and its complement, Quality and Reliability Assurance Handbook 51 (when published); and with MIL-C-45662A, "Calibration System Requirements" and its complement, MIL-HDBK-52.

Both MIL-Q-9858A and this handbook are based on established Department of Defense concepts and policies which provide that:

a. The contractor is solely responsible for the control of product quality and for offering to the government for acceptance only products determined by him to conform to contractual requirements.

b. The Government Representative is responsible for determining that contractual requirements have, in fact, been complied with prior to the acceptance of the product.

c. Final decision of product acceptability is solely the responsibility of the Government.

The contractor, in accordance with MIL-Q-9858A, must design and maintain an effective and economical quality program that includes both processes and products and which makes data available to the Government adequate for use in establishing product acceptance criteria. Facilities, products, and management techniques vary so widely within the broad pattern of national security industrial establishments that this evaluation handbook cannot provide detailed checklists. Instead, it reflects the most reliable quality program control patterns used by much of American industry. It encourages the training of planners and evaluators in all areas that affect the quality program. The emphasis throughout this handbook is on the planning and execution of a comprehensive quality program. The evaluation of such a program depends upon how well decision criteria have been selected, applied and enforced.

The Government's evaluation plan should apply to all aspects of a contractor's program. Thus, the Government Representative must be familiar with all requirements of the procurement if he is to assure himself that the contractor provides effective quality control coverage throughout the entire sequence of operations.

Quality programs are not intended to correct deficiencies in other contractual requirements. The contractor is not obligated to

perform more than the requirements specified in the contract and in MIL-Q-9858A.

A consistent format has been followed throughout this handbook. In order to relate the program evaluation suggestions as directly as possible to the requirements of MIL-Q-9858A, each subsection of the specification is quoted verbatim and followed by appropriate comments, as follows:

#### SUBSECTION OF MIL-Q-9858A

A. "Review of Requirement"—Discussion of the requirements set forth in the subsection.

B. "Application"—Descriptions and examples of practices applied by contractors in the past that are typical and illustrative

rather than all-inclusive or mandatory.

C. "Criteria for Evaluation"—Questions which should be asked to evaluate that particular part of a contractor's quality program.

It is most important to note that the questions contained in the various "Criteria for Evaluation" are essentially YES/NO questions. Asking and answering them alone will not provide a thorough and complete evaluation of a contractor's quality program. The questions serve only as indicators and reminders of important points to cover; *the evaluation is expected to cover them in appropriate depth and detail to assure an effective and complete evaluation.*

## SUBSECTION BY SUBSECTION REVIEW OF REQUIREMENTS

### 1. SCOPE

1.1 Applicability. This specification shall apply to all supplies (including equipments, sub-systems and systems) or services when referenced in the item specification, contract or order.

**A. REVIEW OF REQUIREMENT.** Specification MIL-Q-9858A, Quality Program Requirements, applies to the more complex items of military hardware and systems, when it is essential to assure conformance to contractual requirements through control of all work operations and manufacturing processes, as well as inspections and tests. Complex components and subsystems which are part of a complex system may also require application of MIL-Q-9858A. In any case, when the need for MIL-Q-9858A has been determined by technical and procurement personnel, the following clause (ASPR 7-104.28) shall be used in contracts for these items:

"Quality Program (July 1964). The contractor shall provide and maintain a quality program acceptable to the Government for supplies or services covered by this contract. The quality program shall be in accordance with Military Specifications MIL-Q-9858A."

For those less complex items whose quality can be assured adequately by control of inspection and testing alone, MIL-I-45208A, "Inspection System Requirements," will be used. However, a contractor may, at his option, substitute any or all of the requirements of MIL-Q-9858A for those of MIL-I-45208A specified in his contract, provided that price or fee is not increased. This option permits a contractor to use one system rather than two, if he so desires.

**B. APPLICATION.** Among the types of complex items to which MIL-Q-9858A should be applied are:

(1) Items of complex design, such as missiles, aircraft, tanks, ships, space suits and specialized medicine.

(2) Major components, such as fire control systems, electronic systems, navigation systems, engines, turbines and rocket motors.

(3) Smaller components or parts, such as assemblies, accessories or pieces, when sufficiently complex or required to be ultra-reliable.

### C. CRITERIA FOR EVALUATION.

(1) Is the procurement for complex supplies or services?



(2) Does the contract or order reference specification MIL-Q-9858A?

(3) Is use of MIL-Q-9858A at the contractor's option?

(4) When used optionally, is MIL-Q-9858A used in whole or in part? If only used partially, are all of the remaining contract requirements being met?

**1.2 Contractual Intent.** This specification requires the establishment of a quality program by the contractor to assure compliance with the requirements of the contract. The program and procedures used to implement this specification shall be developed by the contractor. The quality program, including procedures, processes and product shall be documented and shall be subject to review by the Government Representative. The quality program is subject to the disapproval of the Government Representative whenever the contractor's procedures do not accomplish their objectives. The Government, at its option, may furnish written notice of the acceptability of the contractor's quality program.

**A. REVIEW OF REQUIREMENT.** MIL-Q-9858A requires contractors to design and use a complete quality program. The program must be designed to assure adequate controls throughout all areas of contract performance; e.g., development, manufacturing and shipping. The quality program is not acceptable unless all necessary procedures are available and complete when needed. All or any part of a contractor's quality program may be disapproved by the Government when the program does not accomplish its objectives. In some cases the Government may furnish written notice of the acceptability of the quality program.

**B. APPLICATION.** A complete quality program is often the most comprehensive and extensive activity of a contractor. Because the program is dynamic and must be documented throughout, substantial amounts of documentation result. The individual instructions and the records for each job document a quality program. Although also necessary, directions

for preparing instructions and records do not document a program.

In describing the functions to be performed, contractors document the procedures and instructions that apply. Production documentation, for example, frequently takes the form of job operations sheets, routing forms, tote tickets, shop travelers, inspection method sheets and test procedures. For other functions, purchasing manuals, engineering handbooks and similar forms of instruction may be used.

Records are another form of required documentation. Inspection and test records, laboratory analyses, shipping records, records of the effective dates of engineering changes and records of engineering approval are examples of some records used.

Nonconforming products will be disapproved at any time. In addition, when contractors' procedures are unsatisfactory, a DoD activity will disapprove part or all of the quality program and immediately notify the contractor of such action. Conversely, when a DoD activity elects to advise a contractor that his quality program is acceptable, a letter similar to the following shall be used:

"Government representatives of the Department of Defense on \_\_\_\_\_  
(date)  
reviewed the quality program employed by your firm at \_\_\_\_\_  
(describe the location)  
on the production of \_\_\_\_\_  
(type of product)  
\_\_\_\_\_. On the basis of that review the aforesaid quality program appears to be acceptable.

"This evaluation does not relieve you in any way from continuing to comply with the requirements of MIL-Q-9858A and the contract.

"This notice does not signify a preference for or endorsement of your product by the Department of Defense and shall not be so used in advertisements or other publicity. Nevertheless, you may publicize the fact that your quality program for such product has been adjudged by the

Department of Defense as conforming with MIL-Q-9858A.

"Acknowledgement of this communication is requested."

### C. CRITERIA FOR EVALUATION.

(1) Does the contractor have a quality program which assures compliance with the requirements of the contract?

(2) Is the program documented and is such documentation available for Government review?

1.3 Summary. An effective and economical quality program, planned and developed in consonance with the contractor's other administrative and technical programs, is required by this specification. Design of the program shall be based upon consideration of the technical and manufacturing aspects of production and related engineering design and materials. The program shall assure adequate quality throughout all areas of contract performance; for example, design, development, fabrication, processing, assembly, inspection, test, maintenance, packaging, shipping, storage and site installation.

All supplies and services under the contract, whether manufactured or performed within the contractor's plant or at any other source, shall be controlled at all points necessary to assure conformance to contractual requirements. The program shall provide for the prevention and ready detection of discrepancies and for timely and positive corrective action. The contractor shall make objective evidence of quality conformance readily available to the Government Representative. Instructions and records for quality must be controlled.

The authority and responsibility of those in charge of the design, production, testing, and inspection of quality shall be clearly stated. The program shall facilitate determinations of the effects of quality deficiencies and quality costs on price. Facilities and standards such as drawings, engineering changes, measuring equipment and the like which are necessary for the creation of the required quality shall be effectively managed. The

program shall include an effective control of purchased materials and subcontracted work. Manufacturing, fabrication and assembly work conducted within the contractor's plant shall be controlled completely. The quality program shall also include effective execution of responsibilities shared jointly with the Government or related to Government functions, such as control of Government property and Government source inspection.

**A./B. REVIEW AND APPLICATION OF REQUIREMENT.** Contractors generally recognize that most functions of management affect product quality in some manner and to some degree, and that it is essential to identify, and to assign responsibility for, inter-related quality activities. Among the characteristics of an effective quality program are delegation of authority, responsibility and accountability for decisions affecting quality in a clear and precise manner which assures the proper functioning of the quality program.

Contractors also recognize that the quality programs must be responsive to changing needs. Accordingly, contractors ordinarily provide for the continuous acquisition of current data on the status of quality.

Some contractors require early reporting of properly identified quality failures. Such failures are priced using appropriate cost records to emphasize their cost. Many contractors attempt to balance the cost of failures with the cost of control, shifting effort and resources as necessary to achieve optimum results. The cost of preventive actions usually is much less than the cost of failures and after-the-fact corrective action.

Close collaboration and coordination with DoD contract and administrative personnel is a mark of successful DoD suppliers. This cooperation properly extends to subcontractors and vendors.

**C. CRITERIA FOR EVALUATION.** Since this is a summary, no criteria for evaluation are necessary.

1.4 Relation to Other Contract Requirements. This specification and any procedure or document executed in im-

plementation thereof, shall be in addition to and not in derogation of other contract requirements. The quality program requirements set forth in this specification shall be satisfied in addition to all detail requirements contained in the statement of work or in other parts of the contract. The contractor is responsible for compliance with all provisions of the contract and for furnishing specified supplies and services which meet all the requirements of the contract. If any inconsistency exists between the contract schedule or its general provisions and this specification, the contract schedule and the general provisions shall control. The contractor's quality program shall be planned and used in a manner to support reliability effectively.

**A. REVIEW OF REQUIREMENT.** The requirements of MIL-Q-9858A are not intended to cancel or conflict with any other requirements of a contract. Thus, MIL-Q-9858A does not relieve a contractor of any of his contractual responsibility. If there is an apparent conflict between the requirements of the contract and MIL-Q-9858A, the contract requirements shall prevail.

Reliability is often an important contract requirement. The quality program must support the achievement of required reliability by assuring that material is manufactured as designed by a manufacturing process which does not detract from the reliability designed into the product.

**B. APPLICATION.** Contractors usually review with care all of the technical requirements of a contract to make certain that all are effectively covered by their quality programs. Though many requirements may be standard from contract to contract and from specification to specification and can be dealt with by a standard response, most contractors insist on a total and thorough review because special or new contract clauses relating to quality (reliability, maintainability, incentives, etc.) may be included. Even in follow-on contracts for supplies previously furnished, contractors may find specifications requiring compliance to new or different requirements.

Contracts for complex supplies frequently reference many component parts specifica-

tions, and specifications for such characteristics as reliability, maintainability or interchangeability—all of which are elements of, or affect, quality. When contracts and specifications contain reliability requirements, contractors design their quality program to measure and assure compliance. Many suppliers combine their reliability and quality efforts. They often integrate reliability testing, instructions, records and similar reliability aspects into the quality program.

### C. CRITERIA FOR EVALUATION

(1) Does MIL-Q-9858A conflict with any of the other requirements of the contract, or are any features of the quality program superseded by other specifications?

(2) Is the quality program adequately planned to support reliability requirements?

---

1.5 Relation to MIL-I-45208. This specification contains requirements in excess of those in specification MIL-I-45208, Inspection System Requirements, inasmuch as total conformance to contract requirements is obtained best by controlling work operations, manufacturing processes as well as inspections and tests.

**A./B. REVIEW AND APPLICATION OF REQUIREMENT.** This handbook is not directly related to the requirements established in MIL-I-45208A and discussed in H-51, "Evaluation of a Contractor's Inspection System." However, specifications MIL-Q-9858A and MIL-I-45208A and their respective handbooks are complementary. The Government wants contractors to have effective yet economical programs for quality and inspection. Therefore, both MIL-I-45208A and MIL-Q-9858A were developed simultaneously to permit the use of the former, less comprehensive specification whenever appropriate.

Again it is emphasized that MIL-Q-9858A applies to complex services or supplies, where effective control of quality demands control of work operations, this is, where control of inspection and testing only is not sufficient.

### C. CRITERIA FOR EVALUATION

(1) Since this paragraph of MIL-Q-9858A does not contain requirements, no evaluation is necessary.

#### 2. SUPERSEDING, SUPPLEMENTATION AND ORDERING

2.1 Applicable Documents. The following documents of the issue in effect on date of the solicitation form a part of this specification to the extent specified herein.

##### SPECIFICATIONS

###### MILITARY

MIL-I-45208 —Inspection System Requirements  
MIL-C-45662 —Calibration System Requirements

2.2 Amendments and Revisions. Whenever this specification is amended or revised subsequent to its contractually effective date, the contractor may follow or authorize his subcontractors to follow the amended or revised document provided no increase in price or fee is required. The contractor shall not be required to follow the amended or revised document except as a change in contract. If the contractor elects to follow the amended or revised document, he shall notify the Contracting Officer in writing of this election. When the contractor elects to follow the provisions of an amendment or revision, he must follow them in full.

2.3 Ordering Government Documents. Copies of specifications, standards and drawings required by contractors in connection with specific procurements may be obtained from the procuring agency, or as otherwise directed by the Contracting Officer.

The above paragraphs of MIL-Q-9858A are self-explanatory and do not require elaboration.

#### 3. QUALITY PROGRAM MANAGEMENT

3.1 Organization. Effective management for quality shall be clearly prescribed by the contractor. Personnel performing quality functions shall have sufficient, well-defined responsibility, authority and the organizational freedom

to identify and evaluate quality problems and to initiate, recommend or provide solutions. Management regularly shall review the status and adequacy of the quality program. The term "quality program requirements" as used herein identifies the collective requirements of this specification. It does not mean that the fulfillment of the requirements of this specification is the responsibility of any single contractor's organization, function or person.

**A. REVIEW OF REQUIREMENT.** To establish a quality program which fulfills the requirements of MIL-Q-9858A, contractors must identify the functions and activities that directly affect quality and assign specific authority and responsibility for these functions. The assignment is made in terms of decisions and actions to identified elements at all levels of the organization. The mere preparation of organization charts or handbooks is not enough.

MIL-Q-9858A explicitly requires contractors to satisfy certain quality program requirements, but does not specify an organizational arrangement of any kind for meeting these requirements.

**B. APPLICATION.** Although practically all contractors now have quality control and/or inspection departments which are focal points for quality matters, these departments cannot satisfy all of the quality program requirements of MIL-Q-9858A. Many other departments of a contractor's organization contribute to the quality efforts. Their actions, together with those of the quality and/or inspection departments, constitute the quality programs to which MIL-Q-9858A applies. These facts, however, do not preclude assignment of responsibility for coordination and management of the implementation of MIL-Q-9858A to a particular organizational component (e.g., Quality Control Department).

### C. CRITERIA FOR EVALUATION

(1) Does the established program identify the organizational element responsible for each of the various quality efforts?

(2) Do the personnel performing the quality functions have sufficient authority, responsibility, and freedom of action to identify and evaluate quality problems and initiate, recommend, or provide solutions?

(3) Does management regularly review the status and adequacy of the quality program?

**3.2 Initial Quality Planning.** The contractor, during the earliest practical phase of contract performance, shall conduct a complete review of the requirements of the contract to identify and make timely provision for the special controls, processes, test equipments, fixtures, tooling and skills required for assuring product quality. This initial planning will recognize the need and provide for research, when necessary, to update inspection and testing techniques, instrumentation and correlation of inspection and test results with manufacturing methods and processes. This planning will also provide appropriate review and action to assure compatibility of manufacturing, inspection, testing and documentation.

**A. REVIEW OF REQUIREMENT.** Initial quality planning should take place as early as possible, preferably prior to the start of contract performance. The contractor's quality program is not complete unless it is planned and developed in conjunction with all other functions such as research and development, production, engineering, and subcontracting.

One of the main objectives of initial planning is to identify any special or unusual requirements. When such requirements are found, there is frequently a need for study, planning and programming to provide appropriate operations, processes, and techniques. The planning must be timely and provide for operational review to assure compatibility between the quality program requirements and affected manufacturing operations, processes and techniques.

**B. APPLICATION.** There have been instances of late completion and overruns on contracts because of unforeseen problems arising from requirements with which contractors were unfamiliar. Sometimes military requirements

are so advanced that the chances of success depend greatly on the use and adaptation of recent "breakthroughs" in technology. Failure to recognize and plan for such requirements endangers timely and successful performance of the contract.

It is important, therefore, for contractors to review requirements to identify needs for advanced technology in design, engineering, testing, inspection and manufacturing. Such a review should take place at the earliest possible time.

A review for unique requirements entails a complete examination of all contract requirements, including work statements, exhibits, references and the like. The object is to identify those requirements that are unusual by reason of newness, unfamiliarity, lack of experience, or absence of precedents. What is common and ordinary in one industry may be unusual in another. Old familiar products and processes may be adapted to new, unknown applications. Ordinary applications may take on new aspects because of use in new environments. For instance, the use of paper as a material might present new problems to the textile industry. Ceramic cylinder inserts in aluminum engine blocks may create unusual design, foundry, manufacturing, testing and servicing problems for an established engine manufacturer.

As each new special requirement is identified, the means for testing and proving successful compliance with the unique requirement must be considered. Existing inspection practices often are not adequate. For example, if the use of a laser or maser was necessary for compliance with a technical requirement, research might be needed to devise effective tests for the optical and electronic functions involved.

Solutions to the problems of unique requirements are often unusual. The integration of these unusual new functions into the quality program must be carefully planned so that they are compatible. For instance, metrology and calibration systems need to be flexible enough to include many diverse manufacturing and testing requirements, particularly for aerospace applications.

### C. CRITERIA FOR EVALUATION

(1) Does the contractor conduct a complete review to identify and provide for special or unusual contract requirements?

(2) Does the contractor perform initial quality planning as early as possible?

(3) Does planning require the research needed for developing all the advanced or new testing and inspection techniques required?

(4) Has action been taken to make the controls for special requirements compatible throughout manufacturing, inspection and testing?

**3.3 Work Instructions.** The quality program shall assure that all work affecting quality (including such things as purchasing, handling, machining, assembling, fabricating, processing, inspection, testing, modification, installation, and any other treatment of product, facilities, standards or equipment from the ordering of materials to dispatch of shipments) shall be prescribed in clear and complete documented instructions of a type appropriate to the circumstances. Such instructions shall provide the criteria for performing the work functions and they shall be compatible with acceptance criteria for workmanship. The instructions are intended also to serve for supervising, inspecting and managing work. The preparation and maintenance of and compliance with work instructions shall be monitored as a function of the quality program.

**A. REVIEW OF REQUIREMENT.** Documented work instructions are necessary for work which affects product quality. Instructions must be clear, concise and appropriate to the nature of the work and the circumstances under which the work is to be done. The instructions also must establish quantitative or qualitative means for determining that each work operation has been done satisfactorily. These quantitative or qualitative criteria must also be suitable for use with related inspections or tests, because work instructions serve operating personnel, supervisors, inspectors, managers, and in some instances, customers.

The contractor is required to review and assure compliance with his prescribed work instructions.

**B. APPLICATION.** Work instructions have different names in different plants and sometimes even in different departments of the same plant. Among the names used are Production Control Books, Production Control Releases, Job Tickets, Manufacturing Control Sheets and Work Tickets. Regardless of name, each job operation is usually identified with a number that is one of a sequence indicating previous and subsequent work operations. The instructions ordinarily tell how a job will be done, the order in which actions are accomplished, set-up information, speeds and feeds, associated drawings and specifications, and other pertinent information.

The work of many departments affect quality. For example, inferior packaging can lead to damage during transportation. Thus, shipping department work affects quality. Stock rooms also affect quality by issuance of the correct bars, rods, and shapes in the proper alloy of steel, aluminum or other metal. Technical writing is a work operation that has an impact on quality. Though there are many and diverse work operations, only a small number of them constitute inspection or testing. All work operations affecting quality must be covered by effective work instructions.

It is of prime importance that the events that make possible the fabrication of a product follow a systematic, unvarying sequence of work operations. For this reason, work instructions are necessary, regardless of whether a contractor's facilities and organization are considered "small" or "large." Of course, for large enterprises documented work instructions are an absolute necessity for communication purposes because of the large number of people involved. However, smaller organizations have no less need for appropriately documented work instructions to assure exact product replication.

Work instructions must be kept current and complete. The problems involved in controlling drawing use in the shop are also

encountered in controlling work instructions. At times work is attempted using drawings alone without work instructions. Sometimes changes are developed on the shop floor and not entered in the instructions. At other times an attempt is made to use an unsuitable general instruction on new work operations. Often, changes in machines, tools, work locations or conditions are not reflected properly in the work instructions.

Dimensions and tolerances are quantitative criteria for a work operation and are usually specified in a work instruction by reference to a drawing. Comparison standards such as surface finish blocks, color cards, cloth swatches, macrographs or sectioned samples often serve as the qualitative criteria provided in work instructions. Often a qualitative work standard is nothing more than a written description.

Just as drawings are used by designers, engineers, customers, machine operators and many others, so work instructions are used by inspectors, supervisors and managers, as well as by production personnel. Supervisors or others responsible for quality improvement often find in the work instructions manufacturing details that need to be changed. Whenever a drawing is changed, a work instruction change is likely; on the other hand, many work instruction changes do not require drawing changes.

Since work instructions are so numerous and varied, have such wide use, and are subject to much change, it is necessary that contractors continually review work instruction systems to assure that they provide accurate, complete instructions and require worker compliance.

### C. CRITERIA FOR EVALUATION

(1) Are documented work instructions available and used for all work operations which affect quality?

(2) Are such work instructions complete and appropriate?

(3) Are standards available for each work operation?

(4) Are work instructions compatible with associated inspection and testing?

(5) Do supervisors, managers and inspectors make proper use of work instruction?

(6) Are work instructions reviewed on a systematic basis for accuracy, completeness and worker compliance?

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3.4 Records. The contractor shall maintain and use any records or data essential to the economical and effective operation of his quality program. These records shall be available for review by the Government Representative and copies of individual records shall be furnished him upon request. Records are considered one of the principal forms of objective evidence of quality. The quality program shall assure that records are complete and reliable. Inspection and testing records shall, as a minimum, indicate the nature of the observations together with the number of observations made and the number and type of deficiencies found. Also, records for monitoring work performance and for inspection and testing shall indicate the acceptability of work or products and the action taken in connection with deficiencies. The quality program shall provide for the analysis and use of records as a basis for management action.

**A. REVIEW OF REQUIREMENT.** The contractor is responsible for controlling and assuring quality and for providing objective evidence that this control and assurance do, in fact, exist. The essentiality of proper record keeping to contractor quality programs cannot be overemphasized; thus the requirement in MIL-Q-9858A for complete and reliable records wherever essential to an effective and economical quality program.

It is the responsibility of the Government to review a contractor's records to the extent necessary to assure compliance with quality program requirements. This review ordinarily consists of the following actions: (a) checking the contractor's record keeping policies, systems, and procedures, (b) inventory of the contractor's record forms, (c) evaluation of specific records for currency, completeness, accuracy and pertinency, and (d) verification of the records by means of independent examinations (e.g., inspection

and tests) of products and appropriate calibration of test and measuring equipment.

As a minimum, inspection and test records must indicate the number of type of deficiencies found, the actions taken concerning them, and the nature and number of observations made. In addition, these records should indicate the percentage of items passing inspection or test and the quantities of acceptable and rejected items.

Records must be made of work accomplished, compliance or noncompliance with work instructions, and of actions taken to remedy noncompliance.

The design, maintenance and use of records should be accomplished in a systematic manner to assure that the records can be readily analyzed to indicate the state of the over-all quality program. Management decisions must reflect the use and analysis of these records.

**B. APPLICATION.** Records of subcontractor quality assurance programs, of engineering approvals, of customer returns and cost records pertinent to acceptance of nonconforming materials are examples of the records required for an effective quality program.

Government Representatives ordinarily review and use records at the places where the contractor keeps them. If tests records are maintained in a laboratory office, for example, the Government should expect to use them there. Similarly, microfilmed records should be examined at the film storage site, if viewers are available. As for copies of records, the Government should not request them routinely, but only when needed for a definite purpose.

Financial audits are used to verify the accuracy and completeness of fiscal records, and assure their validity as a basis for financial management. Quality management can obtain the same assurance by carefully validating the records used to make decisions, report achievements and identify problems. Contractor inspection alone does not suffice. The Government also needs to sample contractor record keeping practices.

It is conceivable that a minimum of record keeping might suffice—with automated in-

spection, for instance. A coordinated system of record keeping should reduce recording activity substantially. Information may be recorded on individual forms that supplement one another, or information may be combined on a minimum of forms containing the optimum amount of related information.

To establish and maintain a satisfactory quality program, the results of many kinds of work operations must be recorded. For instance, the adjustment set points on a speed governor, or the amount or volume of material added to a manufacturing process, may need to be recorded. Frequently, logbook records for complicated assembly operations, such as those used in the manufacture of aircraft, guidance systems, or engines, must contain a complete record of the inspection of each assembly operation. Where the same worker is responsible for a variety of dissimilar work operations, inspecting and recording his compliance with work instructions often is necessary to properly protect quality.

The value of any failure or rejection record is increased tremendously if it can help prevent repetition of the same error which caused the defects. Such prevention is best achieved by having the failure record show (1) the cause of the error, (2) how the error was corrected and (3) the action necessary to prevent a recurrence. Many factories record such information on job tickets and rejection tags.

It is difficult to consolidate individual item logbook data into a record which permits a broad scale judgment of the quality of whole groups of a specific item. For instance, the logbook record tells very completely the quality of one engine, vehicle or aircraft. However, it is very difficult to tell from logbooks the prevalent quality of a whole year's production of engines, vehicles or aircraft. Because few contractors manage production and quality control on a one-item-at-a-time basis, it is necessary to collate, tabulate, and consolidate all similar or identical quality or deficiency information. From this properly organized and consolidated data a supervisor or manager can evaluate the general quality of precisely identified aspects of the



product and its individual parts. This consolidation is facilitated if the records and reports pertinent to a product are indexed by company part number.

Many producers allocate resources and concentrate corrective efforts on the basis of part number tabulation reports. Management frequently follows a practice of concentrated supervisory action to improve the quality of the most deficient parts, processes or departments in each month. Specialists from design, production and industrial engineering may be assigned to concentrate on improving the quality of these specific areas of deficiency. Management by intuition, rather than by analysis of tabulated records, is not acceptable.

### C. CRITERIA FOR EVALUATION

- (1) Are there records of all essential activities?
- (2) Are records available to Government personnel, and furnished when required?
- (3) Are there effective means for assuring the currency, completeness and accuracy of records?
- (4) Do inspection records include only the number and kind of defectives? Is other essential data recorded? How and where?
- (5) Do inspection records and work instruction compliance records indicate the quantitative degree of acceptance or rejection of product of work effort?
- (6) If rejection is recorded, do records show resulting action?
- (7) Do management actions reflect the analyses and use of records?

3.5 Corrective Action. The quality program shall detect promptly and correct assignable conditions adverse to quality. Design, purchasing, manufacturing, testing or other operations which could result in or have resulted in defective supplies, services, facilities, technical data, standards or other elements of contract performance which could create excessive losses or costs must be identified and changed as a result of the quality program. Corrective action will extend to the performance of all suppliers and

vendors and will be responsive to data and product forwarded from users. Corrective action shall include as a minimum:

- (a) Analysis of data and examination of product scrapped or reworked to determine extent and causes;
- (b) Analysis of trends in processes or performance of work to prevent nonconforming product; and
- (c) Introduction of required improvements and corrections, an initial review of the adequacy of such measures and monitoring of the effectiveness of corrective action taken.

**A. REVIEW OF REQUIREMENT.** Prompt, effective corrective action is essential to a quality program. Segregating defective material from acceptable material is not enough; the cause of the defects must be found and corrected. Occasionally the cause of infrequent or non-repetitive defects cannot be determined and the only action possible is to reject the defective items.

Incorrect ways of working or noncompliance with work instructions are frequent causes of defects. Sometimes inferior design is the cause. As need dictates, correction requires (a) changing unsatisfactory work methods and designs, or (b) enforcing compliance with satisfactory work methods and designs.

It is imperative that the contractor make effective use of all data regarding defects, whether the data comes from using activities or is generated by his own operation. Data from users may concern defects caused by the prime contractor or by his suppliers. In either case, the contractor is responsible for assuring that corrective action is taken.

**B. APPLICATION.** Many contractors have specific methods for detecting and correcting defects. They attempt to detect defective material as early as possible to save the cost of further spoiled material and wasted work. In addition, the desire to maximize production efficiency motivates manufacturers to establish effective methods for rapidly determining and correcting the causes of recurrent defects.

First piece inspection, inspection by machine operators and other production line workers, inspection after each work operation or a small group of work operations, roving inspectors and many other inspection arrangements are used by contractors to determine recurring defects. Sometimes statistical in-process control methods are used to indicate or predict the need for correction of defects. Rejection tags and stamps are devices commonly used to identify products needing corrective action and to initiate such action.

Once defects are found, contractors normally use the services of the responsible manufacturing or design personnel to determine and correct the cause. Engineering, production control, purchasing, or any other function found to have caused the defect is charged with the responsibility for devising and implementing corrective measures. The interests of both the contractor and the Government demand close attention to the effectiveness of corrective actions. Likewise, both the contractor and the Government must monitor "fixes" carefully to be certain of their continued effectiveness. Records of specific recurring defects are essential to the diagnosis of the causes of defects and removal of these causes by corrective action.

Although the major focus of attention in quality program activities is on "hardware", or the output of production lines, other areas which require close attention are processes, methods and manufacturing facilities which may be substandard and inefficient. Deficiencies in these potential sources of difficulty should be corrected before they cause defects in the "hardware".

Since most contractors depend to some extent on subcontractors and vendors for raw materials, parts, and subassemblies applicable to their products, they extend quality assurance to suppliers. Where a contractor finds items or services of the suppliers to be defective, he is responsible to see that corrective action is taken, even to the extent of changing his supplier.

### C. CRITERIA FOR EVALUATION

- (1) Does the program provide for prompt detection of inferior quality and for correction of its assignable causes?
- (2) Is adequate action taken to correct the causes of defects in products and facilities? In functions, e.g., design, purchasing, testing?
- (3) Are analyses made to identify trends towards product deficiencies?
- (4) Is corrective action taken to arrest unfavorable trends before deficiencies occur?
- (5) Does corrective action extend to suppliers' products?
- (6) Is corrective action taken in response to user data?
- (7) Are data analysis and product examination conducted on scrap or rework to determine extent and causes of defects?
- (8) When corrections are made, is their effectiveness reviewed and are they monitored later?

3.6 Costs Related to Quality. The contractor shall maintain and use quality cost data as a management element of the quality program. These data shall serve the purpose of identifying the cost of both the prevention and correction of nonconforming supplies (e.g., labor and material involved in material spoilage caused by defective work, correction of defective work and for quality control exercised by the contractor at subcontractor's or vendor's facilities). The specific quality cost data to be maintained and used will be determined by the contractor. These data shall, on request, be identified and made available for "on site" review by the Government Representative.

**A. REVIEW OF REQUIREMENT.** The purpose of recording and maintaining cost information related to quality is to facilitate sound decision making by contractors regarding their quality programs. The contractor determines the cost data needed and how it is recorded and used.

The cost of preventing and correcting defects is a significant part of total quality costs. Cost data is highly useful in assessing the effectiveness of manufacturing, inspec-

tion and other types of work operations, such as the recording of quality data. Cost information concerning engineering changes, price adjustments for defective material, re-inspection of defective material and similar costs also are useful in managing quality programs.

Contractors will make cost data available for "on site" review by the Government QA Representative when requested. "Make available" means the cost data will be shown, not given. "On site" means that the Government QA Representative examines the data on the spot. He does not make copies nor does he carry the data away nor reveal it to anyone else. The sole purpose of the examination of such data by the QA Representative is to assure that such data are being used in managing the quality program.

**B. APPLICATION.** Procedures for recording quality program costs range from the very simple to the highly complex. In the past, measurement of such costs has not been the subject of intensive study by either the Government or industry; however, many contractors in recent years have designed and implemented highly efficient systems for measuring and controlling quality program costs.

Effective implementation of paragraph 3.6 of MIL-Q-9858A in the interest of both industry and the Government is to a decisive degree a function of the initiative and alertness of management in adopting new techniques for quality costing as these techniques appear increasingly in the literature of the quality assurance field.

#### **C. CRITERIA FOR EVALUATION**

- (1) Has the contractor determined the specific quality cost data that he needs?
- (2) Are the data (in (1)) being collected?
- (3) Do the data identify the cost of prevention or correction of defects, or both?
- (4) Are the cost data used in managing quality?
- (5) Are cost data available for "on site" review by the Government QA Representative?

#### **4. FACILITIES AND STANDARDS**

**4.1 Drawings, Documentation and Changes.** A procedure shall be maintained that concerns itself with the adequacy, the completeness and the currentness of drawings and with the control of changes in design. With respect to the currentness of drawings and changes, the contractor shall assure that requirements for the effectivity point of changes are met and that obsolete drawings and change requirements are removed from all points of issue and use. Some means of recording the effective points shall be employed and be available to the Government.

With respect to design drawings and design specifications, a procedure shall be maintained that shall provide for the evaluation of their engineering adequacy and an evaluation of the adequacy of proposed changes. The evaluation shall encompass both the adequacy in relation to standard engineering and design practices and the adequacy with respect to the design and purpose of the product to which the drawing relates.

With respect to supplemental specifications, process instructions, production engineering instructions, industrial engineering instructions and work instructions relating to a particular design, the contractor shall be responsible for a review of their adequacy, currentness and completeness. The quality program must provide complete coverage of all information necessary to produce an article in complete conformity with requirements of the design.

The quality program shall assure that there is complete compliance with contract requirements for proposing, approving, and effecting of engineering changes. The quality program shall provide for monitoring effectively compliance with contractual engineering changes requiring approval by Government design authority. The quality program shall provide for monitoring effectively the drawing changes of lesser importance not requiring approval by Government design authorities.

Delivery of correct drawings and change information to the Government

in connection with data acquisition shall be an integral part of the quality program. This includes full compliance with contract requirements concerning rights and data both proprietary and other. The quality program's responsibility for drawings and changes extend to the drawings and changes provided by the subcontractors and vendors for the contract.

**A. REVIEW OF REQUIREMENT.** Paragraph 4.1 requires that a contractor's quality program assure current, complete engineering documentation. Approved drawing changes must be initiated at the time scheduled in appropriate orders. Obsolete drawings must be removed from all locations where they mistakenly could be used. The initiation of drawing changes and removal of obsolete drawings must be recorded by the contractor and these records must be available to the Government.

The engineering adequacy of the designs delineated and defined in drawings, specifications and change documentation shall be subject to a verification procedure. Engineering adequacy may be judged in two principal ways. First, the content of the drawing, specification or change order can be checked for compliance with sound application of the engineering practices involved. Second, the content of the engineering documentation can be checked for design validity relative to the specific item and its application.

Other quality-related documentation exists besides drawings, specifications, and change orders and notices. All such supplementary or complementary documentation must be provided on request—none is so unimportant that it may be ignored. Such documents also must be complete, current and adequate. Among the various types of work covered by the supplementary documents are fabrication, service, inspection, tests, preservation, packaging, identification and the like. Supplementary documentation is referred to by many titles, such as "process instructions," "production engineering instructions," "industrial engineering instructions," "work instructions," and "job tickets."

Different types and classes of changes require approval by different authorities. Some changes must be approved by Government authorities who are not resident in the plant. Others require only the approval of on-site Government authorities. Contractors may need to approve certain changes made by their suppliers, that is, vendors or subcontractors. The contractor must establish an acceptable method for processing Class I change proposals and approvals. In addition, arrangements should be made with the appropriate local Government representative to assure his review of all Class II Changes to assure proper classification. Finally, the contractor must develop requirements for his suppliers to satisfy in controlling changes to purchased material.

The quality program should assure contractor compliance with the Government's contract requirements for the acquisition of drawings or other data. Compliance with delivery schedules for required data is particularly important. The contractor is responsible for arranging with his suppliers for the acquisition of all data necessary to fulfill the contract.

**B. APPLICATION.** The control of engineering changes and of drawings is so closely related that many manufacturers combine both in a single operation. Production control requires many documents which supplement drawings, such as process specifications, job orders, work orders and in-plant procedures for accomplishing work.

Ordinarily, the format, dimensional and tolerance accuracy and the degree of design disclosure of drawings are controlled by drawing checkers and supervisors who review the work of the draftsmen. The drafting department frequently is responsible for establishing precise tolerances on drawings since project engineers frequently specify only a general tolerance.

Drawings normally are used in engineering departments, production control departments, purchasing departments and in such shop floor areas as machining, fabrication and assembly. Assurance that everyone is using correct and current drawings can best

be obtained by using procedures which provide for immediate recall of obsolete drawings and issuance of revised or new ones.

Even more important than having the correct drawing in the right place at the proper time is having drawings that are up to standard: drawings that contain the correct delineation, tolerances, and notes that are essential for manufacturing acceptable parts or items. Each drawing must convey a complete design, suitable in all respects for the specific object depicted and its particular purpose. Since design engineers are subject to human failings and have varying capabilities, many contractors provide checks and balances to assure design adequacy from each engineer or designer creating drawings. Frequently, supervisory engineers review the work of project engineers to make certain that drawings are accurate and of sufficiently high quality to give a workable and satisfactory design. Accurate drawings are of paramount importance to effective design and manufacturing efforts.

Production control department engineers and technicians prepare many of the supplemental instructions necessary for manufacture. Checks and balances similar to the aforementioned are used to assure quality work by the personnel who prepare supplemental instructions.

Other departments, for example the company laboratory and metallurgical department, may furnish additional supplements to drawings, such as notes calling out protective coatings or heat treatments. Normally, the work from all such sources should be reviewed to assure its completeness and accuracy.

In some firms, engineering changes are processed by departments other than those responsible for initiating and implementing the changes. In other firms, engineering changes are processed by the group responsible for the original design. Frequently major and minor types of engineering changes are handled by different groups. Regardless of the department held responsible, it is imperative that all engineering changes be adequately controlled.

For DoD work the Government requires prior approval of some or all engineering changes. The extent to which the Government will control each type of engineering change is specified in the contract. Any contractor's change control system must satisfy the Government's change approval requirements.

Contractors usually assign to one particular organization the responsibility for on-time delivery of the drawings and other technical data required by the contract. In some companies this is handled by a technical documentation or publications department; in others, by the engineering department; in others, the contractor order department; and in yet others, by a contract compliance department.

Drawings are one of a contractor's most valuable assets. Therefore, most contractors take appropriate steps to safeguard their rights in engineering data. In recognition of these facts, Government policy is to acquire rights to only those drawings whose acquisition is provided for contractually. Contractors also must adhere to contract provisions for the delivery of data. Contractors should assure that all supplementary documents, such as a company's own work instructions and specifications for special processing, are retained or disclosed strictly in accordance with the contract. At the outset of contract negotiations, it should be determined to what extent the contract calls for such supplementary data.

### C. CRITERIA FOR EVALUATION.

- (1) Is there a procedure for assuring the engineering adequacy of drawings?
- (2) Is there a procedure to insure currentness and completeness of drawings?
- (3) Has all the supplemental documentation necessary to produce articles in conformance with design been provided?
- (4) Does the program assure compliance with contract requirements for proposing, approving and implementing engineering changes?

(5) Is there appropriate monitoring of changes requiring approval by "off-site" Government design authorities?

(6) Is there appropriate monitoring of changes requiring approval by local "on-site" Government authorities?

(7) Is there appropriate monitoring by the contractor of all changes not requiring Government approval?

(8) Does the program clearly delineate and cover the contractor's responsibility for controlling and recording design and other changes originating with suppliers?

(9) Does the contractor monitor all supplier changes which require his approval?

(10) Does the program assure "on-time" delivery of the data prescribed by the contract?

(11) Is there complete contract compliance concerning rights in data?

(12) Does the program adequately cover the contractor's responsibility for providing required rights in data covering items that originate with his suppliers?

#### 4.2 Measuring and Testing Equipment.

The contractor shall provide and maintain gages and other measuring and testing devices necessary to assure that supplies conform to technical requirements. These devices shall be calibrated against certified measurement standards which have known valid relationships to national standards at established periods to assure continued accuracy. The objective is to assure that inspection and test equipment is adjusted, replaced or repaired before it becomes inaccurate. The calibration of measuring and testing equipment shall be in conformity with military specification MIL-C-45662. In addition, the contractor shall insure the use of only such subcontractor and vendor sources that depend upon calibration systems which effectively control the accuracy of measuring and testing equipment.

**A. REVIEW OF REQUIREMENT.** Gages and other measuring and test devices which can assess the quality, performance, dimensions and other technical requirements of products

are an essential element of the quality program specified by MIL-Q-9858A. These devices must be inspected and calibrated on a regularly scheduled basis to prevent inaccuracies or at least to detect them as early as possible. Such devices often need to be repaired, replaced, or calibrated. The inspection and calibration practices covering measuring and testing equipment are prescribed in detail in specification MIL-C-45662A. MIL-Q-9858A requires compliance with this specification.

In selecting suppliers, the contractor must give preference to those that systematically and effectively control the accuracy of the test and measuring equipment required in the performance of their contracts.

**B. APPLICATION.** Most contractors recognize the necessity of carefully and continually checking test and inspection equipment to assure that the necessary degree of accuracy is being maintained. A comprehensive calibration system, such as that required by MIL-C-45662A, is necessary. The system should assure the direct or indirect traceability of contractor calibration standards through an unbroken chain of calibrations to the National Reference Standards. The frequency of calibration is determined on the basis of the type, purpose, usage rate and degree of accuracy of the equipment involved. Contractor and Government personnel may obtain additional information about specification MIL-C-45662A in handbook MIL-HDBK-52.

Gage identification is also extremely important. In addition to numbering every gage, color codes, labels and the like are frequently employed to give a quick visual indication of the gage's accuracy and the date this accuracy was last verified.

To effectively control this equipment, contractors should establish such things as gage-wear policies and keep accurate records on each piece of equipment. Obsolete or inaccurate equipment should be carefully segregated or discarded to prevent its use. When employee-owned testing and measuring equipment is used, it often is serviced by the

contractor's calibration system to assess and maintain its accuracy.

The limits of accuracy required for modern weaponry often are so narrow that contractors must calibrate testing and measuring equipment under controlled environmental conditions, usually at established calibration laboratories. Both industry and Government standards exist which describe the conditions to be maintained in these controlled laboratories.

### C. CRITERIA FOR EVALUATION.

(1) Are the gages, testing and measuring equipment necessary to assure that products meet technical requirements available and used?

(2) Is this test and measuring equipment properly maintained?

(3) Are these devices inspected on a regular basis to determine that they are of the required accuracy?

(4) Is there continuous control of these devices to prevent their use when they become inaccurate, and to correct, repair or replace them?

(5) Does the program comply with MIL-C-45662A, "Calibration System Requirements"?

(6) Are the required certified measurement standards available and used?

(7) Is the certification of these standards traceable to the National Bureau of Standards that are recognized as absolute by the National Bureau of Standards?

(8) Does the contractor require his suppliers to have a system which assures the accuracy of their test and measuring equipment?

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4.3 Production Tooling Used as Media of Inspection. When production jigs, fixtures, tooling masters, templates, patterns and such other devices are used as media of inspection, they shall be proved for accuracy prior to release for use. These devices shall be proved again for accuracy at intervals formally established in a manner to cause their timely adjustment, replacement or repair prior to becoming inaccurate.

**A./B. REVIEW AND APPLICATION OF REQUIREMENT.** Sometimes contractors elect to use production tooling for inspection and gaging. In such cases, they should take special precautions to assure accuracy. This involves both proof of accuracy before release for use as well as checking at regular, formally established intervals thereafter to prevent inaccuracy. Some equipment used for special manufacturing operations contains automatic gaging controls which are considered a part of a contractor's product quality control system.

The aforementioned practices are acceptable if carefully controlled and monitored to assure continued accuracy.

### C. CRITERIA FOR EVALUATION.

(1) Is all tooling which is used as inspection equipment proved for accuracy prior to use?

(2) Is such tooling re-inspected at intervals established in a manner which assures the adjustment, replacement or repair of the tooling before it becomes inaccurate?

4.4 Use of Contractor's Inspection Equipment. The contractor's gages, measuring and testing devices shall be made available for use by the Government when required to determine conformance with contract requirements. If conditions warrant, contractor's personnel shall be made available for operation of such devices and for verification of their accuracy and condition.

**A. REVIEW OF REQUIREMENT.** The contractor is responsible for manufacturing acceptable products. To prove product acceptability, the contractor must have the capability, both in personnel and equipment, to measure, test and inspect. For technical and economic reasons, it frequently is desirable for Government and contractor personnel to jointly use contractor inspection equipment. Therefore, the contractor shall permit the Government to use such equipment, or to witness contractor use of this equipment, to verify inspection accuracy and product quality. However, if required, the contractor must supply operators for inspection equipment being used exclusively for Government verification.

**B. APPLICATION.** The Government normally does not provide its inspectors in the field with gages or measuring and testing devices. The more complex test equipment is so expensive or requires such special facilities that it would be highly uneconomical for the Government to provide it at all contractors' plants. Therefore, contractors make their testing and measuring equipment available to the Government. Sometimes it is necessary to have contractor personnel operate the more specialized equipment for required Government inspections.

In some instances Government use of contractor testing and measuring equipment proves to be a "bottle-neck" to production operations. Therefore, most contractors plan for the Government's use of their equipment and allow sufficient time and provide sufficient equipment so that any joint use does not delay production.

Many contractors choose to protect the performance of their complex and specialized equipment by offering to operate it for the Government. In some cases, however, the manner of operating such testing equipment can give false results. Under these conditions the Government QA Representative may wish to operate the equipment himself. When this occurs, the contractor may wish to instruct the Government QA Representative in the operation of the more specialized testing and measuring equipment.

Contractors rightfully expect Government QA Representatives to avoid unnecessary production delays because of Government inspection and testing. Thus Government QA Representatives sometimes accomplish their inspection by witnessing a company inspection rather than conducting a separate one. However, this is not always required and often is not practical or desirable.

**C. CRITERIA FOR EVALUATION.**

(1) Does the contractor make his inspection equipment or facilities available to the Government QA Representative for verification of the contractor's results?

(2) Does the contractor provide personnel to perform this inspection, if warranted?

4.5 Advanced Metrology Requirements. The quality program shall include timely identification and report to the Contracting Officer of any precision measurement need exceeding the known state of the art.

**A. REVIEW OF REQUIREMENT.** New and unprecedented military requirements may involve "breakthroughs" in technology. Sometimes it is possible to manufacture correctly functioning hardware without being able to make all of the necessary measurements. However, contractors are still obligated to make all of the measurements required by their contract. If the contractor finds he cannot do this because of a lack of technical know-how, equipment or other resources, he must advise his Contracting Officer at the earliest opportunity.

**B. APPLICATION.** In producing today's modern weapon systems contractors may be faced with precision measurement requirements beyond their ability to perform. Normally contractors attempt to meet such requirements by acquiring additional measuring capability.

However, contracts may require measurement capability that is beyond the state-of-the-art. Contractors who have their own precision measurement capability usually are familiar with the latest advances in metrology and quickly recognize, and question, any demand for such high orders of measurement. Conversely, producers who depend primarily on outside sources for precision measurements usually do not recognize excessive requirements as quickly. Regardless of knowledge and capability, however, every contractor is responsible for meeting stated contract measurement requirements. Therefore, if any contractual measurement requirement appears to be unrealistic or in advance of the state-of-the-art, contractors should press for a waiver or change of the measurement requirement.

Some contractors consider a measurement requirement to be in advance of the state-of-the-art only if not known to the science of measurement; other consider a requirement excessive if it cannot be met by industry. Uncertainties about any measurement re-



quirement should be cleared up before completion of negotiations and signing a contract. However, it is not always practicable. In any event, such problems should be resolved as soon as possible after they are recognized.

### C. CRITERIA FOR EVALUATION.

(1) Has the contractor reviewed the request for proposal or contract to determine whether or not there are any unusual precision measurement requirements?

(2) Has the contractor notified the Contracting Officer of his inability to perform any required precision measurement?

### 5. CONTROL OF PURCHASES

5.1 Responsibility. The contractor is responsible for assuring that all supplies and services procured from his suppliers (subcontractors and vendors) conform to the contract requirements. The selection of sources and the nature and extent of control exercised by the contractor shall be dependent upon the type of supplies, his supplier's demonstrated capability to perform, and the quality evidence made available. To assure an adequate and economical control of such material, the contractor shall utilize to the fullest extent objective evidence of quality furnished by his suppliers. When the Government elects to perform inspection at a supplier's plant, such inspection shall not be used by contractors as evidence of effective control of quality by such suppliers. The inclusion of a product on the Qualified Products List only signifies that at one time the manufacturer made a product which met specification requirements. It does not relieve the contractor of his responsibility for furnishing supplies that meet all specification requirements or for the performance of specified inspections and tests for such material. The effectiveness and integrity of the control of quality by his suppliers shall be assessed and reviewed by the contractor at intervals consistent with the complexity and quantity of product. Inspection of products upon delivery to the contractor shall be used for assessment and review to the extent necessary for adequate assurance of quality. Test re-

ports, inspection records, certificates and other suitable evidence relating to the supplier's control of quality should be used in the contractor's assessment and review. The contractor's responsibility for the control of purchases includes the establishment of a procedure for (1) the selection of qualified suppliers, (2) the transmission of applicable design and quality requirements in the Government contracts and associated technical requirements, (3) the evaluation of the adequacy of procured items, and (4) effective provisions for early information feedback and correction of nonconformances.

**A. REVIEW OF REQUIREMENT.** It is not enough for a contractor to control the quality of parts which he makes in his own plant. He also is required by MIL-Q-9858A to assure control of the quality of parts furnished by his suppliers. Thus a contractor should choose subcontractors and vendors who can maintain adequate quality. Furthermore, a contractor must develop and use effective methods for communicating applicable Government requirements to his suppliers.

There are many ways to assure quality in purchased products. Selecting suppliers with a reputation for quality is a good start. Inspection at the supplier's plant, receiving inspection, examination of supplier test and inspection records and a variety of other techniques are used by contractors to select suppliers and assure control of their quality. Of course, contractor effort alone is inadequate—suppliers also must possess the motivation, knowledge, and capability to control quality.

For economic and technical reasons it is essential that contractors make full use of supplier inspection records and test reports as well as all other kinds of accurate quality data. This data must be used for demonstrating that suppliers adequately control quality. Definite documented procedures also must be issued and maintained.

Contractors must not depend upon Government inspection at their suppliers' plants; instead, they must generate their own knowledge and control of supplier quality. How

often a contractor will assess a supplier's quality control depends upon the nature and volume of his purchases from that supplier. In addition, to the degree necessary and possible, receiving inspection should be used to determine the quality of purchases. Further, contractors should establish criteria or standards for qualifying suppliers and avoid suppliers who do not meet the qualifications. Of course, the best evidence of supplier quality comes from the contractor's continuing evaluation of the hardware and services delivered to him by his sources. Any deficiencies which become known to the contractor should be made known immediately to his suppliers and corrected by them.

**B. APPLICATION.** The completeness with which a contractor controls his purchases determines in large measure the success of this phase of his quality program. For instance, even purchases for research and development usually are rigidly controlled by the purchasing system and subjected to appropriate laboratory analyses and suitable receiving inspections.

Contractors following accepted business practices already comply to a great extent with Paragraph 5 of MIL-Q-9858A. In choosing their suppliers, contractors follow the same practice that the Government follows in choosing between qualified competitors: they award the business to the lowest responsible bidder.

Various methods are used by contractors to assure adequate supplier control of quality. A few of the most frequently used are:

- (a) Contractor evaluation of supplier past performance for the type of purchases involved (vendor rating).
- (b) Contractor inspection at subcontractors' and vendors' plants.
- (c) Review of suppliers' test and inspection records.
- (d) Receiving inspection of suppliers' products.

Subcontracts and purchase orders of many contractors require suppliers to maintain quality records such as inspection and test results. The contractor also may require information about inspections and tests made

by the supplier during manufacturing—actions which the contractor cannot duplicate. Often the contractor will require delivery of such records along with the material they cover. When such records accompany shipments, the contractor knows more about the quality of his purchases. He can use this knowledge to advantage in calculating how much his receiving inspection and laboratory testing can be reduced without impairing quality.

An open, active, comprehensive flow of quality information from supplier to contractor can significantly reduce a contractor's costs. Suppliers who provide such information should have a distinct competitive advantage over suppliers who do not.

Contractors increasingly recognize that they must not depend on Government inspection at subcontractors and vendors. Since they alone are responsible for assuring suppliers' quality, no purpose is served by involving the Government in subcontractor or vendor inspection.

It is the DoD policy to refrain from entering directly into the quality and inspection aspects of contractor-supplier relationships. Neither contractor nor supplier should expect the DoD to take responsibility for establishing any aspect of their quality relationships. Contractor surveys of suppliers are a prime example of a relationship which does not directly involve DoD quality assurance functions.

In defense industries, the relationships between contractors and suppliers consist mainly of practices intended to meet the objectives and requirements of the contractors' contract with DoD. The form of these practices ordinarily is not specified. For instance, MIL-Q-9858A requires a contractor to review the suitability of each supplier's quality efforts, but does not specify the details of the review. The contractor may choose to use liaison inspectors at a supplier's plant as a review method. He may decide that surveys are more appropriate. Independent laboratory inspection may be his choice. Some contractors prefer disassembly and teardown audit inspections. These prac-

tices usually are coupled with a review of each supplier's quality program and inspection system documentation. Regardless, and even though the manner of review is unspecified, the review itself is a mandatory requirement.

Contractors sometimes fail to carry out their responsibility for qualified products. If a supplier is producing an item which requires qualification testing and listing on a Qualified Products List (QPL), the contractor is responsible for assuring that the supplier meets all of these requirements. Other forms of qualification also must be properly covered by the purchasing system. Preproduction testing, reliability life testing, aircraft engine part substantiation testing, and a variety of other special qualifications are examples of contractor responsibilities which must be met through appropriate control of purchases.

Receiving inspection is an essential element of a complete purchasing system. However, technology and economy usually limit the extent of such inspection. Receiving inspection can be minimized by obtaining optimum control of quality at the source. Receiving inspection should complement and supplement source quality control, rather than ignore or duplicate it unnecessarily.

### C. CRITERIA FOR EVALUATION.

(1) Does the program assure that products and services furnished by suppliers meet contract requirements?

(2) Does the program provide for the selection of suppliers on the basis of their ability to perform satisfactorily as well as evidence of their capability to produce quality products?

(3) Is objective quality evidence provided by the supplier and is it used to assure effective and economical control of quality?

(4) Does the contractor refrain from using Government source inspection for control of his suppliers?

(5) Does the contractor review his suppliers' quality efforts at intervals consistent

with the complexity and quality of the product?

(6) Does the contractor have complete and effective control of all qualified products, including those of his suppliers?

(7) Does the program provide for sufficient receiving inspection of all supplies and services furnished to the contractor?

(8) Are there adequate procedures for source selection?

(9) Are there adequate procedures for communicating requirements to suppliers?

(10) Are there adequate procedures for evaluating the quality of deliveries?

(11) Are there adequate procedures for providing suppliers with appropriate data regarding unsatisfactory quality?

(12) Are there adequate procedures for assuring that suppliers correct all nonconformances?

5.2 Purchasing Data. The contractor's quality program shall not be acceptable to the Government unless the contractor requires of his subcontractors a quality effort achieving control of the quality of the services and supplies which they provide. The contractor shall assure that all applicable requirements are properly included or referenced in all purchase orders for products ultimately to apply on a Government contract. The purchase order shall contain a complete description of the supplies ordered including, by statement or reference, all applicable requirements for manufacturing, inspecting, testing, packaging, and any requirements for Government or contractor inspections, qualification or approvals. Technical requirements of the following nature must be included by statement or reference as a part of the required clear description: all pertinent drawings, engineering change orders, specifications (including inspection system or quality program requirements), reliability, safety, weight, or other special requirements, unusual test or inspection procedures or equipment and any special revision or model identification. The description of products ordered shall include a requirement for contractor in-

pection at the subcontractor or vendor source when such action is necessary to assure that the contractor's quality program effectively implements the contractor's responsibility for complete assurance of product quality. Requirements shall be included for chemical and physical testing and recording in connection with the purchase of raw materials by his suppliers. The purchase orders must also contain a requirement for such suppliers to notify and obtain approval from the contractor of changes in design of the products. Necessary instructions should be provided when provision is made for direct shipment from the subcontractor to Government activities.

**A. REVIEW OF REQUIREMENT. MIL-Q-9858A** states that a contractor's quality program is not complete, therefore not acceptable, unless it requires suppliers to have effective control of quality. Suppliers usually devise whatever systems they wish. Sometimes, however, suppliers must design their systems to meet specific contractor requirements.

The Government does not directly specify technical requirements for a contractor's suppliers, but may do so indirectly through specifications in the prime contract which apply to items whether produced by the contractor or his suppliers. Contractors must include such contractual and technical requirements in the subcontracts and purchase orders given to their suppliers. Other information often is needed, and sometimes may be provided by using standard reference documents and standard contract clauses. In addition to drawings, specifications, engineering change identifications and testing requirements, less common requirements such as those for quality control procedures and inspections at the supplier's plant often must be included in subcontracts and purchase orders. A requirement for contractor approval before making significant design changes must be included, as should any special shipping instructions covering direct delivery by the supplier to the Government.

**B. APPLICATION. MIL-Q-9858A and MIL-I-45208A** require contractors to have effective control of product quality. Those specifica-

tions, H-51 and this handbook are the vehicles for informing contractor and Government personnel of the over-all Government requirements for quality. However, the specifications and handbooks are of little use if a contract does not include all of the design, manufacturing and testing requirements for the specific product involved. Both the general rules for quality and the specific quality characteristics of the product are essential for Government purchasing from contractors and contractor purchasing from suppliers.

The purchaser should tell the seller exactly what he wishes to buy; that is, the quality characteristics, dimensions, design, materials, performance and all other technical features of the product being purchased. Ordinarily, the purchase order and accompanying drawings do this. Sometimes, however, the technical requirements are better known by the seller, and the purchaser wishes to obtain them along with the product, if feasible.

In any case, contractor purchasing control must provide the complete technical detail required to assure the correct manufacture and proper performance of every item purchased.

Many contractors include standard clauses ("boiler plate" or "fine print") on the bottom or reverse side of their purchase order forms. Sometimes standard flyers or even supplements several pages in length are added to each purchase order. These standard clauses in essence are the contractor's general rules for suppliers. They do not vary appreciably from item to item or order to order.

Most contractors use either standard clauses or a separate purchase order entry to tell their suppliers what type of quality program, inspection system or inspection is required. For standard commercial items few if any of the specific requirements of MIL-Q-9858A or MIL-I-45208A are included in the purchase order. Nevertheless, the contractor is responsible for the quality and suitability of all purchases incorporated into products he sells to the Government. Though his knowledge of vendor effective-

ness may be small and difficult to obtain, the contractor's responsibility is undiminished.

For some purchases, the DoD requires the contractor to include on the purchase order a requirement for Government subcontract inspection. Government QA Representatives indicate when such action is necessary and how it shall be done. However, since routine DoD subcontract inspection is no longer authorized, careful cooperation between contractor and Government QA Representatives is more necessary than ever for efficient operation of the contractor's purchasing system. For example, it is highly desirable for Government QA Representatives to advise the contractor in detail about any Government subcontract inspection plans as early in the procurement process as possible, so that the contractor can adjust his purchasing activities accordingly.

Sometimes purchasing control breaks down because a contractor fails to provide his supplier with adequate requirements for the selection and testing of the raw materials used to make the purchased products. This occurs more frequently with vendor than with subcontractor items.

Several classes of changes can apply to purchased material. Generally, any major change in the design or material of a purchased item is not permitted without the contractor's approval. Insignificant changes not affecting form, fit or function may be permitted without prior approval, but only under certain conditions, and almost always subject to the contractor's review. Regardless, all contractual requirements for the control of changes must be followed exactly.

### C. CRITERIA FOR EVALUATION.

(1) Does the contractor require his suppliers to have effective control of product quality?

(2) Do the contractors' purchasing documents contain all of an item's specific design, manufacturing and testing requirements?

(3) Do purchasing documents also contain all other routine and special requirements, e.g., routine manufacturing, inspecting, test-

ing and packaging requirements; or quality system, direct shipment or other such special requirements?

(4) Do purchasing documents provide for prime contractor and/or Government source inspection when appropriate?

(5) Are requirements for necessary tests and inspections of raw materials specified in purchasing documents?

(6) Is complete and appropriate control of design changes required of all suppliers?

(7) Are the necessary instructions provided for any required direct shipments from subcontractors' or vendors' plants to the Government?

### 6. MANUFACTURING CONTROL

6.1 Materials and Materials Control. Supplier's materials and products shall be subjected to inspection upon receipt to the extent necessary to assure conformance to technical requirements. Receiving inspection may be adjusted upon the basis of the quality assurance program exercised by suppliers. Evidence of the suppliers' satisfactory control of quality may be used to adjust the amount and kind of receiving inspection.

The quality program shall assure that raw materials to be used in fabrication or processing of products conform to the applicable physical, chemical, and other technical requirements. Laboratory testing shall be employed as necessary. Suppliers shall be required by the contractors' quality program to exercise equivalent control of the raw materials utilized in the production of the parts and items which they supply to the contractor. Raw material awaiting testing must be separately identified or segregated from already tested and approved material but can be released for initial production, providing that identification and control is maintained. Material tested and approved must be kept identified until such time as its identity is necessarily obliterated by processing. Controls will be established to prevent the inadvertent use of material failing to pass tests.

**A. REVIEW OF REQUIREMENT.** Contractor receiving inspection is considered essential for

effective control of the quality of purchased supplies. However, the amount and extent of receiving inspection varies. If a supplier has effective quality control, the contractor can safely reduce his receiving inspection. It should be apparent, however, that a contractor's knowledge of supplier quality stems primarily from proven performance and the records the supplier furnishes.

Raw material quality must be adequately controlled, frequently by acceptance testing in the laboratory. Tested and approved materials must not be mixed with untested or rejected materials. Methods for identifying tested, approved material and untested or disapproved material, plus effective controls for keeping them separated, are required and must extend as far as possible into the production sequence.

**B. APPLICATION.** Though contractor assembly or processing of some incoming items automatically provides at least a partial inspection, many contractors have receiving departments which directly and routinely inspect incoming material. The extent, of course, to which this is done depends on the availability of inspection equipment and personnel as well as on the degree to which an incoming product has been assembled.

A basic prerequisite of efficient receiving inspection is complete identification of each incoming item plus full knowledge of the requirements for the item, its quality history and its intended use. Thus, receiving departments usually have complete copies of all purchase orders and pertinent specifications. In addition, most inspectors have ready access to contractor and Government libraries and to files of industry and military specifications and standards. Copies of pertinent drawings often are located in receiving departments or can be requisitioned by these departments.

Supplier test results accompanying each shipment can permit contractors to substitute sample testing for 100% testing. The better a contractor's knowledge of supplier inspection systems or quality programs, the more accurate his adjustments of receiving inspection. The use of traveling inspectors

who check the inspection activity of suppliers can help contractors establish economical and effective control of the quality of incoming material.

Contractors usually detect flaws in raw materials by appropriate laboratory tests. Because the mechanical properties and composition of metals, the chemical composition of fluids, and the physical and chemical properties of a host of other raw materials usually cannot be determined once manufacturing or processing begins, most contractors analyze and test raw materials as soon as possible after receipt.

An important responsibility of contractors is the identification and segregation of material. Identifying stocks of raw material and keeping untested, uninspected material separate from that already tested must be done very carefully—the inadvertent release to production of wrong or defective raw material can be disastrous.

#### C. CRITERIA FOR EVALUATION.

- (1) Does the contractor inspect suppliers' material to the extent necessary upon receipt?
- (2) Does the contractor adjust the extent of receiving inspection on the basis of objective data?
- (3) Does the contractor assure that raw materials conform to the applicable physical, chemical and other technical requirements, using laboratory analyses as necessary?
- (4) Does the contractor require his suppliers to exercise an equivalent control of raw materials ((3) above)?
- (5) Are tested, approved raw materials identified and carefully segregated from those not tested or approved?
- (6) Does the contractor have effective controls for preventing the use of nonconforming raw materials?

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6.2 Production Processing and Fabrication. The contractor's quality program must assure that all machining, wiring, batching, shaping and all basic production operations of any type together with all processing and fabricating of any type is accomplished under controlled

conditions. Controlled conditions include documented work instructions, adequate production equipment, and any special working environment. Documented work instructions are considered to be the criteria for much of the production, processing and fabrication work. These instructions are the criteria for acceptable or unacceptable "workmanship". The quality program will effectively monitor the issuance of and compliance with all of these work instructions.

Physical examination, measurement or tests of the material or products processed is necessary for each work operation and must also be conducted under controlled conditions. If physical inspection of processed material is impossible or disadvantageous, indirect control by monitoring processing methods, equipment and personnel shall be provided. Both physical inspection and process monitoring shall be provided when control is inadequate without both, or when contract or specification requires both.

Inspection and monitoring of processed material or products shall be accomplished in any suitable systematic manner selected by the contractor. Methods of inspection and monitoring shall be corrected any time their unsuitability with reasonable evidence is demonstrated. Adherence to selected methods for inspection and monitoring shall be complete and continuous. Corrective measures shall be taken when noncompliance occurs.

Inspection by machine operators, automated inspection gages, moving line or lot sampling, setup or first piece approval, production line inspection station, inspection or test department, roving inspectors—any other type of inspection—shall be employed in any combination desired by the contractor which will adequately and efficiently protect product quality and the integrity of processing.

Criteria for approval and rejection shall be provided for all inspection of product and monitoring of methods, equipment, and personnel. Means for identifying approved and rejected product shall be provided.

Certain chemical, metallurgical, biological, sonic, electronic, and radiological

processes are of so complex and specialized a nature that much more than the ordinary detailing of work documentation is required. In effect, such processing may require an entire work specification as contrasted with the normal work operation instructions established in normal plant-wide standard production control issuances such as job operation routing books and the like. For these special processes, the contractors' quality program shall assure that the process control procedures or specifications are adequate and that processing environments and the certifying, inspection, authorization and monitoring of such processes to the special degree necessary for these ultraprecise and supercomplex work functions are provided.

**A. REVIEW OF REQUIREMENT.** As part of a contractor's quality program, production and manufacturing operations must be systematically controlled and documented in appropriate work instructions. Only the manner of doing the work specified in these instructions, without deviation, is acceptable. As drawings indicate the configuration, dimensions and special processes to be applied to work, other forms of work instructions establish the level of workmanship required. Systematic, controlled inspection is usually required for each work operation. The result of several work operations may be inspected at one time, if desired, after the work is completed.

When direct inspection of operations is impractical, equipment settings, operator performance and other conditions of manufacture are evaluated instead. Sometimes both direct and indirect inspection of work operations are required for technical or contractual reasons.

The manner of conducting inspections is at the option of the contractor unless a specific procedure is required by the contract either directly or by reference to specifications and standards. When an optional inspection method proves inaccurate or ineffective, it must be corrected.

Contractors should establish criteria for judging the effectiveness of their inspection efforts. This is often more difficult for proc-

ess inspection than for product inspection—nevertheless, it is required for both.

Highly complex or precise manufacturing processes ordinarily cannot be controlled by the usual sheet or card type work instruction. Comprehensive specifications must be prepared for such processes. A book-type specification often is needed to provide all the detailed instructions required to assure the success of special manufacturing processes, including effective inspection of the output. A contractor's quality program must provide the detailed data and tight control needed to implement these special processes satisfactorily.

**B. APPLICATION.** Producers of complex products are generally aware that production control must be highly disciplined to be effective. Omission of any operations or processes from control invites inferior quality. Ineffective, incomplete or intermittent control is almost as bad and usually leads to costly and unnecessary defects. Men, machines, materials and methods all require disciplined control. Most contractors recognize this fact and apply it to all of their production.

Adequate communication is indispensable to effective control. Contractors must tell production personnel exactly what is required of them. The contractor should communicate "what is needed," usually by means of drawings and specifications. "How to do it" must also be communicated, ordinarily through the medium of work instructions which contain more detailed information than drawings or specifications.

Many manufacturers include a variety of detailed information in work instructions. These usually are designed and issued by a production control department. A systematic approach is used in instructions to tell "how" to do the work. Machines, tools, rates, speeds and feeds, and the sequence of operations to be used are stated. Essential environmental conditions, such as cleanliness, temperature and humidity, and safety precautions and other pertinent features of the work also are specified.

Achievement of a single product characteristic may require many work operations.

For instance, degreasing, chemical cleaning, surface treatment, priming, and painting may all be necessary to achieve a desired painted surface. Work control in such a case calls for detailed instructions for operation and checking of every stage and type of work necessary to prepare and paint the item.

Even so-called basic work operations may be prone to defects. For example, in chemical cleaning, too short an immersion time may leave parts dirty, while too long a time can cause corrosion or erosion damage. In priming and painting, coverage can be spotty, with "holidays" or paint furrowing or "tear-dropping." Work instructions usually should include descriptions or references to samples of adequate and inadequate work, so that workers know what is acceptable and unacceptable. Blindly following prescribed instructions is not enough to guarantee acceptable results. The results must be examined critically and compared with satisfactory standard samples. Fortunately, this approach is almost universal in American industry; mass production has made it an economic necessity.

Other parts of this handbook discuss the monitoring and control applied to the work of design engineers and engineering change authorities to assure satisfactory, high quality engineering. Similarly, control and review is required of the activities of production or industrial engineers and their assistants who prepare work instructions.

The work involved in inspection is as important as that involved with manufacturing. Most manufacturing inspections are carried out in the producer's plant. Usually, contractors conduct inspections as soon as possible after each production operation in order to keep defective material from continuing on through the production process. This prevents the needless waste of expending labor and material on items which are already defective.

Sometimes direct inspection of hardware is impractical; or is inadequate without an inspection of the work operations and processes used to manufacture the hardware. For example, inspections of both the welding



process and the welded product often are necessary to assure that the product is of adequate quality. Similarly, it may be necessary to inspect the potting of an electronic component as well as the final potted product.

Some processes and work operations are highly complex. Heat treatment, chemical milling and x-ray inspection are good examples. Such processes may require detailed book-type specifications rather than one- or two-page work instructions. Many producers have well-organized systems for the preparation, issuance, and enforcement of such instructions. The instructions often are included as standard references in purchase orders placed with suppliers.

### C. CRITERIA FOR EVALUATION.

- (1) Are all production processes accomplished under controlled conditions?
- (2) Does control include documented work instructions, adequate production equipment, and appropriate working environments?
- (3) Do the work instructions provide criteria for determining whether production, processing and fabrication work is acceptable or unacceptable?
- (4) Does the quality program monitor both the issuance of work instructions and compliance with them?
- (5) Are physical examinations, measurements or tests of materials and products provided for each work operation?
- (6) When direct inspection of material is not advisable, does the program provide for indirect control by the inspection of processes?
- (7) Are both physical and process inspections used when either alone is inadequate, or when required by the contract?
- (8) Is the inspection and monitoring of processed material accomplished systematically?
- (9) Are unsuitable inspection or monitoring methods corrected promptly?
- (10) Is conformance with documented inspection methods complete and continuous,

and are corrective measures taken when non-compliance occurs?

- (11) Are approval and rejection criteria provided for all inspections and monitoring actions?
- (12) Are approved and rejected products properly identified?
- (13) For highly specialized and complex processes, does the quality program assure that appropriate, more detailed work instructions are provided?
- (14) Does the quality program assure provision of the proper processing environment, as well as the necessary degree of certification, inspection, authorization and monitoring, for such specialized and complex processes?

6.3 Completed Item Inspection and Testing. The quality program shall assure that there is a system for final inspection and test of completed products. Such testing shall provide a measure of the overall quality of the completed product and shall be performed so that it simulates, to a sufficient degree, product end use and functioning. Such simulation frequently involves appropriate life and endurance tests and qualification testing. Final inspection and testing shall provide for reporting to designers any unusual difficulties, deficiencies or questionable conditions. When modifications, repairs or replacements are required after final inspection or testing, there shall be reinspection and retesting of any characteristics affected.

**A. REVIEW OF REQUIREMENT.** Even though inspections are made throughout the manufacturing process, Paragraph 6.3 requires final inspection and testing of completed items to give an over-all measure of each item's conformance to end product specifications. Sufficiently thorough testing must be done to assure that completed products will perform as intended during use. Life, environment, endurance, use and qualification tests may be required. Deficiencies or deviations from established design requirements shall be reported. When any inspected item is reworked, repaired or modified, it must be reinspected or retested.

**B. APPLICATION.** Many contractors attempt to design tests to simulate conditions of intended use of the product. Frequently, great effort is expended to make test environments similar to those expected to be encountered in use. One type of test that may approximate actual end use is endurance or life testing. This type of testing is intended to indicate whether a product which demonstrates satisfactory performance when new is likely to do so after prolonged use. Life testing generally is destructive and is therefore applied only to small samples.

Many problems are encountered in trying to simulate conditions encountered in actual use for testing purposes. Even when properly done, such testing may be very expensive. Inadequate testing, however, is more expensive: thus many contractors employ their best engineering and design talent for the planning of simulative tests. Many producers find that failure mode analysis is helpful in planning or improving final tests.

Contractors usually find that final testing is a useful source of information for improving both manufacturing methods and products.

#### **C. CRITERIA FOR EVALUATION.**

(1) Are completed items given a final inspection and test which indicates over-all quality?

(2) Does the final testing adequately simulate performance in use?

(3) Are inspection and test problems or deficiencies promptly reported to designers?

(4) Is there reinspection and retest of all items which are reworked, repaired, or modified, after initial end product testing?

6.4 Handling, Storage and Delivery. The quality program shall provide for adequate work and inspection instructions for handling, storage, preservation, packaging, and shipping to protect the quality of products and prevent damage, loss, deterioration, degradation, or substitution of products. With respect to handling, the quality program shall require and monitor the use of procedures to prevent handling damage to articles.

Handling procedures of this type include the use of special crates, boxes, containers, transportation vehicles and any other facilities for materials handling. Means shall be provided for any necessary protection against deterioration or damage to products in storage. Periodic inspection for the prevention and results of such deterioration or damage shall be provided. Products subject to deterioration or corrosion during fabrication or interim storage shall be cleaned and preserved by methods which will protect against such deterioration or corrosion. When necessary, packaging designing and packaging shall include means for accommodating and maintaining critical environments within packages, e.g., moisture content levels, gas pressures. The quality program shall assure that when such packaging environments must be maintained, packages are labeled to indicate this condition. The quality program shall monitor shipping work to assure that products shipped are accompanied with required shipping and technical documents and that compliance with Interstate Commerce Commission rules and other applicable shipping regulations is effected to assure safe arrival and identification at destination. In compliance with contractual requirements, the quality program shall include monitoring provisions for protection of the quality of products during transit.

**A. REVIEW OF REQUIREMENT.** Documented work instructions are necessary for both the operation and the inspection of the shipping function. The material handling aspect of shipping requires monitored work instructions. Methods used to clean, preserve, and protect items must be compatible with the intended use of the items, yet protect the items against damage or deterioration in storage. Special requirements, such as a controlled storage environment, must also be carefully devised, maintained, and monitored to assure full protection of quality. Labeling which clearly indicates special handling and storage requirements is imperative. Loading practices must conform with the requirements of common carriers and with specified Government (e.g., Interstate Commerce Commission,

U. S. Post Office) or industry regulations. Contractual requirements for the identification and movement of shipments must be met. The contractor's quality program must establish effective practices for protecting quality during shipping and must monitor compliance. In addition, all handling, storage, and delivery requirements must be covered by documented work instructions.

**B. APPLICATION.** Control of supplies during handling, storage, and delivery is an important aspect of satisfactory quality programs. Manufacturers and users of products which are subject to damage and deterioration when improperly handled and stored carefully plan their preservation, packaging, packing and storage efforts. They conduct regularly scheduled inspections of all stored material. In many cases, the date of manufacture or receipt of the material is marked on incoming materials so that they can be used in order of receipt and thus spend minimum time in storage.

Shipping and storage control departments usually develop documented work and inspection instructions for handling, storing, preserving, packaging, packing, marking, and shipping materials to prevent damage, loss, deterioration, substitution, degradation, or any other quality defects.

### C. CRITERIA FOR EVALUATION.

(1) Are adequate work and inspection instructions prepared and implemented for the handling, storage and delivery of material?

(2) Are handling, storage and delivery procedures monitored in accordance with established quality program requirements?

(3) Are there procedures and regular schedules for the inspection of products in storage, and are these procedures adequate to prevent deterioration or damage?

(4) Is there a procedure to assure that items which can deteriorate or corrode during fabrication or interim storage are properly cleaned and preserved?

(5) Are all required critical environments maintained within packaging?

(6) Is all material to be stored or shipped properly identified and labeled?

(7) Are all shipments prepared and transported in compliance with contractual requirements and applicable Government and carrier regulations?

(8) Is quality protected and monitored during transit?

**6.5 Nonconforming Material.** The contractor shall establish and maintain an effective and positive system for controlling nonconforming material, including procedures for its identification, segregation, and disposition. Repair or rework of nonconforming material shall be in accordance with documented procedures acceptable to the Government. The acceptance of nonconforming supplies is a prerogative of and shall be as prescribed by the Government and may involve a monetary adjustment. All nonconforming supplies shall be positively identified to prevent unauthorized use, shipment and intermingling with conforming supplies. Holding areas or procedures mutually agreeable to the contractor and the Government Representative shall be provided by the contractor. The contractor shall make known to the Government upon request the data associated with the costs and losses in connection with scrap and with rework necessary to reprocess nonconforming material to make it conform completely.

**A. REVIEW OF REQUIREMENT.** Since most production processes inevitably yield some defective products, methods for preventing further regular processing, completion or delivery of such products are essential and must be established by the contractor. Segregation or disposal of defective products is also necessary. Effective segregation and disposal requires proper identification of the withheld, repaired, or unapproved status of defective products at all times prior to Government inspection approval. Segregation can be achieved by clearly marking defective material and removing it, when appropriate, from the production lines to special holding area. Defective material can be disposed by reworking, repairing or scrapping. The contractor is required to disclose scrapping and

rework costs and losses when requested to do so by the Government.

Sometimes superficially nonconforming items may be accepted by the Government, but always under controlled and prescribed conditions. If the degree of nonconformance is serious, a written waiver or contract change notice is necessary before such material can be accepted. In any situation involving Government acceptance of nonconforming material, the contractor shall follow the procedures prescribed or agreed to by the Government. A price reduction often is required to compensate for the Government's acceptance of items of a quality which does not conform completely to applicable specifications.

**B. APPLICATION.** When seeking Government acceptance of nonconforming material, a contractor must furnish the Government with all pertinent information about the material and its nonconformance so that the Government can render a decision on his request and determine if a price reduction is warranted.

It is generally recognized that the repetitive acceptance of nonconforming material degrades production efficiency. Ordinarily, the Government requires contractors to correct the causes of recurrent defects.

Most contractors voluntarily keep complete and accurate records of nonconforming supplies. Government inspectors responsible for accepting such supplies should insist on complete records. The exact nature and extent of each deficiency, as well as any repair or rework, must be recorded. The contractor and Government personnel responsible for assuring that the acceptance of any nonconforming product meets all contractual and other applicable requirements use such records extensively. The records kept by suppliers are carefully categorized and are referred to in connection with corrective action and future production of the items involved.

To preserve the benefits and prevent the ills caused by the acceptance of nonconforming supplies, most producers carefully analyze acceptance trends and attempt to improve their performance.

For repair or rework of nonconforming

supplies, contractors prepare all necessary work instructions, procedures and drawings. These must be documented to the Government's satisfaction. Welding of a defective casting is an example of a repair requiring appropriate documentation.

When a contract requires the establishment and maintenance of a Material Review Board for decisions regarding disposal of nonconforming supplies, the Government prescribes the composition of the Board and its related procedures. Even when not contractually required, some contractors use a material review committee on their own initiative. In these cases, the procedures used and the membership of the group are decided by the contractor but the Government requires that these procedures be documented.

### C. CRITERIA FOR EVALUATION.

(1) Does the contractor have an effective system for controlling nonconforming material?

(2) Does the contractor properly identify, segregate and dispose of nonconforming material?

(3) Are the procedures for repair and rework of nonconforming material documented and acceptable to the Government?

(4) Are scrap and rework cost and loss data maintained and available to the Government for review?

(5) Do repair and rework activities comply with documented procedures?

(6) Are holding areas adequate for the detention and storage of nonconforming material?

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6.6 Statistical Quality Control and Analysis. In addition to statistical methods required by the contract, statistical planning, analysis, tests and quality control procedures may be utilized whenever such procedures are suitable to maintain the required control of quality. Sampling plans may be used when tests are destructive, or when the records, inherent characteristics of the product or the noncritical application of the product, indicate that a reduction in inspection or testing can be achieved without jeopardizing quality. The contractor may

employ sampling inspection in accordance with applicable military standards and sampling plans (e.g., from MIL-STD-105, MIL-STD-414, or Handbooks H 106, 107 and 108). If the contractor uses other sampling plans, they shall be subject to review by the cognizant Government Representative. Any sampling plan used shall provide valid confidence and quality levels.

**A. REVIEW OF REQUIREMENT.** In addition to any statistical quality control techniques required by a contract, contractors may use such other statistical quality control techniques they wish as long as the techniques assure the required control of quality.

Sampling inspection has proven very useful, especially for destructive testing or for non-critical tests, where a reduction in inspection will not jeopardize required quality. Sometimes the sampling plans used are those contained in military standards or handbooks. Other sampling plans may also be used, but are subject to Government review. However, any sampling technique used must assure required quality with appropriate confidence.

**B. APPLICATION.** Two of the most frequently used types of sampling plans are "attributes sampling" and "variables sampling." Attributes sampling is used to inspect items on a good/no good basis; how good or how bad is not determined. An example of this type of sampling is the use of "go" and "no go" gages. Variables sampling determines how good or bad an item is by making and analyzing actual measurements. This method is used if the nature of the product warrants it. With variables sampling, fewer observations are necessary for a given degree of assurance.

Statistical process control or control sampling is used to determine whether a process is in or out of control. Machine control and heat treating control are examples of this method. Statistical process control procedures permit contractors to determine and analyze the causes of significant variations in manufacturing operations.

Some contractors find it advantageous to design their own sampling plans. Usually a

qualified mathematician or statistician develops such plans to assure that they are valid and effective. The Government must have such assurance; thus MIL-Q-9858A requires that the derivation, confidence level, protection and all other features of contractor-designed sampling be made known to the responsible Government authority upon request.

Prudent contractors guard against two great dangers to effective sampling: inadequate knowledge and improper use. They make certain they know completely the limitation and protection afforded by all sampling plans used. They also enforce to the letter all of the conditions, such as population size, sample randomness, homogeneity, order and ranking, which are required to assure effective sampling.

Contractors often find it difficult to perform sampling in accordance with all required conditions. Sometimes supposed shortcuts are used through ignorance or a false sense of economy. It is most important to note that invalid sampling is worse than cursory inspection because it may indicate a level of product quality which does not exist in fact.

#### C. CRITERIA FOR EVALUATION.

- (1) Are contractor-designed sampling plans available for review by the Government Representative?
- (2) Do contractor-developed sampling plans provide valid confidence and quality levels?
- (3) Does the contractor know the degree of protection afforded by his sampling and does he enforce all of the conditions required for its valid use?

6.7 Indication of Inspection Status. The contractor shall maintain a positive system for identifying the inspection status of products. Identification may be accomplished by means of stamps, tags, routing cards, move tickets, tote box cards or other normal control devices. Such controls shall be of a design distinctly different from Government inspection identification.

**A. REVIEW OF REQUIREMENT.** There must be a positive way of knowing at all times whether a product has (1) not been inspected, (2) been inspected and approved or (3) been inspected and rejected. These conditions can be identified in a variety of ways. In the absence of a contractual requirement, MIL-Q-9858A permits contractors to select any method for indicating inspection status, provided only that it cannot be mistaken for Government identification.

**B. APPLICATION.** Many manufacturers engaged solely in commercial production maintain a system for positive identification of inspection status. When such manufacturers become Government contractors, they need not change their method of identification unless it can be mistaken for that of the Government.

Most contractors prefer inspection stamps to other identification methods, both because of their permanence and because they can be applied directly to products. Material handlers know what to do with parts by the presence or absence of inspection stamps and, of course, by the nature of the stamp. Stamping also simplifies required part segregation.

In addition to showing inspection status, stamps are sometimes used to indicate completion of a work operation or process, or a requirement for special handling. Examples are stamps indicating the completion of heat treatment, or stamps assigning a part to the Material Review Board for action.

Some contractors find serially numbered stamps assigned on an individual basis useful in achieving better quality control because they identify each inspector's work. Other suppliers do not. The DoD no longer makes general use of numbered stamps for inspection purposes.

**C. CRITERIA FOR EVALUATION.**

(1) Does the contractor have an effective system for identifying the inspection status of products?

(2) Is the contractor's inspection status identification distinctly different from that of the Government?  
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**7. COORDINATED GOVERNMENT/  
CONTRACTOR ACTIONS**

7.1 Government Inspection at Subcontractor or Vendor Facilities. The Government reserves the right to inspect at source supplies or services not manufactured or performed with the contractor's facility. Government inspection shall not constitute acceptance; nor shall it in any way replace contractor inspection or otherwise relieve the contractor of his responsibility to furnish an acceptable end item. The purpose of this inspection is to assist the Government Representative at the contractor's facility to determine the conformance of supplies or services with contract requirements. Such inspection can only be requested by or under authorization of the Government Representative. When Government inspection is required, the contractor shall add to his purchasing document the following statement:

"Government inspection is required prior to shipment from your plant. Upon receipt of this order, promptly notify the Government Representative who normally services your plant so that appropriate planning for Government inspection can be accomplished."

When, under authorization of the Government Representative, copies of the purchasing document are to be furnished directly by the subcontractor or vendor to the Government Representative at his facility rather than through Government channels, the contractor shall add to his purchasing document a statement substantially as follows:

"On receipt of this order, promptly furnish a copy to the Government Representative who normally services your plant, or, if none, to the nearest Army, Navy, Air Force, or Defense Supply Agency inspection office. In the event the representative or office cannot be located, our purchasing agent should be notified immediately."

All documents and referenced data for purchases applying to a Government contract shall be available for review by the

Government Representative to determine compliance with the requirements for the control of such purchases. Copies of purchasing documents required for Government purposes shall be furnished in accordance with the instructions of the Government Representative. The contractor shall make available to the Government Representative reports of any nonconformance found on Government source inspected supplies and shall (when requested) require the supplier to coordinate with his Government Representative on corrective action.

**A. REVIEW OF REQUIREMENT.** A contractor is solely and exclusively responsible for the quality of all material he delivers to the Government regardless of the source of the product. Therefore, though the Government may conduct inspections at suppliers' plants, the prime contractor's responsibility remains unchanged.

Only the Government Representative can authorize Government inspection at suppliers' facilities. When such inspection is required, MIL-Q-9858A provides appropriate clauses for the contractor to use in his purchase documents.

Contractors must make all purchase orders or subcontracts for materials used in fulfillment of Government contracts available to the Government Representative for review. In addition, reports on any defective Government inspected material received must be made available to the Government Representative.

**B. APPLICATION.** In the past, Government source inspection was routinely designated using lists of items. Recent DoD subcontract inspection policy renders such lists obsolete and forbids routine requests.

Many contractors who have had experience with current DoD policy encourage the Government Representative to request source inspection as early in the purchasing cycle as possible. This gives the Government Representative time to review thoroughly the technical requirements contained in the purchase order. It also permits him to assess the quality history of all material to be source-

inspected. This permits the Government Representative to include the specific characteristics of each item to be inspected on source-inspection requests.

Such reviews assure that the contractor and the Government clearly understand which items will be source-inspected. The reviews also assure that the contractor, his suppliers and the Government Representatives fully understand the purpose, authority and degree of inspection the Government will perform. The extent of Government source-inspection, of course, is limited to that specified in the purchasing documents covering suppliers' items.

#### **C. CRITERIA FOR EVALUATION.**

(1) Do contractor purchasing documents require Government source-inspection of suppliers only when the Government so requests?

(2) Does the contractor use the clauses of Paragraph 7.1 of MIL-Q-9858A in his purchasing documents when source-inspection is required?

(3) Are copies of applicable purchasing documents provided to the Government Representative at suppliers' plants?

#### **7.2 Government Property.**

**7.2.1 Government-furnished Material.** When material is furnished by the Government, the contractor's procedures shall include at least the following:

(a) Examination upon receipt, consistent with practicability to detect damage in transit;

(b) Inspection for completeness and proper type;

(c) Periodic inspection and precautions to assure adequate storage conditions and to guard against damage from handling and deterioration during storage;

(d) Functional testing, either prior to or after installation, or both, as required by contract to determine satisfactory operation;

(e) Identification and protection from improper use or disposition; and

(f) Verification of quantity.

**7.2.2 Damaged Government-furnished Material.** The contractor shall report to the Government Representative any Government-furnished material found damaged, malfunctioning, or otherwise unsuitable for use. In the event of damage or malfunctioning during or after installation, the contractor shall determine and record probable cause and necessity for withholding material from use.

**7.2.3 Bailed Property.** The contractor shall, as required by the terms of the Bailment Agreement, establish procedures for the adequate storage, maintenance and inspection of bailed Government property. Records of all inspections and maintenance performed on bailed property shall be maintained. These procedures and records shall be subject to review by the Government Representative.

**A./B. REVIEW AND APPLICATION OF REQUIREMENT.** "Government Furnished Material"

(GFM) is material owned by the Government and furnished directly to contractors for their use in meeting the requirements of their contracts. This material usually is similar in nature to the material contractors obtain from suppliers; that is, material which is incorporated into the products to be delivered to the Government by the contractor. Production, maintenance or service contracts can include provisions for GFM. Unless otherwise stated, GFM is acceptable as tendered and therefore does not require extensive receiving inspection. However, to avoid using or installing any GFM which is defective because of shipping damage or other reasons, contractors are required to maintain suitable quality control over GFM. This control normally shall include:

(a) Examination of GFM upon receipt to detect any shipping damage. This usually will be limited to visual inspection. In most cases, disassembly or testing is neither required nor desirable.

(b) Inspection to make certain that the GFM is of the correct type and is complete.

(c) Periodic inspection during storage to detect any signs of deterioration; to assure

compliance with reinspection requirements and limitations on time in storage; to assure maintenance of proper conditions; and to determine the current status of the GFM.

(d) Functional testing before or after installation, or both, as required by the contract and applicable specifications. Only qualified personnel may perform such tests.

(e) Appropriate identification and safeguarding of the GFM to prevent any unwarranted use or improper disposal.

(f) Examination to verify the quantity received.

Contractors must report all unsuitable GFM to the authorized Government Representative. If unsuitability is found during or after installation, the contractor must determine the probable cause and determine if it is necessary to avoid use of the material. This information shall be reported to the Government Representative.

Bailed Property refers primarily to equipment provided to the contractor for a special purpose and not for incorporation into deliverable products. Machine tools and production equipment are examples. The appropriate contract clauses or bailment agreement require the contractor to take proper care of such bailed property. The contractor must provide storage facilities and protective measures for bailed property, consistent with its nature, value, and use. At a minimum, the contractor's quality program must assure the following for all bailed property:

(a) Performance of an initial inspection immediately upon receipt, to detect any shipping or other damage and to determine that the equipment is complete and of the proper type,

(b) Maintenance of suitable records of initial and periodic inspection,

(c) Provision of adequate storage facilities and protective measures, and

(d) Maintenance of the property in good repair and condition.

The contractor's quality program procedures for the storage, maintenance, and inspection of bailed property are subject to review by the Government Representative.



**C. CRITERIA FOR EVALUATION.**

(1) Does the contractor examine GFM upon receipt for damage, quantity, completeness, and type?

(2) Are there precautions and inspections during storage against damage and deterioration?

(3) Is functional testing performed before or after installation, or both, as required by the specification or contract?

(4) Is all GFM properly identified and protected from unauthorized use or disposition?

(5) Does the contractor record and report to the Government any damage, malfunction, or deterioration of GFM prior to, during, and after installation?

(6) Does the contractor adequately store and maintain bailed property?

(7) Does the contractor inspect bailed property periodically?

(8) Are records of all inspections and maintenance work on bailed property maintained and available for review by the Government Representative?

**8. NOTES**

(The following information is provided solely for guidance in using this specification. It has no contractual significance.)

8.1 Intended Use. This specification will apply to complex supplies, components, equipments and systems for which the requirements of MIL-I-45208 are inadequate to provide needed quality assurance. In such cases, total conformance to contract requirements cannot be obtained effectively and economically solely by controlling inspection and testing. Therefore, it is essential to control work operations and manufacturing processes as well as inspections and tests.

The purpose of this control is not only to assure that particular units of hardware conform to contractual requirements, but also to assure interface compatibility among these units of hardware when they collectively comprise major equipments, sub-systems and systems.

Paragraph 8 of MIL-Q-9858A is, in essence, a summary of this handbook's discussion of Section 1 of the specification. Two points of that discussion bear repeating:

1. The contract and only the contract states which specification—MIL-Q-9858A or MIL-I-45208A—must be followed by the contractor as a minimum.

2. MIL-Q-9858A is intended primarily for the manufacture of complex equipment; MIL-I-45208A primarily for simple items.

8.2 Exemptions. This specification will not be applicable to types of supplies for which MIL-I-45208 applies. The following do not normally require the application of this specification:

- (a) Personal services, and
- (b) Research and development studies of a theoretical nature which do not require fabrication of articles.

**A./B. REVIEW AND APPLICATION OF REQUIREMENT.** Three classes of contracts are exempted from the application of MIL-Q-9858A. They are contracts for which specification MIL-I-45208A is sufficient, contracts for personal services, and contracts for research studies. Of course, small purchases which do not require even application of MIL-I-45208A will certainly not involve application of MIL-Q-9858A.

8.3 Order Data. Procurement documents should specify the title, number and date of this specification.

The above paragraph of MIL-Q-9858A is self-explanatory and no additional coverage is required.

2. A GUIDE TO ZERO DEFECTS

**QUALITY AND RELIABILITY ASSURANCE**

**HANDBOOK**

**4155.12-H**

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# **A GUIDE TO ZERO DEFECTS**



**1 NOVEMBER 1965**

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE  
(INSTALLATIONS AND LOGISTICS)  
WASHINGTON 25, D. C.

(369)



OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE  
WASHINGTON, D. C. 20301

INSTALLATIONS AND LOGISTICS

November 1, 1965

A Guide to Zero Defects

4155.12-H

Quality and Reliability Assurance Handbook 4155.12-H is approved for printing and distribution. This handbook provides guidance for planning, implementing, and sustaining a Zero Defects-type program designed to motivate all persons directly or indirectly involved in the national defense effort to do their jobs right the first time, every time.

The Department of Defense (DoD) accords its full support and encouragement to both industrial and governmental activities that adopt and practice Zero Defects concepts. To be effective, a Zero Defects program must be a voluntary effort in every respect. For this reason, the DoD does not intend to reference this handbook in contracts, specifications, or any other documents which would make the establishment of a Zero Defects program a contractual requirement.

This handbook is a preliminary effort. It will be reviewed periodically and improved. Users are encouraged, therefore, to recommend suggested changes to the Commanding General, U.S.Army Materiel Command, Attn: AMCQA, Washington, D.C. 20315.

*George E. Fouch*  
GEORGE E. FOUCH

Deputy Assistant Secretary of Defense  
(Equipment Maintenance and Readiness)

**QUALITY AND RELIABILITY ASSURANCE  
HANDBOOK**

4155.12-H

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## SCOPE AND USE OF THIS HANDBOOK

This handbook is a guide for Department of Defense activities and defense contractors in establishing and implementing Zero Defects. Its primary purpose is to provide a review of the basic philosophy and principles of Zero Defects, with particular emphasis on planning, management support, error cause removal, recognition and

measurement of achievement, and ways and means to sustain the program. The application of Zero Defects is expanding rapidly, with beneficial innovations being introduced constantly. Accordingly, this handbook should be considered as only a first step in the treatment of this subject.

## CONCEPTS AND BACKGROUND

### What Zero Defects Is

Zero Defects is a motivational approach to the elimination of defects attributable to human error. It is a voluntary program aimed at improving the quality and reducing the cost of producing and maintaining defense materiel. It is an organized effort to inspire personnel at all levels in an organization to do their jobs right the first time, every time. Zero Defects is dedicated to preventing defects by detecting and removing the causes of their generation. It is an attempt to reverse the unquestioning acceptance of human error as a normal byproduct of personal effort. Zero Defects is an appeal to the individual's pride of workmanship and self-interest. It is a program that can be applied to all activities participating in the defense effort and to all personnel at every organizational level in these activities.

### What Zero Defects Is Not

Zero Defects is not a speedup program.

Zero Defects is not an employee evaluation technique.

Zero Defects is not a technique for censuring error.

Zero Defects is not a substitute for quality control.

Zero Defects is not a substitute for employee suggestion programs.

Zero Defects is not a Department of Defense contractual requirement.

### Background

Zero Defects was originated in 1962 by a major defense contractor who developed this new approach to the problem of preventing errors in engineering and production. This contractor established goals for each department to reduce to zero those defects attributable to human error—hence—"Zero Defects." The program was first applied to an Army weapon system and proved to be highly

successful. Subsequently, in mid-1963 it was adopted for implementation by the Army Missile Command. This action by the Army Missile Command and widespread sensitivity to the need for precision workmanship in defense and space programs accelerated development and implementation of the Zero Defects concept. Early in 1964 the Assistant Secretary of Defense (Installations and Logistics) invited the attention of the Military Departments and the Defense Supply Agency to the potential of Zero Defects. This gave the program substantial impetus. Since that time Zero Defects has been adopted by numerous industrial and Department of Defense activities.

### Role of Top Management

The President of the United States and the Secretary of Defense have repeatedly expressed their determination to reduce the high cost of defense by the elimination of waste. Zero Defects helps to achieve this goal because it is directed at reducing human error that is a major cause of waste.

The Zero Defects concept recognizes that even though a person is dedicated, well trained, and uses the finest tools, he does not necessarily do defect-free work. He needs something more—a reminder that his contribution to the quality of a product is important and is recognized by management. He can be expected to sustain a positive attitude only if his efforts are acknowledged by persons in the higher echelons of his organization. Hence, strong commitment, direction and support by top management are essential prerequisites to the success of a Zero Defects program.

### Achievements

Comprehensive data are not yet available to measure the effect of Zero Defects throughout the Defense-Industry complex. Nevertheless, the success of Zero Defects has been impressive and substantial. Contractors have reported reductions as

high as 70 percent in overall defect rates. Equally important, Zero Defects has proven to be an effective mechanism for integrating all echelons of an organization into a spirited, coordinated, and hard-hitting team for combatting defectiveness and reducing costs.

#### Basic Philosophy

People are conditioned to accept mistakes as inevitable—"to err is human!" Zero Defects attacks this long-accepted tolerance of error. It

asks each individual to accept voluntarily a challenge to do an errorless job. Those who are proud of their handiwork are likely to do error-free work. Accordingly, the Zero Defects concept must be presented as a challenge to the individual's pride.

Pride in workmanship is motivated by knowing that one's work is meaningful. It is, therefore, important that each individual be properly informed of the direct effect of his work on end results—e.g., major end products.

#### PLANNING

Apart from management direction and support, the single most decisive factor in establishing a Zero Defects program is proper planning. Ordinarily, this planning is the responsibility of the Administrator of the program. The first and most important element of a plan is the formulation of objectives. As applied to Zero Defects, these objectives pertain to—(1) identification of prime targets; and (2) establishment of numerical goals. Both of these topics warrant extensive and thorough consideration by the Zero Defects Administrator in cooperation with his advisors. It is important to remember that while Zero Defects appropriately applies to the total organization, not all areas within that organization are likely to derive equal benefit from the program. Therefore, it is highly advisable that at the very beginning of the program the Administrator pinpoint the departments, shops, processes, products, and services that are likely to yield significant rewards. Thus, while an appeal is made to all employees to support Zero Defects, the Administrator should establish a priority for focusing major effort and resources. The identification of these prime targets is made primarily on the basis of surveys to determine current rates of defectiveness and related costs.

There are obviously a variety of approaches and techniques by which the Administrator can assess likely opportunities for Zero Defects. Having pinpointed the targets, it follows that the Administrator must formulate goals in numerical terms. For example, if a defect and scrap rate in a particular shop is 5 percent during a typical week of production, a goal of 4 percent might be established for the first Zero Defects reporting period. On the other hand, it may be desirable to establish goals in financial terms, utilizing data regarding cost of rework which are often maintained by in-

dustrial organizations. In any event, failure of the Administrator to carefully think out the objectives of the program both in terms of targets and of quantitative results can result in the establishment of a program characterized more by preachment than by solid achievement.

Having established targets and goals, it is incumbent on the Administrator to develop procedures for keeping score of actual achievement and for reporting progress from the various elements of the organization to management—and from management back to the employees. Unless the reporting program is a two-way communication system, the Zero Defects program very likely will not be effective. This follows largely from the fact that the program depends on management support and direction. Unless progress is made, such support will not be forthcoming. At the same time, unless the employees who have pledged their support to the program are informed of the results of their efforts, good will or continuing support cannot be anticipated.

Finally, before initiating the program, the Administrator should have delineated in detail the methods by which the causes of errors will be probed, reported to the proper authorities, and removed. It is emphasized that the design of Error-Cause-Removal procedures must be accomplished before the program is initiated.

In summation, it can be said that intensive planning and preparation are an absolutely necessary prelude to the kickoff of the program. Unless this "homework" is accomplished, it would be inadvisable to proceed further in the implementation of a Zero Defects program. Accordingly, each of the aforementioned elements related to planning and preparation for implementation of Zero Defects is discussed in the following paragraphs.

## ORGANIZING A ZERO DEFECTS PROGRAM

### Management Support

Without the direction and support of top management, a Zero Defects program has little chance of success. Management's endorsement is required not only at the start of the program but throughout its subsequent stages. Prior to instituting a Zero Defects program, it is incumbent on management to make an organization-wide assessment of opportunities for eliminating errors and defects. There is no point in instituting a Zero Defects program unless management has information identifying significant targets for elimination of error and related cost reduction. Possibly the most rewarding aspect of management's involvement in Zero Defects will stem from this assessment. In itself this assessment can be both enlightening and rewarding.

Once top management decides that the potential benefits of Zero Defects justify its adoption, implementing instructions should be prepared reflecting management's complete commitment.

### Organization

The institution of a Zero Defects program begins with the assignment of responsibility for its administration to a person at an appropriate staff level. The Zero Defects Administrator must be

selected and positioned in the organization with careful forethought in order to give the program an organizational stature commensurate with the importance management attaches to it.

The specific structure for administering Zero Defects must be tailored to the needs of the organization. In a large organization this might include a full-time Zero Defects Administrator and Zero Defects Representatives for the various functional groups. A Zero Defects Advisory Committee may also be useful in planning, initiating, sustaining, and evaluating the program. In a small organization a part-time Zero Defects Administrator might be sufficient.

### Outlining the Program

The basic plan and schedule for implementing Zero Defects must be precisely and comprehensively prepared at the outset. This plan serves two important purposes—(1) it provides management with a clear picture of the events scheduled and costs budgeted to implement and support the Zero Defects program; and (2) it gives the program administrator a set of guidelines to follow.

Figure 1 illustrates the activities of a typical Zero Defects program and figure 2, the essential elements of a Zero Defects plan.

## FORMULATING OBJECTIVES

### Identifying Targets

The initial step in identifying the primary targets for Zero Defects action is to survey the performance of each functional area of the organization. Quantitative rates of defectiveness as well as the related costs involved in scrap and rework should be determined. The focus of attention should be on all available quantitative sources of data applicable to the functional area, such as inspection reports, cost accounting summaries of scrap and rework costs, and customer complaints.

Cost-reduction potential is a principal criterion in selecting prime targets for Zero Defects. In

addition, however, consideration must be given to the relative importance of a component or an assembly to the satisfactory functioning of the ultimate product. The more important the component or assembly, the more serious may be the consequences of defects.

Care must be taken in the identification of primary targets for Zero Defects to assure that no departments, shops, processes or products are exempted from Zero Defects responsibility. The main objective of identifying these targets is to establish priorities. This forces a preponderance of effort on the potentially high payoff areas.

- I. Preliminary Management Study (Assessment of Opportunities)
- II. Top Management Go-ahead
- III. Selection of Zero Defects Administrator
- IV. Establishment of Zero Defects Committee
- V. Preparation of Program Plan (See fig. 2)
- VI. Management Review of Plan
- VII. Management Approval of Plan
- VIII. Implementation of Plan
  - A. Pre-kickoff Activities
    1. Preparation of promotional material
    2. Buildup phase
    3. Briefing (management, supervisors, employee associations, community)
  - B. Kickoff Activities
  - C. Activation and Implementation of Error-Cause-Removal
  - D. Sustaining Activities
    1. Continuing promotion
    2. Reporting of results
  - E. Recognition and Rewards

*Figure 1. Activities of a typical Zero Defects program.*

- 
- I. Establishing targets and goals
    - A. Identification of prime targets (e.g., departments, shops, processes, products)
    - B. Establishment of numerical goals (e.g., defect rates, scrap and rework costs)
  - II. Formulation of scorekeeping and progress reporting procedures (e.g., measurement of achievement and reporting from departments and shops to management, and vice versa)
  - III. Design of Error-Cause-Removal (ECR) procedures
  - IV. Scheduling and budgeting

*Figure 2. Elements of a Zero Defects program plan.*

#### ESTABLISHING NUMERICAL GOALS

Having selected the targets for Zero Defects, the goals of the activity in each target area must be expressed in quantitative terms to permit the achievements in these areas to be measured and rewarded. Successful Zero Defects programs are characterized by a continuing, systematic effort to define, evaluate and reward achievement on the basis of clearly identified and realistic quantitative goals. If these goals are attainable and are expressed in terms that employees can understand and accept, the typical employee can be expected to make a serious and sustained Zero Defects effort.

To establish numerical goals, the Zero Defects Administrator, in conjunction with his advisors and management, begins by examining specific data pertinent to each primary target. He then

sets goals for each of the specific functional elements whose efforts contribute to the attainment of the target. When a target is a product, the numerical goals might initially be set for the total production effort. For example, if a certain expensive assembly was selected as a primary target because approximately 20 percent of the assemblies were found to be defective after manufacturing, the initial numerical goal might be set at 16 percent (i.e., a reduction of 20 percent in the defect rate). When a target is a shop or process the numerical goals might apply to major processes of the shop or to the shop as a whole. For example, if analysis of the plating department in a shop leads to its selection as a primary target because its scrap and rework costs are currently running about \$22,000 per month, a numerical



goal might be established of reducing this cost by \$4,000 for the first reporting period. The overall primary numerical goals set by the Zero Defects Administrator should then be further broken down by the managers and supervisors involved and allocated to specific groups, functions and individuals. Once primary targets have been identified and expressed in terms of numerical goals, the Zero Defects Administrator must devote some time and effort toward establishing numerical goals for other areas and products of the organization where opportunities for defect reduction are significant even though not of the greatest potential.

Goals must be attainable and realistic. They must neither be set so low that meeting them is too easy, nor so high that their realization is impos-

sible. Moreover, goals are not fixed or final. They are steps in the direction of the ultimate goal of Zero Defects.

Criteria for measuring Zero Defects achievements are practical only if they can be readily applied by the supervisor in his normal daily relationship with the employees under his supervision. Accordingly, each supervisor should participate in the development of these criteria. An individual's achievement in a Zero Defects program can be measured by comparing it with the work of other persons in a group performing the same or a similar task at an equal skill level. To assure a meaningful comparison, this often will require the establishment of different criteria for measuring Zero Defects achievement within each of several functional areas.

### FORMULATING SCOREKEEPING AND REPORTING PROCEDURES

Once targets and goals are established, the Zero Defects Administrator is responsible for assuring that they are effectively and clearly communicated to the individuals, groups and departments to which they apply. A corollary responsibility is to assure that timely, accurate and complete data are gathered on the progress made toward achievement of these goals. These data must then be analyzed and presented to management and all other persons in the organization, so that achievements are clearly and readily apparent.

In planning for the scorekeeping and reporting functions, major emphasis must be placed on making maximum use of already available data gathering and reporting systems. Frequently, the types and sources of data previously employed in identifying primary targets and setting numerical goals can be used with suitable modification. Ordinarily, Zero Defects should not create needs for data beyond what is normally necessary for effective management of the organization. For ex-

ample, inspection reports, cost accounting summaries, and customer complaint reports are invaluable existing sources of data for use in Zero Defects programs.

Ingenuity and imagination are necessary in devising effective methods for graphically portraying Zero Defects goals and the progress made toward their attainment. A wide variety of techniques exist for showing trends, including various kinds of charts described in textbooks on quality control. Such trend charts should be of simple design, readily understandable, and appropriate to the personnel to whom they are addressed.

It is essential to keep in mind that charts intended for public display should be limited to information showing group rather than individual performance. Charts that publicize individual performance may result in adverse reactions. This is particularly true of charts that indicate unsatisfactory or mediocre personal achievement.

### DESIGNING ERROR-CAUSE-REMOVAL (ECR)

Error-Cause-Removal (ECR) is a procedure whereby—(1) individuals are encouraged to identify existing environmental causes of defects on Error Cause Identification forms; (2) the supervisor, with the help of the Zero Defects Administrator and other management personnel, promptly investigates the identified problem; (3) management corrects the environmental cause of error if the problem is substantial; and (4) the employee

is advised of the corrective action to be taken or the reasons why such action is not possible.

Experience with Zero Defects programs has shown that the most impressive and lasting achievements have come from ECR activities. In planning procedures for ECR, therefore, the Zero Defects Administrator should devise procedures which will stimulate active interest and participation in ECR by production workers, super-

visors and management personnel. Zero Defects programs frequently reveal that many defects have their source in causes other than human error. ECR helps to identify these environmental causes of defects.

To be effective, an ECR procedure must—(1) give the employee an opportunity to identify those environmental conditions which he believes are causing him to make errors; and (2) provide for prompt action to remove environmental causes of error in order to demonstrate to employees that management stands squarely behind this element of the Zero Defects effort. So long as errors attributable to environmental conditions are not eliminated it is impossible to achieve Zero Defects.

Appreciating and understanding the causes of errors are essential for the development of effective ECR procedures. Errors are caused either by persons or by deficiencies in the tools, procedures and facilities with which the person does his work. The human error may be diminished or eliminated as pride of workmanship develops from the motivation of a Zero Defects program, but errors stemming from the environment cannot be eliminated by the individual, however dedicated he may be. This is management's responsibility.

In the early stages of a Zero Defects program the individual is inclined to be skeptical that he is the real cause of faulty workmanship; but, as the program develops more and more employees can be expected to examine errors objectively. They want to make certain that errors caused by environmental conditions are not attributed to them. The experience of many organizations indicates that the typical employee does not try to cover up or minimize his own mistakes. However, motivated by a Zero Defects program, he is less inclined to accept defects as inevitable. He will be motivated to investigate further every error that may be caused by something other than his own lack of care.

An ECR procedure may pose some management problems, particularly where the action needed to correct an environmental condition is either more costly than the defects involved or cannot be taken as promptly as might be desired. Any apparent lack of action may be interpreted as an indication that management is not only indifferent to ECR, but is also unwilling to acknowledge its own errors. Thus, management's vital role in the Zero Defects program is nowhere more

apparent than in the operation of the ECR element of a Zero Defects program. Management must respond rapidly and constructively to ECR recommendations and be prepared to present the factual basis for decisions to turn down a recommendation.

To a major degree, the effectiveness of procedures for removing environmental causes of error depends heavily on the first-line supervisor. Experience has shown that—

- (a) Ninety percent of unsatisfactory environmental conditions can usually be corrected by the supervisor.
- (b) Almost ten percent of ECR actions involve changes in procedures, or minor facility alterations, both of which can be accomplished by such groups as plant engineering or the maintenance department.
- (c) The remaining fractional percentage of ECR actions may require costly modifications in facilities or procedures.

Since the supervisor is the link between management and the employees under his supervision, his handling of environmental causes of error is particularly important. When a supervisor corrects an environmental condition, he is in effect correcting a management error since it is management that provides and controls the tools, facilities and procedures that resulted in the unsatisfactory environmental condition. Accordingly, the supervisor must handle suggestions for removing environmental causes of error with courage, tact and understanding, and be willing to present suggestions to higher authority when correction is beyond his authority to accomplish.

As a key element in the success of ECR, the supervisor must be carefully and fully briefed in the operation of the ECR process. He should also be furnished written guidance to explain the procedures he is to follow in ECR and assist him in detecting and identifying environmental causes of error.

There is a relationship in certain instances between the Error-Cause-Removal procedures and the existing suggestion awards program. The ECR procedures motivate the worker to call attention to causes of error, but do not require him to propose a solution to the problem. However, if he can also suggest a practical method for eliminating the cause of error, he submits a suggestion and is eligible for an award under the suggestion program.

## SCHEDULING AND BUDGETING

Prior to presenting a Zero Defects program plan to management for approval, the Zero Defects Administrator should devise a comprehensive schedule of activities and milestones for each phase of the program. The timing of events is most important in order to gain the greatest positive impact from these activities without interfering with other programs or the ordinary routine of the organization. To arrive at a satisfactory schedule, the administrator must consider the following factors as a minimum: (a) availability of key participants for specific planned events; (b) lead time required to obtain promotional and dis-

play materials; and (c) availability of space and facilities required for kickoff and sustaining activities.

A budget for a Zero Defects program must also be carefully prepared. Although experience has indicated that the dollar benefits derived from Zero Defects have outweighed the cost of the program by a large margin, it is imperative that costs be kept to a minimum. Overly elaborate promotional materials and activities and unwarranted intrusions on productive time of personnel should be resolutely avoided.

## PRE-KICKOFF ACTIVITIES

### Preparation of Promotional Material

Certain items necessary for the support of the Zero Defects program must be prepared at a very early stage in the program's development. These include various official documents establishing the program. For example, a management letter explaining the Zero Defects concept and philosophy, a program plan, a packaged visual presentation for indoctrinating the staff, and a handbook to help supervisors understand and carry out their assigned roles in the program should be available before the program is implemented.

The planning and preparation of promotional materials for kickoff activities must necessarily be tailored to the specific needs of the implementing organization. Promotional materials need not and should not be expensive. Posters, banners, tags, stickers, pledge cards and similar items have been used very successfully.

### Buildup Phase

The buildup phase should include time for a warmup period to increase quality awareness and foster general receptiveness to the Zero Defects philosophy. The purpose of this period is to improve the employees' knowledge of the importance of the products or services they produce in order to facilitate their acceptance of the Zero Defects concept. The warmup period is characterized primarily by poster campaigns and educational programs.

It may also be effective during the last week or two of the buildup phase to initiate an awareness campaign describing some part of the Zero Defects concept each day but holding back its name until

some predetermined date. As with any promotional approach, imagination and ingenuity in planning and executing the buildup phase of Zero Defects is essential to assure optimum impact.

### Personnel Briefings

A major step in the pre-kickoff stage of a Zero Defects program is to explain all facets of the program to those management personnel who were not involved in the planning phase. This can be accomplished in a series of briefings by the Zero Defects Administrator. The briefings should be given first to the senior executive's staff, next to midmanagement personnel, and finally to supervisory level personnel. The briefing for the top management element of the organization should be arranged by the senior executive in order to indicate clearly that the program has his full support. All of the briefings should include a review of the complete program plan.

Midmanagement briefings should be arranged and conducted in such a manner as to reflect the support of all elements of top management. Experience has shown that mass briefing sessions for the management staff should be avoided. Small meetings convened by members of the top management staff, with the senior executive present when possible, have been found to be most effective.

Probably the most important part of this phase of the program is the briefing prepared for the first level of supervision. Acceptance of the Zero Defects challenge by this level of personnel is the key to acceptance by the individuals working under their supervision. It is important also because the supervisor, in his day-to-day contact with the in-

dividual workers, must be able to answer questions and direct activities with respect to Zero Defects.

Experience has shown that carefully prepared plans for briefing supervisors with material specially prepared for these briefings are well worthwhile. When a supervisor is furnished a handbook outlining his responsibilities and presenting suggestions for handling specific problems, he is better able to contribute to the success of Zero Defects.

It is desirable to have management staff members present at briefing sessions for supervisors. This assures that supervisors are aware of management's support of the program. It is advisable to schedule the sessions for supervisors just prior to initiation of the program to assure their peak interest at the time of the kickoff events.

Special briefings should be arranged for representatives of employee organizations, professional societies, press, and civic organizations. A briefing for representatives of labor organizations, for example, should be designed to preclude misinterpretation of Zero Defects concepts and goals. The

primary purpose of this briefing should be to explain that the objectives of Zero Defects are compatible with the best interests of the employees and their organizations. It is particularly important that this briefing emphasize the voluntary aspects of Zero Defects. If employee organization leaders wish to brief their officials with respect to Zero Defects, arrangements should be made and the time allowed for such briefings.

Community briefings are also useful, particularly in situations where a community's economy is largely dependent on one organization, e.g., where a military supply depot or industrial complex is the major employer in a small city. The briefing of community leaders and community service organizations should serve to marshal strong community support for Zero Defects. Briefings should be arranged for the local press as early as possible, particularly if the program is to be initiated in an organization which is a major employer in a community.

#### KICKOFF ACTIVITIES

##### Communication Media

The timing for the "kickoff" of a Zero Defects program should be arranged to make maximum use of available communication media. For example, the kickoff date should be selected to coincide with the publication date of the plant newspaper or house organ. Arrangements can then be made for the plant newspaper to carry a banner headline announcing the Zero Defects kickoff events and to feature messages from the company president and community and union leaders. The paper might also include articles describing Zero Defects programs implemented by other organizations to indicate that the Zero Defects concept is widely accepted.

Announcement of the kickoff should make use of all available communication media in addition to newspapers and house organs. Public address systems, banners, posters, bulletin boards, and other information media can be used to good advantage.

##### Kickoff Meetings

An effective way to launch Zero Defects is to hold a company-wide rally on kickoff day. Representatives of management, supervisory levels,

employee organizations, suppliers, customer organizations, and prominent public figures should be given key roles in this event. Brief, motivational speeches should be made by selected individuals who hold positions of leadership in the sponsoring organization and the community. One of the featured speakers may well be a representative of an organization which uses the products of the sponsoring organization.

An alternative or addition to the company-wide rally which has proven effective is group meetings in various areas of the organization to initiate action programs to meet Zero Defects goals.

The kickoff of a Zero Defects program is also an appropriate occasion to introduce the pledge card if one is to be used. A typical pledge card states the basic Zero Defects philosophy on one side and contains a pledge to strive toward the goal of Zero Defects on the other. It permits the individual to express his personal endorsement and acceptance of the Zero Defects philosophy. Its wording should be formal and its use should emphasize the voluntary aspect of the pledge. It is also useful to give a pin to each person who accepts the Zero Defects challenge.

### SUSTAINING ACTIVITIES

During the initial phase of a Zero Defects program, a primary goal is to explain the basic concepts and to obtain the widest possible acceptance of the program's challenge. Once the program is in operation, the primary objective is to help the individual achieve the goal of error-free work and to maintain his interest and dedication at the highest possible level. This latter objective can best be met through a sustaining program that— (1) identifies and eliminates the causes of error; and (2) recognizes and rewards Zero Defects achievements.

#### Continuing Promotion

House organs, the local press, and local radio and television stations are all media that should be used to help sustain interest by publicizing important developments in a Zero Defects program. These media are particularly valuable for publicizing significant achievements. This publicity adds measurably to the motivational impact of Zero Defects.

It is also desirable to publicize plant-wide achievement such as exceptional performance of the company's product as reported by the company's customers. Other newsworthy achievements include improved quality as evidenced by reduced scrap and rework rates, customer commendations for schedules met or exceeded, and cost reductions. All publicity releases should be designed to make each employee proud of his contribution to the well-being of the organization even if his particular task is not readily related to the production of the company's product line. This applies, for example, to administrative, clerical and service employees.

Interest can also be sustained by publicizing the achievements of Zero Defects programs of other organizations, both in Government and industry. Such an exchange of experiences can add impetus to the program by showing employees that they are not alone in their Zero Defects efforts.

#### Exchanges of Information

Any exchange of experience and knowledge gained in the operation of a Zero Defects program can be of mutual benefit to participants in the Zero

Defects movement. Much can be learned about new developments and techniques by arranging visits to plants where Zero Defects programs are in progress. Subcontractors and vendors, particularly, can benefit from the experiences of their customers with Zero Defects. Seminars also have been used successfully for exchanging ideas among large numbers of personnel involved in Zero Defects programs. The seminar approach makes it possible for personnel with experience in different phases of the subject to help solve each other's problems. The workshop type of seminar is a particularly valuable tool for disseminating new ideas quickly and effectively to a large number of people.

#### Briefing of New Employees

The organization's program for briefing new workers should include a presentation on Zero Defects. This will give the new employee an opportunity to participate in the program, including an opportunity to sign a pledge card and to receive a Zero Defects pin if such promotional material is used.

#### Management-Employee Liaison

Effective management-employee contact is essential to the success of a Zero Defects program. Periodic visits by management to work areas are particularly useful. In those areas where significant achievement and progress have been made, such visits not only reinforce the effectiveness of the immediate supervisor, but also provide opportunities for personal approbation for the accomplishments of individuals and groups.

Similarly, the Zero Defects Administrator should maintain close liaison with first-line supervisors to offer assistance in resolving problems. A significant increase in the number of defects reported in an area, for example, is often the first indication that the supervisor needs help to identify and correct some environmental cause of error. By maintaining close liaison, the Zero Defects Administrator can often assist the supervisor not only to seek out possible environmental causes of errors, but also to stimulate action to eliminate these causes when such action is beyond the supervisor's authority.

## ACTIVATION OF ERROR-CAUSE-REMOVAL (ECR)

Experience has shown that a majority of the error causes identified under ECR procedures are attributable to environmental conditions related to the tools, facilities and procedures provided and controlled by management. Most of these causes can be acted upon promptly by the supervisor, but some will require decisions by a higher management level. It is essential to the success of this effort for management to indicate an objective attitude toward ECR and to act decisively in correcting the causes of error once they are uncovered.

Whatever the final decision, the originator of an ECR suggestion must receive a report of the action taken on his suggestion. This report should be sufficiently complete to convince the originator that the evaluation of his suggestion was thorough and objective. If the suggestion is accepted, he should be given a date for its implementation and, when appropriate, an opportunity to indicate whether or not he concurs in the action taken.

Effective implementation and control of ECR procedures requires suitable documentation of the actions taken to report, identify and eliminate error causes. Provisions should be made for a report form, such as the "Error Cause Identification Form" shown in figure 3, to help employees describe what they believe to be the causes of errors. This will also facilitate a review by the supervisor, who can often analyze and correct the problem promptly without any outside help.

Because the solution to an error-cause problem recommended by a worker may also constitute a valid suggestion under an existing suggestion program, provisions should be made to permit an employee to submit an appropriate suggestion form whenever he proposes an ECR action. This assures that a worker will be rewarded for each valid suggestion.

The Zero Defects Administrator should review all ECR proposals and keep suitable records to indicate that appropriate follow-through actions have been taken. He should also review each case to make sure that no employee considers that the action taken in response to his proposal was inappropriate.

Following are two case histories that illustrate the variety of error causes that have been encountered in current Zero Defects programs. One is a relatively simple problem; the other is quite complex. Both cases involve environmental conditions that caused defects which might normally have been attributed to human error if the Zero Defects program had not motivated management to take a second look.

*CASE A:*

A lamp service man whose job is to replace burned-out fluorescent tubes used a cart to carry the tubes and ladder. He always carried his ladder on the top of the cart where the tubes were stacked, and occasionally "accidentally" broke one or more tubes. He suggested that a pair of hooks be attached to the side of the cart from which he could hang the ladder. The supervisor approved the suggestion, had the hooks fabricated and installed. The suggestion reduced breakage. The employee received an award under the suggestion program.

*CASE B:*

A sheet metal worker reported that his machine was too close to a wall to permit him to manipulate large sheets of metal and this caused the production of defective material. The supervisor not only verified the worker's statement, but also found that it was dangerous to handle large, sharp-edged sheets without at least two additional feet of space between the wall and the machine. The supervisor could not correct the situation because the wall could not be moved without interfering with an adjoining production area.

The supervisor submitted his findings to the Zero Defects Administrator, who discussed the problem with the Plant Engineer. It was found that the production line adjacent to the wall was scheduled to be modified in three months. This would permit moving the interfering wall to provide the required clearance for the sheet metal operation. In the meantime, the fabrication of large sheets of metal was scheduled for other machines. Thus, a cause of error and a dangerous working condition were initially alleviated and ultimately corrected.

Front

**ZERO DEFECTS  
ERROR CAUSE IDENTIFICATION**

NAME		LOCATION	MAIL POINT
OCCUPATION TITLE		DEPT.	CLOCK NO.
			<input type="checkbox"/> HOURLY <input type="checkbox"/> SALARY

IN ORDER THAT A BETTER JOB BE PERFORMED TOWARD THE GOAL OF ERROR-FREE PERFORMANCE, I AM IDENTIFYING THE FOLLOWING CAUSE OR POTENTIAL CAUSE OF ERROR:

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**IMPORTANT INFORMATION**

IF, IN ADDITION TO IDENTIFYING ERROR CAUSE, YOU FEEL THAT YOU HAVE A WAY TO SOLVE IT, PLACE THIS SOLUTION IN THE ABOVE AREA. IF ADDITIONAL SPACE IS REQUIRED, USE A SEPARATE SHEET, ATTACH IT TO THIS FORM AND PLACE A CHECK IN THE FOLLOWING BLOCK.

THE ERROR CAUSE IDENTIFICATION PORTION OF THE ZERO DEFECTS PROGRAM IS NOT A SUBSTITUTE FOR THE SUGGESTION AWARDS PROGRAM.

IF YOUR SOLUTION IS ADOPTED, AS A COST REDUCTION TECHNIQUE, YOU MAY ALSO BE ELIGIBLE FOR A SUGGESTION AWARD. REMEMBER, YOU MUST FILL OUT AN ADDITIONAL FORM TO BE ELIGIBLE FOR THE SUGGESTION AWARDS PROGRAM.

ERROR CAUSE IDENTIFICATION IS NOT NECESSARILY RESTRICTED TO YOUR OWN WORK AREA - THE SITUATION MAY EXIST ANYWHERE IN THE PLANT.

IN ALL CASES, THE DECISION OF THE COMPANY WILL BE FINAL. ALL IDEAS SUBMITTED BECOME THE PROPERTY OF THE COMPANY.

Figure 3. Error cause identification form.





## RECOGNITION AND REWARDS

Official and public recognition of achievement is an important part of a Zero Defects program. Accordingly, procedures must be devised for identifying and evaluating those accomplishments which warrant such recognition. It is not necessary, however, to delay implementation of Zero Defects until all details of the procedure for measuring and recognizing achievement have been worked out. It is often possible to continue to use the existing basic tools of employee evaluation for this purpose, such as supervisory judgment supported by such data as production quality control statistics and audit reports.

Although Zero Defects is directed primarily at motivating the individual, it is also desirable to provide for the recognition of Zero Defects achievement at three organizational levels—(1) the small group; (2) the large group; and (3) the organization as a whole. Provisions for small and large group recognition are particularly important where teamwork by such groups rather than individual effort alone is of primary importance to error-free results.

The initiation of action leading to the formal recognition of Zero Defects achievement should be assigned as part of the regular duties of each supervisor. Procedures should be established for the use by supervisors of existing data and records of past performance to facilitate the evaluation of potential achievements. If the supervisor's evaluation indicates that a significant achievement has been made, the procedure should provide for the submission of a recommendation for formal recognition prepared on an appropriate form.

To assure that formal recognition is accorded only for significant achievements, all recommendations should be reviewed by a formally organized committee. The use of an achievement recognition committee has two important advantages—(1) its deliberations will be objective; and (2) its actions will not be subject to intra-organizational bias.

The most effective method of recognizing Zero Defects achievement is some form of personal approbation. Such personal action has been found to be a more potent stimulant to Zero Defects efforts than monetary or other material reward.

The procedure for recognizing achievement must also provide for suitable publicity. Well publicized recognition of a Zero Defects achieve-

ment may be used to good advantage in assuring continued interest in the program.

Group recognition provisions are valuable primarily as support elements of a Zero Defects program. Such recognition encourages team effort and engenders a competitive spirit between groups. The disadvantage inherent in group recognition is that those members of a group who have not contributed to the group's success and, in fact, who may be negative in their attitude, will be given the same recognition as those who have contributed. Conversely, an outstanding worker in a low achievement group may go unrecognized because his group's performance is inadequate. Accordingly, the procedure for recognizing group achievement must not negate or downgrade the importance of individual achievement. If it does, it may cause an adverse reaction to the Zero Defects program as a whole. Thus, group recognition procedures must be used with caution. Zero Defects is most effective when it is directed at encouraging individual achievement. Its benefits derive primarily from individual motivation and recognition. Group motivation, accordingly, must always be subordinated to motivation of the individual if the Zero Defects program is to succeed.

Among the group recognition techniques that have been used successfully in the Zero Defects chart. This technique is best applied where group achievement can be expressed in quantitative terms. Properly designed, this chart can be used to illustrate more than one aspect of a group's Zero Defects achievement. It may show, for example, that the defect rate actually achieved by the group is not only lower than the defect rate that the customer will tolerate, but is also lower than the defect rate established as a performance goal.

Almost every successful Zero Defects program has been best able to motivate the individual employee by identifying him with the product of his labor. One way to accomplish this is to arrange for employees to see their products in use. Another way is to have customers who are well satisfied with the product explain to the employees how important it is to obtain a product that is defect-free.

Of the various methods that have been used to cause employees to identify themselves with their products, one of the most effective has been to reward individuals who have shown outstanding Zero Defects achievement with a trip to the site

where the product is being used. Another method is to have a user of the product (e.g., an aircraft pilot) visit the plant to meet and talk with employ-

ees individually. Films or photographs of the product in action have also been found useful and rewarding motivational material.

#### GENERAL REVIEW

A Zero Defects program requires careful planning and execution if it is to accomplish its intended purpose. Such a program can be expected not only to motivate employees to perform effectively, but also to disclose environmental conditions that impede employee efforts to achieve error-free performance of their assigned tasks.

It is more difficult to sustain a Zero Defects program than to start one. This is due primarily to the normal human inclination to lose interest in something that is no longer new. Accordingly, the plan to sustain interest in a Zero Defects program must be thoughtfully and imaginatively developed before the program is adopted.

Some of the key points of the Zero Defects concept may be summarized as follows:

- (a) Success of a Zero Defects program is contingent on sustained management, interest, support and direction.
- (b) Participation in a Zero Defects program is voluntary.
- (c) The opportunity to participate in Zero Defects should be offered to all personnel in an organization, both those whose work

directly affects product quality and those whose work does not.

- (d) A Zero Defects program must be designed to motivate the individual employee and should include no group recognition that detracts from this primary objective.
- (e) Well-publicized recognition by management of employees' Zero Defects achievements is essential to the success of a Zero Defects program.
- (f) While motivating employees to prevent human error, the Zero Defects program also motivates them to identify environmental conditions that cause defects and which are often erroneously attributed to human error.
- (g) The Error-Cause-Removal (ECR) element of the Zero Defects program is a means for identifying and correcting error-causing environmental conditions such as tools, facilities and procedures that are provided and controlled by management. ECR is an essential feature of a Zero Defects program.

## APPENDIX 10

### DOD COST AND ECONOMIC INFORMATION SYSTEM

OFFICE OF THE SECRETARY OF DEFENSE,  
*Washington, D.C., July 7, 1965.*

HON. THOMAS B. CURTIS,  
*House of Representatives*  
*Washington, D.C.*

DEAR MR. CURTIS: Mr. Ray Ward of the staff of the Joint Economic Committee has advised that you desire information on the Cost and Economic Information System.

Enclosed please find a copy of the Department of Defense directive which establishes this system. In addition, copies of two informal papers which further describe this system are enclosed.

Sincerely,

C. R. RODEBICK,  
*Brigadier General, U.S. Air Force,*  
*Director, Office of Legislative Liaison.*

#### DEPARTMENT OF DEFENSE DIRECTIVE No. 7041.1

Subject: Cost and economic information system.

Reference: (a) DoD Directive 5100.39, Government-Industry PERT Orientation and Training Program—July 24, 1963.

#### I. PURPOSE AND OBJECTIVE

A. This directive establishes a Cost and Economic Information System for:  
(1) The collection and analyses of actual and estimated cost and related information pertaining to the acquisition of weapons systems and major items of equipment.

(2) The collection and analyses of employment and related economic impact data.

B. This directive also assigns responsibilities for carrying out the system.

C. Its objective is to provide to the military departments, Defense agencies and the Office of the Secretary of Defense comparable, reliable, and timely cost and economic data on weapons systems, major items of equipment, and Defense contractor employment to:

(1) Improve cost estimating, cost and price analysis, and progress reporting, and

(2) Enhance the effectiveness of planning, programing, budgeting, contract negotiating, and program or project management, and

(3) Provide data necessary for analysis of economic impact by geographic area and industry.

#### II. APPLICABILITY

The provisions of this directive apply to the military departments, Defense agencies and other DOD organizations involved in the acquisition of weapons systems and major items of military equipment.

#### III. SCOPE

A. The Cost and Economic Information System will develop comparable cost and related data on weapons systems and major items of equipment as defined in and selected from the Materiel Annex/Weapons Dictionary.

B. Cost data will encompass the full acquisition cycle (research, development, engineering, preproduction, and production) for uniformly defined systems, sub-systems, major components (such as propulsion, guidance, structure, support equipment) and other activities for aircraft, missiles, space systems, ships,

electronic systems, armor, ordnance, and other weapons and support systems designated in subsection III-A above. Economic data will encompass plant and geographic employment data on Defense contractors.

C. Data sources will include contractor reports and reports prepared in house by DOD components (i.e., reports on procurement and industrially funded activities).

#### IV. RESPONSIBILITIES AND FUNCTIONS

A. The Assistant Secretary of Defense (Comptroller) will be responsible for overall surveillance of the Cost and Economic Information System. In carrying out this program, the ASD (Comp), with the assistance of a DOD Cost and Economic Information System Steering Group, chaired by the ASD (Comp) and composed of representatives of the Director of Defense Research and Engineering, the Assistant Secretary of Defense (Installations and Logistics), the military departments, and any other DOD organization which may be concerned, will:

- (1) Develop and promulgate, in coordination with Assistant Secretary of Defense (Installations and Logistics) and Director of Defense Research and Engineering, procedures and instructions for operating the Cost and Economic Information System.
- (2) Publish and maintain a "DOD Guide for the Cost and Economic Information System."
- (3) Promote the training under reference (a) needed in order to maximize the use of the Cost and Economic Information System.
- (4) Insure uniformity, comparability, and reliability of the data.
- (5) Arrange for a free interchange, within the Department of Defense, of source data and analytical products, such as learning curves and other cost-estimating relationships.
- (6) Perform, and encourage the military departments and Defense agencies to perform research in cost-estimating methodology.
- (7) Study and develop recommendations for:
  - (a) The integration of the Cost and Economic Information System with other systems (including PERT/Cost) used for accumulating cost and related data from contractors and DOD components into a single cost information system; and
  - (b) The elimination of duplicate or overlapping systems.

B. The Secretary of each military department and the head of each Defense agency, as appropriate, shall be responsible for carrying out, within available resources, the functions of the Cost and Economic Information System within his respective jurisdiction, including:

- (1) Establishing one or more cost analysis organizations to:
  - (a) Organize and manage the Cost and Economic Information System as a single, integrated system.
  - (b) Insure the validity, comparability, and timeliness of actual cost and related data obtained from contractors.
  - (c) Develop techniques for cost estimating and analysis.
  - (d) Provide a central point of storage and retrieval of data.
  - (e) Make available analyses of cost and related data within DOD to program, budget, and contract analysts, program or project managers, industrial readiness planners, and economic analysts.
- (2) Assuring coordination between the appropriate cost analysis organization and the weapon system or equipment project manager or other responsible officer in applying uniform work breakdown structures and standardized cost definitions and in validating data.
- (3) Identifying and eliminating other systems providing the same or similar cost information to avoid duplication of effort.

#### V. IMPLEMENTATION AND EFFECTIVE DATE

A. The Secretaries of the military departments and the directors of Defense agencies concerned will submit to the ASD (Comp), within 30 days of the date of this directive, for approval, a schedule and plan for the prompt implementation of the Cost and Economic Information System. The ASD (Comp) will provide such additional guidance for this purpose as may be requested. The following will be included in the plan:

- (1) Establishment of the cost analysis organization or organizations.

(2) Selection and schedule of weapon systems or major equipment to be used in the initial implementation of the Cost and Economic Information System.

(3) List and schedule of remaining weapons systems or major equipment proposed for coverage.

B. This directive is effective immediately.

CYRUS VANCE,  
*Deputy Secretary of Defense.*

## BRIEF DESCRIPTION OF THE CEIS

### INTRODUCTION

The following is designed to provide a general description of the concepts and objectives of the Cost and Economic Information System (CEIS) and the environment in which it is designed to operate. While a much more comprehensive description of CEIS will be issued in the future in the form of a CEIS Guide, this preliminary discussion will provide sufficient background to permit the military departments to review and evaluate the attached CEIS instructions to contractors.

Although CEIS is designed to provide data to assist in estimating the costs of weapons systems and components and, also, to assist in estimating the economic impact of defense spending, only the former—estimating the costs of weapon systems and components—is dealt with here. The economic impact aspects of CEIS are being developed in a parallel effort, and a one-time test of the economic impact reports is already underway.

### NEED FOR CEIS

The requirement to improve the cost estimating capability within the military departments is an urgent one. Recent history on some of our most important and costly programs has demonstrated that there did not exist an adequate understanding of the most likely ultimate cost of these programs. The current practice of dependence on contractors' estimates must be replaced by a capability within DOD to generate independent estimates of program costs and to evaluate contractor estimates of such costs.

### DESCRIPTION OF CEIS

CEIS consists of a series of reports, together with organizations within the military departments to administer, process, and analyze them, and service a variety of other organizations requiring cost data and cost estimates.

The cost report of the CEIS currently consists of a cost data plan submitted by the military departments to OSD and a series of six reports to be submitted by contractors to the military departments.

### OBJECTIVES OF CEIS

The major objectives of CEIS are:

1. To provide a body of cost data which can be used to estimate the costs of current or future weapon systems and components through the extrapolation of past experience.
2. To provide information on fund requirements which will permit adequate and timely funding of major contracts.
3. To assist program management by providing information on the financial status of contracts.
4. To provide a framework which will permit the consistent reporting of costs from proposal through the completion of production in order to evaluate contractor performance.

### USES OF CEIS

1. CEIS has been specifically designed to be operated and used by the military departments. The data generated and the organizations and procedures established by CEIS are intended to support the day-to-day needs of the military departments for cost estimating and cost analysis in a variety of applications, and it is strongly urged that they be fully utilized. At the present time no regularly recurring reports will be required by OSD, although it is contemplated

that OSD will request CEIS data from time to time in connection with specific projects.

2. It is anticipated that at least the following activities will make use of CEIS data and organizations.

(a) Systems analysts who make use of cost estimates in cost-effectiveness or weapon-selection studies.

(b) Financial managers, who must estimate the costs of their systems in order to budget for them properly, to evaluate estimates made for them by contractors and to anticipate overruns or underruns.

(c) Contract negotiators, who must develop independent estimates in order to evaluate properly proposals which have been submitted to them.

(d) Programers, who must submit PCP's to OSD and who must be able to justify the costs being requested.

(e) Budget analysts, who require estimates of weapon-system costs to evaluate or justify budget submissions.

3. CEIS forms can and should also be required as proposal forms by contractors when proposals are being requested on systems which will be covered by CEIS.

#### COVERAGE

The attached instructions currently apply only to aircraft and missile systems and components of such systems. It is anticipated that coverage will be expanded in the future to other types of systems as more experience is gained with CEIS.

It is not intended that full CEIS coverage be applied to every aircraft or missile system. The CEIS has been designed to be flexible, so that the amount of coverage of a weapon system will vary in accordance with the size and importance of the system. Thus, depending on the system, some (or all) of the cost reports may not be required; further, the frequency and detail required will vary from system to system.

#### COST DATA PLAN

The military departments will select the systems to be covered and will determine the detail and frequency with which they will be covered, subject to the approval of OSD. The cost data plan is the mechanism by which this approval is obtained. Exhibit I to this paper describes the cost data plan and how it is to be used.

In the determination of the detail and frequency with which a system is to be covered, the military departments will insure that OSD minimum reporting requirements and reporting frequencies are satisfied. These are specified in exhibits II and III to this paper. The military departments may expand on these minimum requirements in accordance with their specific management needs and the unique characteristics of the weapon systems being reported on. It is strongly urged, however, that any expansion be limited to only that which is deemed absolutely essential, in order that contractor reporting burdens be minimized. The OSD review of the cost data plan will attempt to recognize the legitimate management needs of the military departments; however, the military departments should be prepared to justify in detail any significant enlargement of the OSD minimum requirements.

#### SIGNIFICANT CHARACTERISTICS

CEIS contains some significant features which are more or less novel with respect to prior reporting systems. The more significant of these are:

1. Standard cost categories (e.g., engineering, tooling, manufacturing, etc.).

2. Consistent work breakdown structures (e.g., airframe, fire-control systems, etc.).

3. Subcontractor reporting:

(a) Major subcontractors—the military departments will have the option on any given program of requiring certain very large subcontractors to provide reports identical to those required by the military departments of the prime contractor. Copies of these subcontractor reports will be forwarded either directly to DOD, or to DOD through the prime contractor at the option of the subcontractor.

(b) Minor subcontractors—for the WBS item, airframe, the prime contractor will be asked to estimate, in aggregate, the functional breakdown of the prices paid by him to minor subcontractors.

4. Reporting on firm fixed price contracts.

5. Continuity of cost reporting from proposal through R. & D. and production.

The first three of these are essential in order to achieve a data base of actual, experienced costs comparable across weapon systems and components of a given type. The first feature is required to insure that the functional cost categories include the same activities (or as nearly the same activities as possible) regardless of the contractor reporting or the particular program reported upon. The second feature insures that the scope of the work being reported upon in each cost category is the same. For example, airframe costs reported by all contractors will exclude static and fatigue testing, spares, AGE, etc. The third feature attempts to minimize the impacts of varying make or buy structures and is particularly useful for airframe costing. It permits the handling of a complete work breakdown item in functional detail instead of only that portion performed by the prime contractor.

The fourth feature reflects the increasing trend toward the use of firm fixed-price contracts wherever feasible, even where major systems are involved. Even in such cases, it is important for the military departments to be able to estimate the cost of producing the systems (or components) in question, in order that the Government's interest may be appropriately protected. Such estimating will require an adequate data base; unless reports such as those specified by CEIS are imposed on these contracts, the data base will dissipate in direct relationship to the growth of the use of firm fixed-price contracts.

The fifth feature will be extremely useful both in program management and cost estimating. On the one hand, it will permit the program manager to measure the deviation of actual costs from those proposed, and on the other hand, it will facilitate the use of information gathered during the development phase in estimating subsequent production costs.

#### CEIS ORGANIZATIONS

DOD Directive 7041.1 requires that each military department create one or more CEIS offices. The major functions of such offices will be:

(a) To receive, review, and process data received from contractors. This will include, among other functions, continuous validation of data and referral of reports back to contractors for correction, development, and maintenance of an information retrieval system for easy access to data whenever needed, and processing of data into forms most usable for cost analysis (e.g., application of price indexes to convert dollars appearing in the reports to a given base year price level, and generation of unit cost curves).

(b) To perform cost analyses and special cost studies which can be used by systems analysts, budget and programing personnel, contract negotiators, and price analysts. This will include the generation of independent DOD estimates of the cost of new or follow-on quantities of weapon systems and components by extrapolating from past experience.

(c) To prepare, or participate in the preparation of cost data plans for weapon systems and components. It is essential that the CEIS offices play a major role in the preparation of cost data plans because of their knowledge of the data which are required for effective cost analysis and cost estimating, and of the general problems of cost data collection.

(d) To improve cost estimating techniques through independent research and through knowledge of research in costing methodology performed elsewhere, in order that the support provided to using organizations may be continuously upgraded.

#### RELATION TO DOD PROGRAMING SYSTEM

DOD Instruction 7045.2 requires that costs in PCP's be appropriately supported and justified. It is anticipated that certain CEIS reports will be required to accompany PCP's dealing with major systems. After CEIS has been placed into operation DOD Instruction 7045.2 will be revised to specify this requirement.

#### RELATION OF CEIS TO OTHER MANAGEMENT SYSTEMS

CEIS is intended to be compatible with other DOD-wide management systems such as PERT/cost and configuration management (now under development).

For example, the work breakdown structures required by CEIS will be consistent with those required by PERT/cost and configuration management. Thus, contractors will be able to organize their data-gathering structures in such way as to satisfy the requirements of all three systems.

Where a PERT/cost system is now in effect, and inconsistencies would result upon implementation of CEIS, an analysis will be made by OSD agencies and the military department concerned to determine what modifications, if any, should be made.

#### ECONOMIC IMPACT DATA

The economic impact effort is designed to keep the Secretary of Defense and other top level officials of Government aware of potential future impacts resulting from trends and changes in Defense programs. However, in accordance with Department of Defense policy, economic impacts will not be allowed to influence weapons acquisition decisions. Defense Department policy in this regard is to buy what is needed, when it is needed, at the lowest cost to the Government, quality and delivery schedules considered. Nevertheless, the expenditure for goods and services for national defense, of which the Department of Defense is the principal component, account for nearly 10 percent of the gross national product and, moreover, are significantly important to specific industries and communities. The Defense Department considers it vitally important, therefore, to be aware of the impact of its programs on individuals, communities, companies, and industries and to be able to disseminate impact information to other Government agencies, committees, and organizations which are responsible for taking such actions as may be desirable in alleviating adverse consequences of shifts in Defense spending when they can be foreseen.

#### CEIS ECONOMIC IMPACT TEST

In collaboration with the National Aeronautics and Space Administration, the Department of Defense has secured clearance from the Bureau of the Budget to conduct a test run of economic reporting from industry. About 200 major contractors have been requested to provide 2 reports which will serve as a basis for internal forecasts of Defense and NASA activity. The first report summarizes actual and projected employment on DOD projects, on NASA projects, and on all other work in the plan. The second report includes employment, total costs incurred, purchased materials and subcontracting dollars, and production flow-time, for specific major DOD programs in the plan. Both reports will reflect firm contracted business only.

#### ECONOMIC IMPACT REPORT FOR THE SECRETARY OF DEFENSE

These reports from the contractors will be used by the military departments to project costs incurred and employment based on the trends in the 5-year program. Each military department is responsible for projecting employment on its own weapon systems programs, as reflected in the 5-year program, using production flow-time and other available data to convert programed obligations into estimated cost trends, and factors developed from contractors' reports (such as percentage of value added by manufacture to total costs incurred, and value added per employee).

This one-time reporting test was introduced by personal visits of DOD and NASA personnel to several companies. Suggestions received during these interviews and others which are expected to be forthcoming from respondents and the working groups in the military departments will serve as a basis for setting up a permanent semiannual reporting requirement. Department of Defense personnel are anxious not to burden the contractors unnecessarily with reporting detail and, therefore, welcome the opportunity to discuss with company representatives any peculiar reporting problems.

Continuing effort is being applied through CEIS to improve the integration of DOD data requirements, often uniquely and separately imposed on contractors, so that the data needs of Defense management will continue to be met at the lowest cost to industry and Government.



## APPENDIX 11

### ADDITIONAL QUESTIONS AND ANSWERS

(The following letter was sent by Chairman Douglas to the Secretary of the Department of Health, Education, and Welfare:)

APRIL 6, 1966.

HON. JOHN W. GARDNER,  
*Secretary of Health, Education, and Welfare,*  
*Washington, D.C.*

DEAR MR. SECRETARY: At recent hearings of the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee, members were granted the privilege of submitting written questions to be answered by appropriate agencies in order to cover subject material that could not be covered during the short hearings.

As you may know, the subcommittee has for several years been interested in developing management techniques to insure the economic use of the Government's multibillion-dollar investment in personal property stores. Of especial and urgent concern has been the so-called short-shelf-life items, including medical supplies of various classes.

It would be appreciated if you will bring the subcommittee up to date with regard to steps taken within the past year regarding the management of medical supplies generally in your custody and specific comments about the vaccines in response to the following statement and question:

"In a report to the Congress dated July 23, 1965 (B-133038), GAO stated that a review of the management of vaccines stored in the civil defense medical stockpile indicated that storage methods employed by the Public Health Service, Department of Health, Education, and Welfare, were deficient to the point of impairing the effectiveness of the emergency health service program. It was noted that, in the event of an emergency, it would have been highly improbable for the vaccines to be distributed in a timely manner because additional processing of the vaccines, to put them in a useable form, would have been required after their removal from the stockpile. It was noted further that most of the vaccines were not adequately deployed to prevent the total loss of one or more types of vaccines in the event of damage to or destruction of a storage depot. In testimony before the Federal Procurement and Regulation Subcommittee of the Joint Economic Committee on March 24, 1966, the Comptroller General stated that certain of the vaccines had been converted and that a target date of 1970 for completion of the conversion program, established by the Public Health Service, was dependent upon the availability of sufficient funds. He stated further, however, that no funds were provided for this purpose in the 1967 budget request submitted to the Congress. Also, it is understood that the Public Health Service does not plan to further deploy the vaccines until they have been converted into finished products.

"The Government's investment in vaccines in the medical stockpile is about \$3 million. Since this substantial investment serves little purpose unless the vaccines are in a form and are so located as to reasonably assure their availability for widespread distribution in the event of a national emergency, and since funds to correct the deficiencies cited in the GAO report have not been requested from the Congress, what further action is contemplated by the Department of Health, Education, and Welfare to correct the situation?"

Your response will be appreciated by April 15 at room G-133, New Senate Office Building.

Faithfully yours,

PAUL H. DOUGLAS,  
*Chairman, Subcommittee on Federal*  
*Procurement and Regulation.*

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(The Department's response to the preceding follows:)

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE,  
*Washington, April 15, 1966.*

HON. PAUL DOUGLAS,  
*U.S. Senate,  
Washington, D.C.*

DEAR SENATOR DOUGLAS: This is in response to your letter of April 6, 1966, requesting information as to the management of stocks of short-shelf-life medical items under our custody with special reference to vaccines in the medical stockpile.

The principal problem area which has confronted the Department in this respect was the assumption of responsibilities for the management of the medical stockpile program in 1961. The program was initiated approximately 10 years before by the Federal Civil Defense Administration and composed an inventory of about \$200 million worth of medical supplies and equipment. Within this inventory was a large segment of items subject to shelf-life control. A comprehensive testing and quality control program was immediately instituted by the Public Health Service, the constituent agency in the Department which administers the medical stockpile program.

As testing results were accumulated, a significant portion of the older inventory was placed in the category of being under suspect or actually below acceptable quality standards. Simultaneously, preliminary efforts were extended to rotate quality shelf-life items with other Government agencies but only limited success was experienced.

As the result of General Accounting Office evaluations and the committee mechanism provided under the auspices of your office, The Interagency Committee for Utilization of Civil Defense Medical Stockpile Shelf-Life Material, considerable progress has been made in stock rotation. Agreements and commodity interchanges with the military, Veterans' Administration, the internal medical supply services of the Public Health Service, and, to an extent, the Agency for International Development, has resulted in very gratifying successes in rotation and utilization of medical stockpile materials. The attached table shows a line-item analysis of these transactions, by agency, from May 1965 to date.

The General Accounting Office review of the status of the vaccine inventory of the medical stockpile points up maintenance-wise one of the most complex and potentially costly areas of the overall program. Except for two types of vaccines related to treatment of the injured, the balance of the stock is for disease control in a postattack environment. The estimated required quantities of these materials is substantial and each vaccine, when in dosage form, is subject to an expiration date of from 18 to 60 months depending on the type.

The medical stockpile objective for vaccines is based on quantitative requirements as related to time periods postattack. Interim objectives or acquisition phasing places a descending order of priority on procurement to cover national postattack needs by 30-day increments up to 180 days. Procurement projections for up to 365-day-postattack needs compose the ultimate or ideal goal.

The assumption of the responsibility for the medical stockpile program by the Department included bulk vaccine stocks stored at manufacturers' facilities. These storage facilities were main or subsidiary plants located in geographic areas classed as "safe" according to prevailing official bomb damage assessment data. Bottling and labeling supplies for preparation of dosage forms from bulk stocks were stored at the same facility.

These stocks constituted an initial phase of vaccine acquisition in the mid and late fifties. The bulk form was selected to significantly minimize deterioration and maintenance costs inherent in labeled and expiration dated dosage forms.

The leadtime to convert bulk vaccines into dosage form presented a serious problem in effective and immediate distribution logistics even though the estimated phased requirement for many of the items would be several weeks on up to months after attack.

The Public Health Service, in 1963, undertook a comprehensive review of vaccine requirements to update the estimates of national need by postattack time periods. A revised list of vaccines was prepared and a schedule for conversion of existing bulk stock and procurement projections were developed.

Within a limited fund primarily designated for the maintenance of manufacturers' stored vaccines, a portion of the bulk vaccine was converted to dosage

form in 1964. This amounted to 120,000 vials of gamma globulin, 8 million doses of smallpox vaccine, 2½ million doses of typhoid vaccine, 3 million doses of tetanus antitoxin and 1 million doses of tetanus toxoid. These finished forms were removed from manufacturers' plants and placed in storage at medical stockpile depots.

While this conversion constituted a significant advance in vaccine stock immediate readiness, the amounts involved are far short of even the first 30-day postattack requirement. Approximately \$145,000 would be required to convert existing stocks toward the first-month needs and an additional procurement of about \$2 million worth of vaccines is required to reach total 30-day national needs. For cost comparison, a 6 months stockpile goal of dosage form vaccines would require about \$750,000 for conversion of existing stock in addition to about \$20 million in new procurement.

The question of rotation potential is the key issue in the maintenance of dosage form vaccines. Quantitatively, a stockpile of vaccines exceeds the usage rates of vaccines in the economy to an extent where only a token portion of the stock can be effectively rotated within expiration dating periods. While we feel that interagency rotation agreements including foreign aid programs can be improved to include larger segments of vaccine stocks, replacement of outdated items composes a continuing cost of large proportions.

The replacement value of a 30-day stock of vaccines involving items with an 18- to 60-month expiration date is about \$9.4 million. If the stockpile is extended to 6-months-postattack coverage, the 18- to 60-month replacement cycle would require about \$32 million. Within the context of the overall medical stockpile program, these costs are weighed against and are competitive to the equivalent value in essential pharmaceuticals, surgical instruments and supplies, hospital equipment, and related materials.

The Department seriously considered including vaccine conversion and acquisition in its 1967 program projections. However, upon review of program priorities, these two projects were not included in the fiscal year 1967 budget.

At present, a review is being afforded medical stockpile objectives by an Office of Emergency Planning chaired Interagency Committee for Emergency Health Preparedness. This evaluation is designed to maintain alinement of medical stockpile program with overall national defense policies. We are anticipating a statement of principles and policies and possible adjustments in program priorities about July 1, 1966. At that time, medical stockpile content and program objectives should be clearly delineated and oriented for consistency with current disaster threat concepts. The vaccine stocks are included in this evaluation.

We remain available for any further assistance or details you may desire.

Sincerely yours,

WILBUR J. COHEN,  
*Under Secretary.*

*PHS medical stockpile items accepted by other Government agencies  
(period May 1965 to Apr. 7, 1966)*

	Unit	Quantity	Amount
<b>DEPARTMENT OF DEFENSE</b>			
<b>(a) Pharmaceuticals:</b>			
Rotation:			
6505-146-4425 sulfisoxazole tablets .....	Bottle.....	34, 136	\$358, 107. 62
6505-153-8278 globulin immune serum .....	Vial.....	209, 980	1, 469, 860. 00
Subtotal .....			1, 827, 967. 62
Sales: 6505-146-2200 sulfadiazine, 500 milligrams .....	Bottle.....	5, 016	45, 042. 68
Grand total .....			1, 873, 011. 30
<b>(b) Medical gases:</b>			
Loans:			
6505-130-1940 nitrous oxide, 2,000 gallons .....	Each.....	110	4, 798. 20
6505-132-5225 oxygen, USP, 750 gallons .....	do.....	2, 332	9, 936. 76
Subtotal .....			14, 734. 96
Sales:			
6505-130-1920 nitrous oxide, 250 gallons .....	Each.....	222	3, 349. 98
6505-132-5181 oxygen D, 95 gallons .....	do.....	127	1, 619. 25
Subtotal .....			4, 969. 23
Grand total .....			19, 704. 19
<b>(c) Vaccines:</b>			
Sales:			
6505-160-1500 cholera vaccine .....	Bottle.....	31, 900	7, 337. 00
6505-634-7279 antirabies serum, 1,000 .....	do.....	19, 934	82, 526. 76
6505-160-7000 plague vaccine .....	do.....	60, 725	80, 764. 25
Grand total .....			170, 628. 01
<b>(d) Surgical dressings:</b>			
Rotation:			
6510-200-4000 bandage, gauze, 2 inches by 6 yards .....	Package.....	23, 769	13, 786. 02
6510-200-5000 bandage, gauze, 3 inches by 10 yards .....	do.....	50, 400	71, 830. 08
6510-200-6000 bandage, gauze, 4 inches by 10 yards .....	do.....	111, 977	206, 161. 07
6501-201-1755 bandage, muslin, 37 by 37 by 52 .....	Each.....	604, 136	96, 661. 76
6510-201-2900 compress and bandage .....	do.....	9, 384	15, 202. 08
6510-201-7430 dressing field, 7½ inches by 8 inches .....	do.....	184, 472	49, 807. 44
6510-201-7435 dressing, field, 4 inches by 7 inches .....	do.....	669, 600	93, 744. 00
6510-203-5500 adhesive plaster, 12 inches by 10 inches .....	Roll.....	65, 184	97, 776. 00
6510-203-8448 pad, gauze, 4 inches by 4 inches .....	Package.....	512, 640	505, 990. 80
6510-593-3221 pad, gauze, 2 inches by 2 inches .....	do.....	184, 430	40, 574. 60
Subtotal .....			1, 191, 533. 85
Sales:			
6510-200-2200 bandage, elastic 3 inches by 5½ inches .....	do.....	123, 678	399, 479. 94
6510-200-2500 bandage, elastic 6 inches by 5½ inches .....	do.....	55, 536	349, 321. 44
6510-201-7425 dressing, field, 11¼ inches by 5 yards .....	Each.....	99, 836	46, 969. 92
6510-202-1000 gauze, absorbent, 36 inches by 5 yards .....	Package.....	18, 000	5, 220. 00
6510-202-3000 gauze, absorbent, 36 inches by 100 yards .....	do.....	24, 108	101, 253. 60
6510-203-8480 sponge, surgical, 4 inches by 8 inches .....	do.....	227, 956	303, 181. 48
Subtotal .....			1, 205, 426. 38
Grand total .....			2, 396, 960. 23

*PHS medical stockpile items accepted by other Government agencies  
(period May 1965 to Apr. 7, 1966)—Continued*

	Unit	Quantity	Amount
<b>DEPARTMENT OF DEFENSE—continued</b>			
<b>(e) Medical and surgical equipment:</b>			
Loans:			
6505-000-0222 anesthesia apparatus.....	Each.....	2	\$1,346.02
6515-299-8337 suction and pressure apparatus.....	do.....	700	95,900.00
6515-333-3100 scissors, 7 inch.....	do.....	2,800	2,937.60
6515-349-5900 needle hypo.....	Box.....	4,116	1,975.68
6515-360-9200 retractor set.....	Set.....	2,976	8,035.20
6515-363-8840 scissors, 7½ inch.....	Each.....	25,344	55,756.80
6515-364-0500 scissors, 5½ inch.....	do.....	7,776	13,219.20
Subtotal.....			179,170.50
Sales:			
6515-363-8400 scissors, bandage.....	do.....	1,998	13,186.80
6515-344-7800 handle, surgical knife No. 3.....	do.....	214,638	96,587.10
Subtotal.....			109,773.90
Grand total.....			288,944.40
<b>(f) Hospital furniture and equipment:</b>			
Loans:			
6530-000-0010 sterilizer 8 inches by 16 inches.....	do.....	7	4,484.41
6530-000-0011 sterilizer 16 inches by 36 inches.....	do.....	158	153,672.38
Grand total.....			158,156.79
<b>(g) Laboratory equipment:</b>			
Sales: 6640-412-8960 centrifuge, hand.....	do.....	67	435.50
<b>(h) Miscellaneous:</b>			
Loans: 7105-269-9279 cot, folding, canvas.....	do.....	225,000	1,575,000.00
<b>PUBLIC HEALTH SERVICE—FERRY POINT, MD.</b>			
<b>(a) Pharmaceutical:</b>			
Rotation:			
6505-237-8480 penicillin G.....	Bottle.....	1,200	1,536.00
6505-153-8278 globulin immune serum.....	Vial.....	40,000	280,000.00
Grand total.....			281,536.00
<b>(b) Vaccines:</b>			
Rotation: 6505-161-2450 tetanus toxoid.....	Bottle.....	2,000	240.00
<b>(c) Surgical dressings:</b>			
Rotation: 6510-200-4000 bandage, gauze 2 inches by 6 yards.....	Package.....	160	92.80
<b>VETERANS' ADMINISTRATION</b>			
<b>(a) Pharmaceuticals:</b>			
Rotation:			
6505-153-8225 ether U.S.P., pound.....	Can.....	37,634	8,655.82
6505-153-8750 acetylsal. tablets.....	Bottle.....	9,396	7,328.88
6505-237-8480 penicillin G.....	do.....	2,336	2,990.08
6505-582-4590 chlorpromaz tablets.....	do.....	1,980	34,307.40
Subtotal.....			53,282.18
Sales: 6505-146-2200 sulfadiazine, 500 milligrams.....	Bottle.....	264	2,370.72
Grand total.....			55,652.90
<b>(b) Surgical dressings:</b>			
Rotation:			
6510-200-5000 bandage, gauze, 3 inches by 10 yards.....	Package.....	11,160	14,396.40
6510-200-6000 bandage, gauze, 4 inches by 10 yards.....	do.....	3,000	4,890.00
6510-201-2600 cellulose, abstract surgical.....	do.....	4,800	3,024.00
6510-203-5500 adhesive plaster 12 inches by 10 inches.....	Roll.....	8,460	13,113.00
Subtotal.....			35,423.40

*PHS medical stockpile items accepted by other Government agencies  
(period May 1965 to Apr. 7, 1966)—Continued*

	Unit	Quantity	Amount
<b>VETERANS' ADMINISTRATION—continued</b>			
(b) Surgical dressings—Continued			
Sales:			
6510-200-2200 bandage, elastic 3 inches by 5½ yards.	Package.....	5, 016	\$16, 201. 68
6510-200-2500 bandage, elastic, 6 inches by 5½ yards.	.....do.....	2, 000	12, 580. 00
6510-202-1000 gauze, abstract 36 inches by 5 yards.	.....do.....	25, 000	7, 250. 00
6510-202-3000 gauze, abstract 36 inches by 100 yards.	.....do.....	8, 500	35, 445. 00
Subtotal.....			71, 476. 68
Grand total.....			106, 900. 08
<b>AGENCY FOR INTERNATIONAL DEVELOPMENT</b>			
(a) Pharmaceutical:			
Sales: 6505-664-7116 Penicillin G.....	Bottle.....	66, 000	4, 620. 00
(b) Vaccines:			
Sales: 6505-000-8470 typhoid vaccine.....	.....do.....	10, 000	2, 300. 00
(c) Surgical dressings:			
Sales:			
6510-201-7425 dressing field 11¼ inch.....	Each.....	21, 000	9, 870. 00
6510-201-7430 dressing field 7½ inch by 8 inch.	.....do.....	28, 000	7, 776. 00
6510-203-8480 sponge, surgical 4 inch by 8 inch.	Package.....	25, 000	33, 250. 00
6510-203-8480 sponge, surgical 4 inch by 8 inch.	Package.....	25, 000	33, 250. 00
Grand total.....			50, 896. 00
<b>RECAPITULATION</b>			
DOD:			
Rotation.....			3, 019, 501. 47
Loans.....			1, 927, 062. 25
Sales.....			1, 536, 276. 70
Total.....			6, 482, 840. 42
PHS (Perry Point): Rotation.....			281, 868. 80
VA:			
Rotation.....			88, 705. 53
Sales.....			73, 847. 40
Total.....			162, 552. 98
AID: Sales.....			57, 816. 00
Grand total.....			6, 985, 078. 20

QUESTIONS AND ANSWERS: SUBCOMMITTEE TO DEPARTMENT OF DEFENSE

Chairman Douglas submitted the following questions to Secretary of Defense McNamara:

APRIL 6, 1966.

Hon. ROBERT S. McNAMARA,  
*Secretary of Defense,*  
*Washington, D.C.*

DEAR MR. SECRETARY: Members of the Subcommittee on Federal Procurement and Regulation request answers to the following additional questions for inclusion in the printed hearings of January 24, March 23, and March 24, 1966:

(1) Do you consider it feasible to develop a centralized employment referral system along the lines so successfully utilized in the Department of Defense for the 3 million persons now unemployed in the United States?

(2) Is the DOD amending its instructions to conform to BOB Circular A-76? If so, please provide a copy to the subcommittee when available.

(3) Does the DOD lease Government-owned facilities, equipment (aircraft, floating equipment, machine tools, etc.), to private industry? If so, under what authority and to what extent?

(4) What is the status of the DOD study on management of publications and printing in the DOD to which previous reference has been made? Can the DOD develop an integrated, stable, and efficient system under present laws and regulations?

(5) How do printing costs by DOD facilities, GPO, and private industry compare?

(6) Where do the DOD printing plants obtain their stocks of paper and other materials?

(7) Compare cost of GPO furnished materials with DOD direct purchase costs and purchases through GSA.

(8) Reports of the General Accounting Office have continually identified the lack of control over inventory transactions which have caused supply management problems. What actions are being taken to establish accounting controls over inventory receipts, issue, and transfer transactions? What actions are being taken to provide for effective physical inventories, including the correction of basic operating deficiencies which have caused frequent and large adjustments identified during the physical inventories?

(9) During a review of procurement of electronic parts, the General Accounting Office found that very often competitive bidding was limited where the item being procured required advance qualification. In response to the General Accounting Office report of January 1965, the Department of Defense stated that the Army, Navy, and Air Force were actively engaged in reviewing specifications to reduce the extent of qualification requirements which restrict competition. What is the current status of this program?

(10) In November 1963, the General Accounting Office issued a report concerning the unnecessary central management and distribution of commercially available items. In reply to a draft report on this matter, the Assistant Secretary of Defense indicated that a program would be established to eliminate from centralized management all items which, consistent with military necessity, could be efficiently and economically procured by using activities directly from commercial sources. What is the current status of this program and how many supply items have been transferred to local procurement by using activities?

(11) During several reviews performed by the General Accounting Office in the areas of Defense standardization, cataloging, and supply management by the Defense Supply Agency, there has been noted items coded by one military service for supply management by the Defense Supply Agency but coded by another service for retention of supply management by itself. How many such items are there in the supply system? To what extent are these determinations reviewed for justification of service retained supply management?

(12) Your comments on the three GAO reports on (a) sales receipts, (b) contractor inventory, and (c) priority requisitioning which were submitted to the subcommittee at the time of the hearings will be included in the printed hearings if you do desire.

We would appreciate your replies by Friday, April 15, at room G-133, New Senate Office Building.

Faithfully yours,

PAUL H. DOUGLAS,  
*Chairman, Subcommittee on Federal  
Procurement and Regulation.*

(The Department of Defense response to the preceding follows:)

ASSISTANT SECRETARY OF DEFENSE,  
*Washington, D.C., April 22, 1966.*

HON. PAUL H. DOUGLAS,  
*Chairman, Subcommittee on Federal Procurement and Regulation, Joint Economic Committee, Congress of the United States, Washington, D.C.*

DEAR MR. CHAIRMAN: This is in reply to your letter of April 6 to Secretary McNamara in which you asked for answers to certain questions to be included in the printed transcript of hearings conducted by your subcommittee on January 24, March 23, and March 24, 1966.

Enclosed are separate papers quoting each question, followed by our answer. We appreciate your interest in these subjects.

Sincerely,

PAUL R. IGNATIUS,  
*Assistant Secretary of Defense  
(Installations and Logistics).*

Question 1. Do you consider it feasible to develop a centralized employment referral system along the lines so successfully utilized in the Department of Defense for the 3 million persons now unemployed in the United States?

Answer. The Centralized Referral System in operation in the Department of Defense was designed specifically around the job and installation structure in the DOD and was tailored to preclude hiring of new employees in DOD vacancies which displaced employees could fill. It is supported by a specific requirement that the household transportation expenses of the displaced employee be paid to the new location. In its present form this system would not be applicable to the economy generally. However, it might be possible to adapt the concept for use within the Employment Service to provide faster matching of available applicants with vacancy requisitions on a community, regional, or nationwide basis. Undoubtedly among the major problems which would have to be overcome when matching jobs and people outside a single commuting area are the lack of geographical mobility on the part of many individuals seeking work, the difficulty of getting employees and employers together for interview, and the ultimate movement of the applicant and his household to a new location.

Question 2. Is the DOD amending its instructions to conform to BOB Circular A-76? If so, please provide a copy to the subcommittee when available.

Answer. Preparation of Department of Defense directives which will implement Bureau of the Budget Circular A-76 is now underway. Copies of the directives will be provided to the subcommittee as soon as they are published.

Question 3. Does the DOD lease Government-owned facilities, equipment (aircraft, floating equipment, machine tools, etc.), to private industry? If so, under what authority and to what extent?

Answer. Government-owned property, both real and personal, is used by private industry under a variety of contract arrangements. Where leased, the authority relied upon by the military departments is title 10, United States Code, section 2667. Property is leased when it is idle (but not excess) and private industry desires to use it for commercial purposes or for a mix of commercial and Government business.

Leasing is more prevalent in real estate transactions where high costs of continued Government plant maintenance is a prime factor and where the economy, particularly local communities, will realize significant advantage through activation of idle facilities not presently needed for defense purposes but which must be kept available for potential mobilization needs. Out-leasing of real estate is



cleared in advance with the Senate and House Armed Services Committees where the provisions of title 10, United States Code, section 2662, applies. To a lesser degree, personal property is leased under the same statutory authority. However, because of wear-out factors and defense reutilization potentials through shifts from one defense plant to another it is seldom advantageous to tie up nonexcess but idle personal property under commercial out-leasing "use" agreements would require several months to accomplish.

Most contractual arrangements involving use of Government-owned facilities by private industry are those in which the property is authorized for use in the performance of defense contracts under the terms of a standard facilities contract. Generally, such facilities are used without charge, the consideration to the Government being the reduced cost of supplies. Use charges, or lease rental equivalents, are assessed for incidental commercial usage or for Government work in some cases where this is in the Government's interest.

To provide complete data on the number and scope of existing lease and the DOD develop an integrated, stable, and efficient system under present laws

Question 4. What is the status of the DOD study on management of publications and printing in the DOD to which previous reference has been made? Can the DOD develop an integrated, stable, and efficient system under present laws and regulations?

Answer. Action on the recommendations in the DOD project staff report on management of publications and printing in DOD was deferred pending completion of the Joint Committee on Printing (JCP) survey of the Federal printing program. By letter of March 19, 1966, the chairman of the Joint Committee on Printing requested this deferral which was agreed to by letter of March 26, 1966. In this response it was noted that any prolonged deferment of remedial action to improve DOD's system of printing production and procurement would result in appreciable waste of monetary and personnel resources. To date, the JCP study findings have not yet been made available.

The Department of Defense firmly believes that an integrated stable and efficient publications and printing system can be developed and operated under present laws and regulations. In fact, the Department of Defense project staff itself specifically developed an outline of a proposed, fully centralized and integrated publications organization and recommended it be accepted. The project staff did not find it necessary to recommend any revision to present laws or regulations governing Federal printing to implement this recommendation.

Question 5. How do printing costs by DOD facilities, GPO, and private industry compare?

Answer. Comparison of printing costs by DOD facilities, GPO, and private industry cannot validly be made because of the extreme differences in the character of work produced and procured by these three categories of facilities.

(a) DOD operations usually are located on military installations and are of a small-scale nature generally involving reproduction of highly classified, customer-furnished typewritten copy of short run and short delivery deadlines.

(b) GPO operations are located at the seat of government and are of a more varied nature. In addition to job shop and specialty functions, GPO operations generally involve type set, long-run, high-quality publications.

(c) Commercial operations are generally located in areas of hardware contractors and are essentially restricted to multipage, large-scale orders of technical and supply manuals where composition is furnished by the hardware contractor himself.

However, in the procurement of the departmentwide printing from commercial sources, the GPO establishes the majority of contracts for such services and does add a surcharge of approximately 7½ percent. This surcharge adds significantly to the cost and would, in the main, be eliminated if such contracts were let directly by DOD.

Question 6. Where do the DOD printing plants obtain their stocks of paper and other materials?

Answer. In accordance with title 44, United States Code, DOD printing plants within the Washington area must procure their printing stocks of paper from the GPO.

Printing plants outside the Washington area may, as provided by ruling A-22657 of May 10, 1928, by the Comptroller General, procure their paper from

sources other than the Government Printing Office if the total cost of the paper from sources other than the Government Printing Office is less than the cost from GPO, including shipping charges.

Procurement of other consumable supplies used by printing plants is generally obtained through the annual supply schedules established by the GSA.

Question 7. Compare cost of GPO-furnished materials with DOD direct-purchase costs and purchases through GSA.

Answer. In the Washington area there are, of course, no competitive prices between GPO and the facilities of either GSA and DOD, inasmuch as the GPO is the sole source of supply. In this regard, we do find that the GPO prices for large quantities of paper under contracts established by the JCP are quite favorable. However, outside the Washington area, DOD and GSA prices may be as much as 10 percent less than GPO prices because paper is bought and warehoused by DOD and GSA in various locations throughout the United States and therefore shipping costs from these locations are less than they would be if deliveries were from GPO in Washington.

Question 8. Reports of the General Accounting Office have continually identified the lack of control over inventory transactions which have caused supply management problems. What actions are being taken to establish accounting controls over inventory receipt, issue, and transfer transactions? What actions are being taken to provide for effective physical inventories, including the correction of basic operating deficiencies which have caused frequent and large adjustments identified during the physical inventories?

Answer. The application of new automatic data-processing systems throughout the DOD supply system has enabled us to increase control over all inventory transactions. Each military service and Defense Supply Agency (DSA) has installed or is planning to install a new generation of electronic computers to support improved inventory management systems. While these systems are designed and programed within each DOD component, to a great extent they utilize standard codes and formats prescribed by the Department of Defense in the Military Standard Requisitioning and Issue Procedures (MILSTRIP) and the Military Standard Transaction Reporting and Accounting Procedures (MILSTRAP).

MILSTRIP was the forerunner of DOD-wide system standardization of mechanized supply documentation and in 1962 replaced 16 different systems for issue and receipt of supplies throughout the military establishment and the General Services Administration (GSA). This standardization has now been expanded by MILSTRAP to provide machine sensible codes and card formats for the interchange of data among inventory control points and storage depots to permit the more rapid and accurate posting to accountable records of all types of transactions, i.e., receipts, issues, and adjustments affecting on-hand stock balances. Techniques for coding ownership, condition, purpose or type of physical inventory are prescribed by MILSTRAP for use by all DOD components. The coding structure has also been designed to accommodate the income, expense, and inventory accounting classifications of the stock fund and appropriated fund accounting systems.

These military standards logistics documentation procedures have served to identify the most effective management control techniques and require their adoption on a DOD-wide basis.

The installation of a new generation of ADP systems at depots and inventory control points has resulted in a strengthening of document control procedures throughout each organization and across organizational lines. The retraining of clerical personnel in the processing of input and output documentation which is necessary in implementing new systems has also worked to assure proper handling of transactions. In converting to new systems, file purification programs have been activated to validate asset information, as well as other item management data essential to inventory control.

The increased capacity of these new computers has also permitted expansion of ADP system coverage to include automated warehouse locator files which simplify the warehouseman's job as well as provide for continuous automatic reconciliation between locator file entries and data in other inventory management files.

Machine processable receipt documents are prescribed by MILSTRAP to facilitate the rapid and accurate capture of materiel arriving from contractors. To exercise greater control over materiel due-in from procurement, new military standard contract administration procedures are now under development which will provide for uniform mechanized documentation of contract delivery schedules, vendor shipment notices, and related items of information.

From the foregoing, it is evident that we have approached this problem from a point of view oriented to the opportunity for greatest payoff, that is from a DOD-wide systems standardization basis rather than from an installation by installation basis.

Question 9. During a review of procurement of electronic parts, the General Accounting Office found that very often competitive bidding was limited where the item being procured required advance qualification. In response to the General Accounting Officer report of January 1965, the Department of Defense stated that the Army, Navy, and Air Force were actively engaged in reviewing specifications to reduce the extent of qualification requirements which restrict competition. What is the current status of this program?

Answer. To arrive at meaningful conclusions leading to the continuation, discontinuance or reorientation of the qualification process, questionnaires designed to reveal pertinent information relative to each specification wherein qualification is a requirement, were distributed to the three departments. Associations representing a cross section of industry were simultaneously requested to submit comments relative to qualification approval and the administration of the process. The study was completed during March 1966 and it was concluded that the qualification process is a legitimate procurement technique appropriate for implementation in military and Federal specifications. This conclusion was concurred in by the larger percentage of industry including the electronic segment, and completely by the military departments.

Questionnaires revealed, however, that the policies and procedures governing the process were not always implemented effectively and recognition was given to the fact that corrective action was in order. Consequently, on March 25, 1966, the military departments were directed to schedule within the next 90 days actions to:

(a) Revise or cancel specifications where no OPL has been established within certain specified time frames.

(b) Delete qualification requirements from documents where qualification and conformance tests are identical.

(c) Cancel or revise documents where OPL's have been established and the product of only one manufacturer has been qualified.

(d) Delete qualification requirements from documents where the requirements have been repetitively waived.

(e) Survey those documents where production leadtime has been identified as being at least two times greater than the time required for qualification testing. Where time has been identified as the criteria for establishment of qualified products list, delete the qualification requirement.

The above constitutes action to be scheduled on 1,634 procurement documents. Additionally, action is being undertaken to revise procedures, criteria, and practices designed to more effectively operate and control the qualification process.

It is considered that this study and the resultant actions have the effect of increasing competition and removing limitations and restrictions.

Question 10. In November 1963, the General Accounting Office issued a report concerning the unnecessary central management and distribution of commercially available items. In reply to a draft report on this matter, the Assistant Secretary of Defense indicated that a program would be established to eliminate from centralized management all items which, consistent with military necessity, could be efficiently and economically procured by using activities directly from commercial sources. What is the current status of this program and how many supply items have been transferred to local procurement by using activities?

Answer. The Department of Defense program to review items for possible elimination from central management in favor of "Local Purchase" or decentralized management, which was undertaken in response to the November 1963

General Accounting Office report, was suspended in February 1965. The suspension, which remains in effect today, was imposed when it became apparent that (1) the organizational impact of the decision warranted a second look at the basic rationale, and (2) the support of the Armed Forces in southeast Asia was being, or would be, degraded by any mass migration to decentralization of items under the criteria then being applied.

The principal changes in the organizational environment that affected the suspension decision were the development of standard systems such as MILSTRIP and MILSTRAP which provided a format universally understood, machine sensible structure for communicating logistics data, whether it be in the form of requisitions, follow-ups, status, transaction reports of receipts and issues, or billing documents. When combined with improved communication linkage of the type provided by the AUTODIN system, these computerized systems made centralization of item management as feasible on a practical basis as it was attractive on a theoretical basis. In that regard, the opportunity afforded by centralized management for a single agency to police the entry of one item into the system, to act as the procurement and storage agency for the needs of the entire military supply system, and to reduce through standardization action (or otherwise) the excessive number of items in the supply system, should not be discounted by considering:

(a) That the decentralization decision eliminates the costs associated with item management.

(b) That the aggregate costs of the several separate management units required for each decentralized item are always less than the cost of central management.

Of more immediate importance in suspending the decentralization action was the realization that support effectiveness was diminishing on items already decentralized. More and more it became apparent that not all activities could make the local purchases that were contemplated when the items were decentralized. Procurement increasingly required access to technical and source data available only at the inventory manager level. The urgent requirements for Vietnam only served to underscore that point.

In one Defense Supply center, in the period September 1965 through March 1966, it was found necessary to change 2,170 items from supply status code 2 (decentralized—local purchase) to supply status code 1 (centrally managed and stocked). Of these 2,170 items, 810 were items indicated to be of high military essentiality. Over 500 were reinstatements of old stock numbers which had been prematurely retired because of zero demands or zero assets.

Currently there are 197,000 decentralized items in the Defense Supply Agency assignment. In view of the need to suspend the review and reclassification process, that number is not likely to increase significantly in the coming months. The Department of Defense position remains that there are valid reasons for decentralizing items. These will be developed in a revised rationale and incorporated into decision criteria and decision rules. In the meantime, we will emphasize item entry control, inactive item reduction, and standardization.

Question 11. During several reviews performed by the General Accounting Office in the areas of Defense standardization, cataloging, and supply management by the Defense Supply Agency, there has been noted items coded by one military service for supply management by the Defense Supply Agency but coded by another service for retention of supply management by itself. How many such items are there in the supply system? To what extent are these determinations reviewed for justification of service retained supply management?

Answer. At the present time there are 16,000 items being service-managed and DSA-managed simultaneously. This situation, referred to as the A/B mix problem, is gradually being brought under control. In July of 1963, more than 63,000 A/B mixes were identified. Since that time more than 100,000 have been resolved as additional conflict cases were revealed and as DSA moved more and more into integrated management. In terms of the starting position (63,000 cases), plus the interim additions (about 53,000 cases), the remaining unresolved cases seem of minor significance. Most of them, it is believed, will be eliminated through the application of the new item management coding criteria. This program, closely monitored, is currently underway. These criteria are not expected to eliminate all conflicts; some arbitrary decisions may be required to achieve that result. The new criteria, however, should reduce the magnitude of excep-

tional cases to the point where separate individual review action at a high level is feasible.

Question 12. Your comments on the three GAO reports on (a) sales receipts, (b) contractor inventory, and (c) priority requisitioning which were submitted to the subcommittee at the time of the hearings will be included in the printed hearings if you so desire.

Answer. The following comments are offered in connection with the GAO report of March 17, 1966, entitled "Survey of Adequacy of Controls Over Government-Owned Property in the Possession of Contractors." We are engaged in effecting general revisions to our "Manual for Control of Government Property in the Possession of Contractors." This effort involves updating and the consolidation of guidance formerly contained in separate procedures published by the military departments, and more precise and detailed delineations of duties and responsibilities of both Government and contractor personnel. The GAO report recommended that policy on these matters should be reevaluated. We are not prepared to state, in advance of careful study, the extent to which contractors should be held liable for Government property loss or damage and the effect of such liability on contractor property management. The matter of contractor responsibility for Government-owned property and related problems of insurance and expense are important and complicated. We are prepared to undertake a study to determine what changes in present policies may be required.

With respect to the GAO reports dated March 18, 1966, "Report on Cost of Sales of Surplus Property and Disposition of Proceeds," and "Report on Use of High Priority Requisitions by Military Activities," we propose to submit a full statement upon completion of a more detailed analysis which is currently underway. The briefing papers provided at the time of the hearing are not regarded as responsive and in sufficient detail to appear in the printed record.

QUESTIONS AND ANSWERS: SUBCOMMITTEE TO BUREAU OF THE BUDGET

The following questions were submitted to the Bureau of the Budget by Chairman Douglas:

APRIL 6, 1966.

HON. CHARLES L. SCHULTZE,  
*Director, Bureau of the Budget,  
Washington, D.C.*

DEAR MR. SCHULTZE: Members of the Subcommittee on Federal Procurement and Regulation request answers to the following additional questions for inclusion in the printed hearings of January 24, March 23, and March 24, 1966.

(1) What plans have been made or are underway in the BOB for monitoring Circular A-76? Furnish copies of any internal instructions.

(2) Mr. Hughes' statement on March 24 regarding the subcommittee's report of July 1965 on the use of the DOD facilities at Battle Creek, Mich. (DLSC), for improved inventory management and utilization of Federal property is encouraging. However, Admiral Lyle's testimony on the same subject is less optimistic. Will you confer with DSA representatives and furnish the subcommittee a step-by-step approach deemed necessary to achieve the objectives we all seem to agree are desirable and obtainable in this regard?

(3) Does the BOB support the current practice of executive agencies applying different differentials under the Buy-American Act when purchasing (a) the same item, or (b) the same class of items?

(4) There is some pooling of automotive equipment and automatic data processing equipment in the executive branch. Is anything being done to pool other classes of equipment, i.e., heavy earthmoving, machine tool, aviation, etc.?

(5) Would you supply for the record a statement of the various methods now used by Federal agencies to make payments in lieu of taxes to local governments for federally owned property or interests within the local jurisdictions?

(6) What portion of the total Federal printing and reproduction costs are for the legislative, executive, and judicial branches of Government respectively?

(7) Does the BOB, in the light of Circular A-76 intend to utilize commercial printing and reproduction sources to the optimum extent in the future?

(8) Has the executive branch ever raised the legal question with the Justice Department as to the control of its printing and hence program functions by a legislative agency of the Government? If so, attach copy of opinion.

(9) Please comment on the following submission regarding BOB Circular A-76:

"As our Procurement Subcommittee of the Joint Economic Committee indicated to Mr. Hughes when he appeared before it on March 24, 1966, it is a pleasure to know that the Bureau has now published a new Circular (A-76) setting forth policies for determining when the Government should provide products and services for its own use. The Budget Bureau staff is to be congratulated for issuing this circular and for the continuing recognition of the advantages to the Government in considering all costs—even if they are not paid from an agency's current appropriation—when determining whether to procure products and services from itself or from private enterprise. The fact that the President has made the circular's policy his own is of particular significance.

"As one must surely recognize, the policy established by the circular will not always be uniformly applied by all agencies. In fact, all of the finest objectives of the circular will come to naught if agencies are permitted to make interpretations of the circular by which they would be entirely excluded from its operation.

"Section 4(a) exempts contracts when they would be a departure from agency regulations. This subsection would appear to be subject to possible interpretations that any agency could avoid the application of the provisions of A-76 by issuing or refusing to change a regulation inconsistent with it. What assurance is there that agencies could not adopt this approach?

"Section 4(d) provides that the circular does not apply to products and services which are provided to the public. It would seem possible that agencies could construe this to exempt procurement of such supplies and services merely because they may be obtainable from some agency somewhere which happens to provide them to the public in some quantity. Certainly if one Federal agency provides a product or service to the public, then—without any requirement for a comparative cost analysis—all other Federal agencies could make their procurement decisions exempt from the provisions of the circular by procuring the product or service from that agency. Thus, it would seem that the circular would be subject to the interpretation that every time we in Congress authorize a Federal agency to provide a product or service to the public, we are also negating the application of Circular A-76 by permitting all other Federal agencies henceforth to ignore cost considerations, and in fact the entire policy of the circular, for all purchases of such a product attainable from the agency which we authorize to provide the product to the public. The door could thus be opened to the unlimited expansion of Government, commercial, and industrial activities to supply any such product or service. What assurance is there that agencies could not adopt this approach?

Also, section 4(e) exempts products or services obtained from other Federal agencies which are authorized or required by law to furnish them. This subsection would appear to be subject to the interpretation that, if an agency obtains a product or service from another Federal agency, the circular would apply only if the agency supplying the product or service is not authorized or required by law to furnish them. Since it is presumed that no agency is engaged in activities not authorized or required by law, this would leave little scope for application of the circular. What assurance is there that agencies could not adopt this approach? It would seem that the cost test, etc., of the circular should apply to a Federal agency having the alternative of obtaining a product or service from another Federal agency but not required by law to do so."

We would appreciate your replies by April 15, at room G-133, New Senate Office Building.

Faithfully yours,

PAUL H. DOUGLAS,  
*Chairman, Subcommittee on Federal  
Procurement and Regulation.*

(The Bureau responded as follows:)

EXECUTIVE OFFICE OF THE PRESIDENT,  
BUREAU OF THE BUDGET,  
Washington, D.C. May 3, 1966.

HON. PAUL H. DOUGLAS,  
*Chairman, Subcommittee on Federal Procurement and Regulation, Joint Economic Committee, Congress of the United States, New Senate Office Building, Washington, D.C.*

DEAR MR. CHAIRMAN: This is in response to your letter dated April 6, 1966 requesting answers to additional questions for inclusion in the printed hearings of January 24, March 23, and March 24, 1966. Also attached are materials requested for insertion in the record at points indicated in the transcript previously returned to staff of the subcommittee. Following are responses to additional questions:

1. What plans have been made or are underway in the Bureau of the Budget for monitoring Circular A-76? Furnish copies of any internal instructions.

Our principal effort to date has been to assure that, in drafting their implementing directives and in organizing to carry out their responsibilities under the directive, agencies have correctly interpreted the requirements of the circular. Most of the principal agencies have drafted implementing directives and have designated an Assistant Secretary or official of equivalent rank to assume direct responsibility for administering the policy.

Although both the circular and the President's memorandum of March 3, 1966 (copy enclosed), placed primary responsibility upon executive agencies, we anticipate that followup by the Bureau of the Budget will be appropriate. However, we will not be able to determine the nature or extent of such followup until agencies have completed organizational and procedural arrangements and until reasonable progress has been made toward completion of the inventory of Government commercial and industrial activities which is required by the cir-

cular. The circular provides that this inventory is to be completed by July 1, 1966.

We shall be pleased to inform the subcommittee of more detailed plans for followup as they are developed.

2. Mr. Hughes' statement on March 24 regarding the subcommittee's report of July 1965 on the use of the DOD facilities at Battle Creek, Mich. (DLSC), for improved inventory management and utilization of Federal property is encouraging. However, Admiral Lyle's testimony on the same subject is less optimistic. Will you confer with DSA representatives and furnish the subcommittee a step-by-step approach deemed necessary to achieve the objectives we all seem to agree are desirable and obtainable in this regard?

We believe there are excellent opportunities for improved inventory management and utilization of Federal property by means of the services available from the Defense Logistics Supply Center in Battle Creek, Mich. We believe that officials of the Defense Supply Agency share this optimism. The first step toward realizing the full potential in this area is to increase the computer capability at the Center and to refine further the data processing programs and systems required by the Center. The DSA is already in process of completing this essential step. When this is done it will be feasible to bring civilian agencies into the system, not only with respect to cataloging but also for management of long stocks and other measures for assuring maximum utilization of Government property. The GSA is engaged in developing methods of bringing selected civilian agencies into the system. However, because of different systems and different degrees of mechanization among the civilian agencies, considerable time will be required for this objective to be fully realized. Following the issuance of a general procedure for using long supply to meet procurement requirements, the General Services Administration will need to give special attention to the individual problems of the civilian agencies so that the general procedures can be adapted to individual agency capabilities.

3. Does the Bureau of the Budget support the current practice of executive agencies applying different differentials under the Buy American Act when purchasing (a) the same item, or (b) the same class of items?

As a temporary measure, the Bureau of the Budget has supported the existing practice among civilian agencies and the Department of Defense. We believe the existing differences between the practices followed by the Department of Defense and the civilian agencies should be eliminated when problems of trade negotiations and balance of payments are less critical. We believe a change at this time would not be advisable but will be pleased to support appropriate actions toward a more uniform policy as soon as these problems are relieved.

4. There is some pooling of automotive equipment and automatic data processing equipment in the executive branch. Is anything being done to pool other classes of equipment, i.e., heavy earthmoving, machine tool, aviation, etc.?

In addition to pooling of automotive equipment and automatic data processing equipment, considerable progress has been made in pooling printing and duplicating equipment to serve agencies occupying Federal buildings. There are 25 such locations at present operated by the General Services Administration and the feasibility of pooling arrangements is a consideration in the planning of every new Federal office building. Also there is some pooling of equipment in the operation of central health units in buildings housing several agencies, each of which ordinarily would have its individual health unit. There are 12 such central health units in operation now with plans for 18 additional by the end of this calendar year. Further pooling of equipment has been accomplished with respect to training and conference devices such as projectors, screens, and chalkboards. Opportunities for pooling earthmoving equipment and machine tools have been limited by difficulties of moving such equipment and, in the case of earthmoving equipment, by the fact that the Government's requirements are generally accomplished under contract with contractor-owned equipment.

An opportunity for pooling of aviation maintenance equipment has been identified in the course of reorganization plans for a new transportation agency. We believe there are potential savings to be realized by combining selected aircraft repair and maintenance activities of the Coast Guard with those of the Federal Aviation Agency. This opportunity for savings will be facilitated by the establishment of the proposed Department of Transportation.



5. Would you supply for the record a statement of the various methods now used by Federal agencies to make payments in lieu of taxes to local governments for federally owned property or interests within the local jurisdictions?

This information is supplied separately for the record as requested by Congressman Curtis during the hearings for insertion in the record. (See p. 200.)

6. What portion of the total Federal printing and reproduction costs are for the legislative, executive, and judicial branches of Government respectively?

In fiscal year 1965, obligations for printing and reproduction were distributed among the three branches of the Government as follows:

[Dollar amounts in millions]

	Obligations	Percent to total
Legislative branch.....	\$67	24.7
Judicial branch.....	1	.4
Executive branch.....	203	74.9
Total.....	271	100.0

<sup>1</sup> Does not include obligations for printing and reproduction for trust funds which totaled \$3,000,000.

7. Does the Bureau of the Budget, in the light of Circular A-76, intend to utilize commercial printing and reproduction sources to the optimum extent in the future?

Circular A-76 provides that "No executive agency will initiate a 'new start' or continue the operation of an existing Government commercial or industrial activity except as specifically required by law or as provided in this circular."

The Bureau of the Budget estimates its printing and reproduction costs for fiscal year 1966 will be \$264,000. The President's budget and reports directly related to it have been printed by the Government Printing Office. These publications account for about 88 percent of the Bureau's expenditures for printing and reproduction work. These documents include the budget estimates for the entire Federal Government, including the legislative branch and the judiciary, as well as the executive branch. The remaining 12 percent also was obtained through the GPO. Like the executive agencies, the Bureau of the Budget considers itself bound by the longstanding statutory requirements provided under 44 U.S.C. 111, which is quoted below.

"All printing, binding, and blank-book work for Congress, the Executive Office, the Judiciary (other than the Supreme Court of the United States), and every executive department, independent office, and establishment of the Government, shall be done at the Government Printing Office, except (1) such classes of work as shall be deemed by the Joint Committee on Printing to be urgent or necessary to have done elsewhere; and (2) printing in field printing plants operated by any such executive department, independent office, or establishment, and the procurement of printing by any such executive department, independent office, or establishment from allotments for contract field printing, if approved by the Joint Committee on Printing \* \* \*.

"Such printing, binding and blank-book work authorized by law, as the Public Printer is not able or equipped to do at the Government Printing Office, may be produced elsewhere under contracts made by him with the approval of the Joint Committee on Printing."

8. Has the executive branch ever raised the legal question with the Justice Department as to the control of its printing and hence program functions by a legislative agency of the Government? If so, attach copy of opinion.

Procurement of printing and reproduction services for the executive branch was considered when the General Services Administration was being established, but we are not aware that a request for an opinion of the Attorney General actually was submitted or that such an opinion has been rendered. In 1920, President Wilson disapproved a bill which provided that the printing of magazines by executive agencies must have the prior approval of the Joint Committee on Printing. Such prior approval is not required at present and the Joint Committee on Printing has concerned itself with printing activities rather

than the program functions of the Government. The printing statutes are of long standing and we share the views expressed to your subcommittee by the Department of Defense that, while improvements in this area can be achieved, "an integral, stable and efficient publications and printing system can be developed and operated under present laws and regulations."

9. Please comment on the following submission regarding Bureau of the Budget Circular A-76:

Following are comments concerning the quoted submission:

We agree that Circular No. A-76 could involve differences in interpretation on the part of executive agencies. If carried to extremes, such interpretations could cause the results of the directive to be unsatisfactory. We do not anticipate that such strained or distorted interpretations will occur in view of the stated objectives of the circular and the President's request for effective support of these objectives. If any such problems arise, however, we shall attempt to deal with them.

The purpose of the language in section 4a is to make clear that the circular is not intended to provide independent contracting authority for agencies not otherwise authorized by law to enter into contracts nor is it intended to set aside Government-wide regulations which are issued pursuant to law by such organizations as the Civil Service Commission, the Joint Committee on Printing, or the General Services Administration. The provision is not intended to permit an agency to issue internal regulations which would exempt it from the provisions of Circular No. A-76 and we are inclined to question whether such a strained interpretation will be made. If any such question actually arises we shall take appropriate action.

The purpose of section 4d is to make clear that products or services provided to the public by Federal agencies pursuant to specific laws are not to be affected by the circular. For example, the electric power provided by the TVA, the Bureau of Reclamation, the Bonneville Power Administration, etc., is not intended to be affected by the provisions of the circular.

It is possible that a Federal agency may use products or services provided by another agency whether or not such products or services also are provided to the public but in such a case, the agencies would be guided by section 5d of the circular. We shall try to resolve any problems which may arise involving this language.

Section 4e is included in the circular because it is not feasible for an agency which obtains products or services from another agency to assume responsibility for cost comparison studies and other analyses required by the circular. For example, it would be impractical and wasteful to require every Federal agency to conduct a cost comparison study before sending a supply requisition to GSA in order to determine whether total costs from GSA are lower than from commercial sources. Similar problems exist with respect to other central services such as management of motor pools and public buildings and to products from various kinds of Government facilities which are operated by agencies primarily for their own requirements but which can also supply the needs of one or more other agencies. If such facilities must be retained by the Government we believe they should be fully utilized.

This means that agencies relying upon other agencies are relieved of responsibility under the circular but it does not mean that the products or services themselves are exempted. The circular provides in section 5d that the agency which provides a product or service used by another agency is responsible for compliance with the circular. This arrangement is necessary because the agency which uses a service furnished by another agency usually is not aware of the total costs which should be charged against the Government activity. The using agency usually is aware only of the costs which it must pay as reimbursement which may not include all of the elements which should be included as Government costs under the circular. The agency which furnishes a product or service is in the best position to compute total costs and should, therefore, assume responsibility for compliance with the circular. We believe these provisions are generally understood but we will deal with any questions or problems which may arise in order to assure that the circular is properly administered.

Sincerely,

(Signed) PHILLIP S. HUGHES,  
Deputy Director.

Enclosures.

QUESTIONS AND ANSWERS: SUBCOMMITTEE TO GENERAL SERVICES ADMINISTRATION

(Chairman Douglas submitted the following questions to the General Service Administration):

APRIL 6, 1966.

Mr. LAWSON B. KNOTT, Jr.,  
*Administrator, General Services Administration,  
Washington, D.C.*

DEAR MR. KNOTT: Members of the Subcommittee on Federal Procurement and Regulation request answers to the following additional questions for inclusion in the printed hearings of January 24, March 23, and March 24, 1966.

(1) Why is automotive equipment and office equipment not made available for donation to eligible education and health institutions before it is sold for all practical purposes as surplus to the Government's needs?

(2) Is legislation required to make it eligible for donation or could this be done by administrative regulation?

(3) Would the motor pools show a profit if the receipts from sales of vehicles were not credited to them?

(4) In view of the present state of the economy and improvement in roads and mechanics, would it not be desirable for the Government to buy automotive equipment at much longer replacement basis, say, 100,000 miles in lieu of 60,000?

(5) To what extent is there duplication in the supply functions of GSA and the GPO with respect to paper and envelopes, standard and other forms, tabulating cards, inks, glues, and other supplies?

(6) Do DOD printing plants obtain stocks of paper and other supplies from GSA or GPO or both? Indicate extent of each.

(7) To what extent do other executive agencies obtain supply items from the GSA and GPO?

(8) What is a fair value of the tract (85 acres estimated) proposed to be used for a new Printing Office site on the boys training school land?

(9) What criteria do you use in determining when an item should be (a) purchased directly by you or the requisitioning agency, (b) placed on an open-ended Federal supply schedule, (c) stored and issued, or (d) obtained from excess stocks?

We would appreciate your replies by April 15, at room G-133, New Senate Office Building.

Faithfully yours,

PAUL H. DOUGLAS,  
*Chairman, Subcommittee on Federal Procurement and Regulation.*

(The response of the General Services Administration follows:)

GENERAL SERVICES ADMINISTRATION,  
*Washington, D.C., May 2, 1966.*

Hon. PAUL H. DOUGLAS,  
*Chairman, Subcommittee on Federal Procurement and Regulation, Joint Economic Committee, U.S. Congress, Washington, D.C.*

DEAR SENATOR DOUGLAS: In response to your letter of April 6, 1966, there are attached answers to questions raised by the subcommittee following the hearings held last month.

If we can be of further assistance to the subcommittee, please do not hesitate to call on us.

Sincerely yours,

J. E. MOODY,  
*Acting Administrator.*

Enclosure.

GENERAL SERVICES ADMINISTRATION RESPONSE TO QUESTIONS RAISED IN LETTER DATED APRIL 6, 1966, FROM THE CHAIRMAN, SUBCOMMITTEE ON FEDERAL PROCUREMENT OF THE JOINT ECONOMIC COMMITTEE

*Question 1.*—Why is automotive equipment and office equipment not made available for donation to eligible education and health institutions before it is sold for all practical purposes as surplus to the Government's needs?

*Question 2.*—Is legislation required to make it eligible for donation or could this be done by administrative regulations?

*Response.*—In 1965, GSA conducted a study of the existing exchange/sale procedures with an intention of providing more exacting requirements. The study resulted in a substantial revision of the GSA exchange/sale regulation. The most significant of the changes were these:

- (1) Limiting the exchange or sale of items to a one-for-one basis.
- (2) Expanding the types and kinds of items which cannot be exchanged or sold.
- (3) Further curtailing the categories of property which may be sold or exchanged without a specific similarity test.
- (4) Precluding the acquisition of excess property by agencies to be used only for exchange or sale under section 201(c).

The revised draft regulation was circularized among Government agencies, comments were received and evaluated, and the new regulation published in the Federal Register on March 26, 1966, carrying an effective date of July 1, 1966.

Specifically, the list of property not eligible for handling as exchange/sale property has been expanded from 7 types to 30 complete FS groups, including such additions as woodworking and metalworking machinery, construction and building materials, and firefighting equipment. Correspondingly, the categories of property which may be sold or exchanged without a specific similarity test have been reduced from 69 to 41.

The combined effect of these changes will, of course, materially limit the volume and nature of property which can leave the Government through the exchange/sale route; and will increase proportionately the volume and types of personal property which will flow through surplus disposal channels and be made available for donation.

Used automotive equipment and office equipment are frequently disposed of under the exchange/sale authority and the revised regulation probably will not affect this practice of numerous Government agencies. If, as a general rule, motor vehicles and office machines planned for replacement were made available for donation, and were in fact donated, there would be no trade-in allowances or proceeds of sale obtained, and agencies would, of a necessity, have to request new appropriation authority each year for the full cost of purchasing new similar equipment. In the case of replacement of GSA motor pool vehicles, which are financed from a working capital fund, the rental rates charged user agencies would have to be increased whenever a loss would otherwise result.

Both the existing exchange/sale regulation and revision which will be effective July 1, 1966, are permissive in nature. That is, individual agencies need not process any of their eligible categories of property under exchange/sale procedures, but can follow instead the excess-surplus channels. Because of this, many office machines and vehicles have been made available for donation and will undoubtedly continue to be so handled in the future.

In our opinion, however, GSA could not, by administrative regulation, preclude the use by agencies generally of the exchange/sale authority in connection with the replacement of office machines and automotive equipment. Prior to 1949, a number of Government agencies had authority to enter into exchange or exchange/sale transactions involving the replacement of these two categories of property. The legislative history of section 201(c) of the Federal Property Act indicates clearly that it was the intent of Congress, in enacting that section, to preserve all such existing authority.

*Question 3.*—Would the motor pools show a profit if the receipts from sales of vehicles were not credited to them?

*Response.*—No. GSA motor pools would show a loss if the receipts from sales of vehicles were not credited. While the overall motor pool fund showed small profits in prior years, there was a loss of \$261,535 in fiscal year 1965 which would have been increased to \$3,158,391 if the \$2,896,856 in receipts had not been credited to the fund. GSA motor pool accounting is patterned after that used in private industry. Its rate structure and depreciation allowances assume a

salvage value of the vehicles and only the net cost is programed for recovery through charges for use of motor pool vehicles. If this were not done, the rates charged to using agencies would have to be increased and an increase in capital expenditures equivalent to the amount of receipts would have to be budgeted for. GSA rates are designed to achieve a break-even position to the maximum extent possible.

*Question 4.*—In view of the present state of the economy and improvement in roads and mechanics, would it not be desirable for the Government to buy automotive equipment at much longer replacement basis, say, 100,000 miles in lieu of 60,000?

*Response.*—No. We would not consider it advisable to extend the 60,000 mile replacement standard on a mandatory basis.

Subpart 101-38.9 of the Federal Property Management Regulations prescribes minimum motor vehicle replacement standards. Passenger cars and station wagons may be replaced when they have been operated for 6 years or 60,000 miles, whichever occurs first. Buses for 11 or more passengers may be replaced when they have been operated for 8 years. Without regard to years of use, such buses may be replaced when they have been operated the following number of miles:

	<i>Miles</i>
Intercity-type bus.....	280,000
City-type bus.....	150,000
School-type bus.....	80,000

Motortrucks provided with pickup or express, panel or sedan-delivery, carryall, van, open van, platform, stake, rack, dump, truck-tractor, or tank bodies may be replaced in accordance with the following table of years or mileage operation, whichever occurs first:

Payload rating	Total years	Total miles
1 ton and less.....	6	50,000
1½ through 2½ tons.....	7	60,000
3 tons and over.....	9	80,000

The regulations state that "The replacement standards prescribed are minimum standards. Executive agencies shall retain motor vehicles which are usable and in workable condition *even though the standard permits replacement*, provided the item of property can be used or operated an additional period without excessive maintenance cost or substantial reduction in trade-in value."

In evaluating replacement standards for motor vehicles, the key costs are those which vary with the age of the vehicle; namely, depreciation (or replacement cost) and maintenance. Historically, maintenance costs increase with the age of the vehicle. GSA experience indicates that with reasonable preventive maintenance, a passenger car can be operated 60,000 miles without major repairs. Our regulations provide the flexibility for retention of vehicles beyond 60,000 miles whenever it is economical to do so.

*Question 5.*—To what extent is there duplication in the supply functions of GSA and the GPO with respect to paper and envelopes, standard and other forms, tabulating cards, inks, glues, and other supplies?

*Response.*—Both GSA and GPO perform supply functions to some extent in connection with the item categories listed in your letter. Each category is discussed below. GSA has been working with the Joint Committee on Printing and GPO, and some studies have been undertaken to identify and eliminate avoidable duplication in the procurement and distribution of these items.

(a) Paper, ink, and glues: Both GSA and GPO supply these commodities. Items available through GPO are procured from that source for distribution from the GSA Supply Depot at Franconia, Va., to agencies in the States of Maryland, Virginia, West Virginia, the District of Columbia, and certain overseas areas. Some activities, especially printing plants in the District of Columbia and vicinity, obtain these items directly from GPO. Stocks of these items which are distributed by other regional GSA supply depots are procured from commercial sources.

(b) Envelopes: GSA executes Federal Supply Schedule contracts and makes other contracts for special requirements for plain and printed envelopes. A limited number of plain (nonmailing) envelopes are stocked in the GSA supply depots. Executive agencies obtain other plain envelopes for use in the District of Columbia from GPO. The GPO uses the GSA Federal Supply Schedule contracts for certain envelopes and from time to time makes special purchases of other envelopes for delivery in the District of Columbia.

(c) Standard forms, other forms, and miscellaneous supplies: GSA is the central control point for the consolidated procurement, supply control, storage and distribution of standard and optional forms. GSA obtains such standard and optional forms through the GPO. These forms are stocked by the GSA supply depots and distributed to all executive agencies except (1) agency requirements for overprinted forms, (2) standard and optional forms for the Department of Defense, and (3) any exceptionally large requirements which are procured through GPO for direct delivery to the using agency. Order for the overprinted forms and for forms required by DOD are ordered direct by using agencies with the order flowing through GSA for consolidation and control only. Stenographic notebooks, wall calendars, and blank books are stocked by all GSA supply depots and distributed to all using agencies. These items are obtained by GSA from GPO.

(d) Marginally punched continuous forms: GPO makes indefinite quantity requirements contracts for marginally punched continuous forms. GSA stocks and distributes a limited number of items of blank, marginally punched tabulating machine forms which are widely used by executive agencies. GSA stocks are obtained from GPO contracts except where quantities exceed GPO contract limitations. Agencies obtain other item requirements within the maximum order limitation from these GPO contracts. Requirements above the maximum order limitation are purchased by GPO or by the individual agencies (including GSA) under waivers issued by GPO.

(e) Tabulating cards: GPO makes annual indefinite quantity requirements contracts and agencies obtain their requirements from these contracts.

*Question 6.*—Do DOD printing plants obtain stocks of paper and other supplies from GSA or GPO or both? Indicate extent of each.

*Response.*—DOD printing plants obtain supplies from GPO, DSA, and GSA. DOD printing plants in the Metropolitan area of Washington obtain supplies through GPO. In areas outside of Washington, both GSA and DSA provide supply support to printing plants. However, as a result of our efforts to eliminate avoidable duplication of supply support, DSA and GSA have agreed to transfer the supply support for the FS classes involved to GSA. We expect this agreement to be implemented by the end of calendar year 1966. However, the duplication between GSA and GPO will continue to exist.

*Question 7.*—To what do other executive agencies obtain supply items from the GSA and GPO?

*Response.*—The degree of overlapping supply support to executive agencies by GSA and GPO is described in our answer to questions 5 and 6, above.

*Question 8.*—What is a fair value of the tract (85 acres estimated) proposed to be used for a new Printing Office site on the Boys' Training School land?

*Response.*—GSA estimates the fair value of this property at \$3.5 to \$4 million.

*Question 9.*—What criteria do you use in determining when an item should be (a) purchased directly by you or the requisitioning agency, (b) placed on an open-end Federal Supply Schedule, (c) stored and issued, or (d) obtained from excess stocks?

*Response.*—The criteria requested under this item has been issued in the Federal Procurement Regulations (FPR) and the Federal Property Management Regulations (FPMR).

(a) The criteria for purchase by GSA is set forth in FPMR 101-25.203. In addition, arrangements may be made for purchasing by GSA on other than a centralized basis in accordance with the criteria in FPMR 101-25.205. In this latter category, we are performing purchasing for the Office of Economic Opportunity, Peace Corps, AID, and other smaller activities. The criteria for independent purchases by executive agencies is set forth in FPMR 101-25.101-5, and 101-25.206. In addition to the cited published regulations, the Commissioner, Federal Supply Service, has advised the GSA Regional Administrators under

date of January 19, 1965, that our future purchase support for items not stocked will be limited to the centralized purchase items (see FPMR 101-25.101-3), for agencies without adequate purchase capability within their own organizations, or under arrangements made in accordance with FPMR 101-25.205. Also of interest is the criteria for interagency purchase assignments as prescribed in FPMR 101-25.201 and .202.

(b) The criteria for placing an item on an open-end Federal Supply Schedule is set forth in FPMR 101-25.101-4 as Federal Supply Schedules are, in fact, indefinite quantity requirement-type contracts.

(c) The criteria for determining when an item should be stored and issued is contained in FPMR 101-25.101-2.

(d) FPR Subpart 1-5.3 and FPMR 101-43.301, .302, and .303 establish the criteria for use of excess personal property as a source of supply. In addition, the Commissioner, Federal Supply Service, has directed that "it shall be the policy of the FSS to utilize certain excess personal property in 'like new' condition, which has not been requested by any other Federal agency, by adding such items to stores depot stocks and merchandising such items to assure their maximum use by Federal agencies." This policy is in accordance with FPMR 101-43.302(b)(1).

See attachment 2 for cited regulations keyed to the above paragraphs.

## ATTACHMENT 1

### SUBPART 101-46.49—ILLUSTRATIONS

#### § 101-46.4901 Property ineligible for exchange/sale.

Items which are found in any of the Federal supply classification groups listed below are not eligible for handling under the provisions of part 101-46:

#### FEDERAL SUPPLY CLASSIFICATION

<i>Group No.</i>	<i>Group identification</i>
10	Weapons.
11	Nuclear ordnance.
12	Fire control equipment.
14	Guided missiles.
15	Aircraft; and airframe structural components.
16	Aircraft components and accessories.
17	Aircraft launching, landing, and ground handling equipment.
20	Ship and marine equipment.
22	Railway equipment.
31	Bearings.
32	Woodworking machinery and equipment, except lathes, milling machines, and saws, circular or band.
34	Metalworking machinery, except drill presses, lathes, milling machines, and saws, circular or band.
40	Rope, cable, chain, and fittings.
41	Refrigeration and air-conditioning equipment.
42	Fire-fighting, rescue, and safety equipment.
44	Furnace, steam plant, and drying equipment; and nuclear reactors.
45	Plumbing, heating, and sanitation equipment.
46	Water purification and sewage treatment equipment.
47	Pipe, tubing, hose, and fittings.
48	Valves.
51	Hand tools.
53	Hardware and abrasives.
54	Prefabricated structures and scaffolding.
55	Lumber, millwork, plywood, and veneer.
56	Construction and building materials.
68	Chemicals and chemical products, except medicinal chemicals.
71	Furniture.
75	Office supplies and devices, except cards, tabulating.
83	Textiles, leather, and furs.
84	Clothing and individual equipment.

**§ 101-46.4902 Exchange/sale category list.**

In the acquisition, exchange, or sale of property in the categories below, both the item to be acquired and the item to be replaced must fall within a single number category :

1. Agriculture products, processed foods and forage.
2. Ammunition and ammunition components.
3. Animals and animal products.
4. Batteries, storage.
5. Cards, tabulating.
6. Ditching machines.
7. Dozer blades.
8. Drill presses.
9. Drugs, biologicals, and official reagents.
10. Earth augers.
11. Graders, self-powered and towed.
12. Lathes.
13. Machines, adding and calculating.
14. Machines, addressing and mailing.
15. Machines, dictating and transcribing.
16. Machines, duplicating.
17. Machines, punched card, bookkeeping, tabulating and accounting.
18. Milling machines.
19. Mixers, concrete, portable or truck mounted.
20. Pile drivers.
21. Plows, snow, motorized.
22. Road rollers, wheeled and sheepsfoot.
23. Saws, circular or band.
24. Scrapers, earth moving, self-powered.
25. Scrapers, earth moving, towed.
26. Sedans, station wagons, coupes, limousines.
27. Shovels, power.
28. Spreaders, aggregate and lime.
29. Tractors, warehouse.
30. Tractors' wheeled or crawler, with or without special attachments, up to 65 h.p.
31. Tractors, wheeled or crawler, with or without special attachments, 65 h.p. and up.
32. Trailers, general purpose, multiple axle.
33. Trailers, general purpose, single axle.
34. Trailers, tank mounted.
35. Trucks, forklift.
36. Trucks, general purpose, cargo and construction, 12,500 GVW through 28,000 GVW (including truck tractors, dump, multiple drive, etc.)
37. Trucks, general purpose and utility, up to 12,500 GVW (including suburbans, carryalls, and sedan deliveries).
38. Trucks, straddle.
39. Trucks, tank (special purpose trailer of which the tank is an integral part of the construction).
40. Trucks, warehouse, platform, electric and gasoline powered.
41. Typewriters, manual and electric.

(SEC. 205 (C) ; 63 STAT. 390 ; 40 U.S.C. 486 (C) )

*Effective date.*—This regulation is effective July 1, 1966.

Dated :

## ATTACHMENT 2

### PART 101-25 GENERAL

#### SUBPART 101-25.1—GENERAL POLICIES

#### § 101-25.101 Criteria for determining method of supply.

##### § 101-25.101-1 General.

(a) This § 101 25.101 prescribes general criteria governing selection of the appropriate methods of supply to be utilized in meeting the planned requirements of the Government. It is directly applicable to executive agencies, and other



Federal agencies are requested to observe these criteria in conducting their supply operations.

(b) As used in this § 101-25.101, the term "use point" means a storeroom or other redistribution point where supplies, materials, or equipment representing more than a 30-day supply are maintained primarily for issue directly to consumers within the local area, as distinguished from storage points where supplies and equipment are issued to redistribution points.

**§ 101-25.101-2 Supply through storage and issue.**

The following criteria shall govern in determining whether an item can be most advantageously supplied through storage and issue to use points:

(a) The item shall be physically adaptable to storage and issue and of such a character that it is feasible to forecast overall requirements of the use points served with reasonable accuracy;

(b) Rate of use and frequency of ordering at use points shall be sufficient to warrant storage and issue;

(c) The rate of deterioration or obsolescence shall be sufficiently low to avoid unnecessary loss; and

(d) Conditions exist where any of the following factors require supply through storage and issue (except that dangerous commodities of high weight and density, or commodities highly susceptible to damage normally should not be considered for supply through storage and issue unless one or more of such factors are determined to be of overriding importance)—

(1) Where price advantage through bulk buying is sufficient to render storage and issue more economical, all costs, both direct and indirect, considered.

(2) Where close inspection or testing is necessary to secure quality, or where repetitive inspection and test of small lots are prohibitive from the standpoint of cost or potential urgency of need.

(3) Where advance purchase and storage are necessitated by long procurement leadtime.

(4) Where an item is of special manufacture or design and is not readily available from commercial sources.

(5) Where an adequate industry distribution system does not exist to assure availability at use point.

(6) Where volume purchases are necessary to secure timely deliveries and advantageous prices.

(7) Where market conditions are such that supply through storage and issue is required to assure adequate supply.

(8) Where stocking of supplies and equipment necessary for implementation of emergency plans is required for an indefinite period.

**§ 101-25.101-3 Supply through consolidated purchase for direct delivery to use points.**

The following criteria shall govern in determining whether an item can be most advantageously supplied through consolidated purchase for direct delivery to use points:

(a) The items shall be equipment or supply items of such a character that it is feasible to forecast requirements for delivery to specific use points; and

(b) Conditions exist where any of the following factors requires consolidated purchasing of such items for direct delivery to use points—

(1) Where greatest price advantage, both direct and indirect costs considered, is obtainable through large definite quantity purchasing.

(2) Where an item is of special manufacture or design and is not readily available from commercial sources.

(3) Where market conditions are such that central procurement is required to assure adequate supply.

(4) Where contracts for production quantities are necessary to secure timely deliveries and advantageous prices.

(5) Where the quantity is large enough to assure lowest transportation costs or, conversely, where transportation costs for small quantity redistribution are so excessive that it is not feasible to store and issue the items.

**§ 101-25.101-4 Supply through indefinite quantity requirement contracts.**

The following criteria shall govern in determining whether an item can be most advantageously supplied through the medium of indefinite quantity requirement contracts covering specific periods and providing for delivery to use points as needs arise:

(a) The item shall be such a character that—

(1) Handling on a storage and issue basis is not economically sound, under the criteria prescribed in § 101-25.101-2;

(2) Rate of use and frequency of ordering at use points is estimated to be sufficient to warrant the making of indefinite quantity requirement contracts;

(3) It is either not feasible to forecast definite requirements for delivery to specific use points (as in the case of new items initially being introduced into a supply system), or no advantage accrues from doing so; and

(b) Industry distribution facilities are adequate properly to serve the use points involved; and

(c) Conditions exist where any of the following factors requires the maintaining of indefinite quantity requirements contracts—

(1) Advantage to the Government is greater than would be secured by definite quantity procurements by individual offices or agencies (the determining consideration being one of overall economy to the Government, rather than one of direct comparison of unit prices of individual items obtainable through other methods of supply); or no known procurement economies would be effected but the requirements of offices or agencies can best be served by indefinite quantity requirements contracts.

(2) Acute competitive bidding problems exist because of highly technical matters which can best be met on a centralized contracting basis.

(3) The item is proprietary or so complex in design, function, or operation as to be noncompetitive and procurement can best be performed on a centralized contracting basis.

#### § 101-25.101-5 Supply through local purchase.

The following criteria shall govern in determining whether an item should be supplied through local purchase:

(a) Urgency of need requires local purchase to assure prompt delivery;

(b) The items are perishable or subject to rapid deterioration which will not permit delay incident to shipment from distant points;

(c) The local purchase is within applicable limitation established by the agency head; or

(d) Local purchase will produce the greatest economy to the Government.

#### SUBPART 101-25.2 INTERAGENCY PURCHASE ASSIGNMENTS

##### § 101-25.201 General.

(a) This subpart prescribes the basic policy for interagency purchase assignments within the executive branch of the Government. It is directly applicable to executive agencies and concerns other Federal agencies in their purchasing from, through, or under contracts made by executive agencies.

(b) The term "purchase assignment" as used in this subpart shall normally be considered to include performance of the following functions:

(1) Arranging with requiring agencies for phased submission of requirements and procurement requisitions.

(2) Soliciting and analyzing bids and negotiating, awarding, and executing contracts.

(3) General contract administration.

(4) Arranging for inspection and delivery.

(5) Promotion of a maximum practicable degree of standardization in specifications and establishment of Federal Specifications, when possible, in accordance with applicable regulations.

(c) Notice of purchase assignments and applicable delegations of authority, made under the provisions of this Subpart 101-25.2, shall be furnished to the General Accounting Office by GSA.

##### § 101-25.202 Factors to be used to determine assignment of purchase responsibility.

With their consent or upon direction of the President, executive agencies will be designated and authorized by the Administrator of General Services exclusively, or with specified limited exceptions, to make purchases and contracts on a continuing basis for items or item groups of articles and services for the executive branch of the Government, after due consideration of the following factors, weighted as appropriate:

- (a) Current or potential predominant use or consumption by a given agency.
- (b) Availability of funds to carry out the assignment on a Government-wide basis or with limited exceptions.
- (c) Specialized personnel, or the nucleus of such personnel, regularly employed by the agency, such as scientific, research, and operating technicians, especially qualified or experienced in specification writing, buying, inspecting, testing, using, installing, or operating a particular item or group of items.
- (d) Custodianship and operation of special facilities such as research and testing laboratories and inspection or testing stations and devices.
- (e) Actual or potential qualifications and experience of agency purchasing and contracting officials and their operating units with due regard to adequacy of staff.
- (f) Past experience of the agency in performing services to other agencies on an informal or joint cooperative basis.
- (g) Relations of the agency with the industry involved.
- (h) Physical proximity of the agency purchasing office or offices to the requirement-compiling elements of the principal using agencies.
- i) Physical location of the agency purchasing office or offices in relation to market areas.
- (j) Physical proximity of the agency purchasing offices in relation to engineering or design offices, in the interest of speed in processing modifications in design and specifications, and also reviewing bids for specifications compliance.
- (k) Relative interest of agency heads in receiving the purchase assignment and specific requests of agency heads to do the buying of a given item or group of items on a Government-wide basis.

#### **§ 101-25.203 Centralized purchases by GSA.**

GSA will exclusively, or with specified limited exceptions, make purchases and contracts on a continuing basis for articles and services for the executive branch of the Government in the interest of lower prices, improved quality, and service or standardization when:

- (a) The item or item groups of articles and services are items of "common-use" which are defined as items of standard commercial production or items covered by Federal Specifications commonly used by both civilian and military activities, or by two or more civilian activities, and not requiring such substantial alterations to adapt them to military or other particular application as to render inclusion in a centralized purchasing program impracticable; or
- (b) A number of agencies, representing the majority users according to dollar volume, request GSA to make purchases and contracts exclusively for a given item or item groups of articles and services even though not "common-use" items as defined in § 101-25.203(a); and
- (c) GSA is best equipped to do the buying based upon the factors listed in § 101-25.202, or must of necessity act as the central purchasing office when other agencies more appropriately suited to make central purchases do not do so and are not so directed by the President; and
- (d) The head of another executive agency has not been delegated authority by the Administrator of General Services exclusively, or with specified limited exceptions, to make purchases and contracts for prescribed items or item groups of articles and services for the executive branch of the Government in accordance with §§ 101-25.202 and 101-25.204.
- (e) GSA has issued appropriate regulations, or a Federal Supply Schedule, specifically designating the item or item groups of articles or services that fall within (a), (b), and (c) of this §101-25.203 that are thereafter to be purchased exclusively for all executive agencies, or with specified limited exceptions, by GSA.

#### **§ 101-25.205 Arrangement for performance of purchasing functions other than centralized.**

(a) Upon request, GSA will make purchases and contracts for any of the items or item groups of articles or services authorized to be purchased independently by executive agencies. GSA will also arrange, on a basis mutually agreeable, with any executive agency to perform its purchase and contracting functions on a continuing basis, if requested in writing to do so by the agency head, provided the arrangements agreed upon will result in lowered cost or improved service either to the individual agency or to the Government as a whole.

(b) In those instances where lowered cost of improved service, either to an individual agency or to the Government as a whole will result, GSA will arrange, on a basis mutually agreeable to the agencies involved, to assign all or a portion of the purchase and contracting functions of one executive agency to another executive agency on a continuing basis.

**§ 101-25.206 Independent purchases by executive agencies.**

Items or groups of items of articles or services may be purchased independently by executive agencies, in accordance with regulations of GSA otherwise applicable, when:

(a) Not otherwise prescribed in current regulations, or included in mandatory Federal Supply Schedules, issued by GSA or by another executive agency designated by the Administrator of General Services.

(b) For emergency requirements when time does not permit purchasing through the authorized central purchasing agency. A record shall be maintained of such transactions and be made available to the responsible central purchasing agency upon request.

(c) By consultation between GSA and agencies concerned, it is determined that interagency purchase assignment would adversely affect the national security or military operations.

(d) The purchases cannot be publicly disclosed in the interest of national security.

**SUBPART 1-5.3 EXCESS PERSONAL PROPERTY**

**§ 1-5.300 Scope of subpart.**

This subpart sets forth policies and related material regarding the use of excess personal property as a source of supply. This subpart does not include, modify, or supersede instructions concerning the reassignment of personal property within executive agencies and the transfer of excess, or other instructions concerning the utilization of Government-owned personal property, which are contained in Chapter III, Title 1, Personal Property Management, Regulations of the General Services Administration.

**§ 1-5.301 Definition of excess personal property.**

"Excess personal property" means any personal property under the control of any Federal agency which is not required for its needs and the discharge of its responsibilities, as determined by the head thereof.

**§ 1-5.302 Policy.**

To the fullest extent practicable, agencies shall use excess personal property as the first source of supply in fulfilling their requirements and requirements of their cost-type contractors.

**§ 1-5.303 Implementation of policy.**

(a) In giving effect to the policy stated in § 1-5.302, agencies should provide that:

(1) Personnel authorized to approve actions for procurement or other acquisition of personal property will make positive efforts to obtain excess before such actions are undertaken.

(2) Personnel mentioned in (1) of this § 1-5.303(a) will receive available information concerning excess personal property from appropriate General Services Administration regional offices.

(b) Prior to procurement or other acquisition of property, careful and receptive consideration shall be given to utilization of known usable excess personal property of a similar type, including the possibility of substitution or adaptation of excess items not identical with requested items, whether the excess items are unused, rehabilitated, or in used condition, and regardless of whether the intended acquisition would be from General Services Administration stores stock or from other sources of supply.

**§ 1-5.304 Assistance by General Services Administration in filling requirements from excess.**

(a) Information regarding the availability of excess personal property may be obtained through the following:

(1) Personal contact with the General Services Administration or the holding installation.

(2) Review of excess personal property catalogs and bulletins circularized by the General Services Administration.

(3) Submission of personal property requirements to the regional offices of the General Services Administration. (GSA Form 1539, Request for Excess Personal Property, is available for this purpose.)

(4) Examination and inspection of reports and samples of excess personal property assembled for this purpose in General Services Administration regional offices.

(b) The General Services Administration will assist agencies in meeting their requirements for property of the types excepted from reporting as excess by subsection 302.02, Chapter III, Title 1, Personal Property Management, Regulations of the General Services Administration. Federal agencies requiring such property should contact the appropriate General Services Administration regional office. General Services Administration area utilization officers, stationed at key military excess generating points throughout the United States, are screening and offering for Government use non-reported excess personal property as it becomes available for transfer.

#### SUBPART 101-43.3 UTILIZATION OF EXCESS

##### § 101-43.301 Federal Government procedure.

The first source of supply is excess personal property, which should be utilized by agencies to the fullest extent practicable, as prescribed in this Part 101-43. Any need for personal property expressed by any Federal agency (including the Senate, the House of Representatives, the Architect of the Capitol and any activities under his direction, the District of Columbia, and mixed-ownership corporations as defined in the Government Corporation Control Act) shall be paramount to any disposal, if such need is made known to the holding agency prior to shipment or delivery in the case of donation, or prior to an award in the case of sale.

##### § 101-43.302 Agency responsibility.

(a) In order to obtain maximum utilization and minimize the procurement of new items, each executive agency shall be responsible for making excess property available and facilitating the transfer of the property to other Federal agencies, to its cost-reimbursement type contractors, and to the organizations specified in § 101-43.315. The transfer of excess property to a cost-reimbursement type contractor shall be made only by the agency administering the contract. Each executive agency shall, to the maximum practicable extent, fulfill its requirements for property, including those of its cost-reimbursement type contractors, by obtaining excess from other Federal agencies in lieu of new procurement.

(1) Prior to procurement of new property, careful and receptive consideration shall be given to utilization of known usable excess property of a similar type, including the possibility of substitution or adaptation of excess items not identical with requested items, whether the excess items are unused, rehabilitated, or in used condition, and regardless of whether the intended new procurement would be from GSA stores stock or other sources of supply. Executive agencies shall accept, to the fullest extent practicable, the reasonable substitution of such excess property in lieu of new procurement.

(2) GSA will assist agencies in meeting their requirements for property of the types excepted from reporting as excess by this Part 101-43. Federal agencies requiring such priority should contact the appropriate GSA regional office as indicated by § 101-43.4903. GSA area utilization officers, stationed at key military excess generating points throughout the United States, are screening and offering nonreported personal property as it becomes available for transfer.

(b) To implement the policy for maximum utilization of excess personal property, as outlined in paragraph (a) of this § 101-43.302, the regional offices of the GSA will screen all requests for replenishment of stores stock and direct delivery purchase requests submitted by executive agencies against lists of excess personal property available in their respective regions.

(1) GSA may take physical custody of such excess personal property for redistribution, or may direct its transfer to executive agencies in lieu of procurement of new property from commercial sources of supply. If the excess property is used, rehabilitated, or differs in some substantial characteristic from the item ordered, notice of intent to substitute will be given the ordering agency to permit such agency the opportunity to inspect the property prior to shipment.

(c) Acceptance of excess property under the above circumstances shall be required unless the using agency submits a full and convincing written justification that such transfers or substitutions would result in serious hardship or impairment to its operations programs.

(d) Part 101-27 prescribes standards for executive agencies in computing inventory levels. To encourage the use of excess property which might otherwise be disposed of as surplus, inventory levels may be adjusted upward when items of stock are to be acquired from excess sources. Such adjustments should be tempered by caution and arrived at after careful analysis which gives consideration to the factors set forth in Part 101-27 and in this Part 101-43. Generally, acquisitions of items for inventory from excess shall not exceed a two years' supply except when:

(1) A greater quantity is needed to meet known requirements for an authorized planned program.

#### PART 101-43 UTILIZATION OF PERSONAL PROPERTY

(2) The item is not available without special manufacture and a predictable requirement exists.

(3) Administrative determination has been made that in application of the EOQ principle of stock replenishment within an agency an inventory level in excess of two years is appropriate for low dollar-volume items.

(4) The items are being transferred into authorized stock funds for resale to other Government agencies.

(5) In addition, the following conditions should be met prior to acquisition of excess:

(i) There must be a predictable requirement for an authorized program.

(ii) The cost of acquisition, including packing and shipping, carrying in inventory, and preservation shall not exceed delivered cost of new material.

(iii) The supply acquired does not exceed the expected shelf life, considering condition at time of acquisition.

(iv) The supply of spare parts acquired shall not exceed the life expectancy of the equipment supported.

#### § 101-43.303 Suspension of procurement.

The Administrator of General Services may, as circumstances warrant, suspend the initiation of procurement for new items of property when these same items, or those which can be substituted or adapted for them, are available from excess property.

