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ECONOMY IN GOVERNMENT PROCUREMENT AND PROPERTY MANAGEMENT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ECONOMY IN GOVERNMENT

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETIETH CONGRESS

FIRST SESSION

NOVEMBER 27, 28, 29, 30, AND DECEMBER 8, 1967

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CONTENTS

	Page
Proxmire, Hon. William, chairman of Subcommittee on Economy in Government: Opening remarks	1
Reprint of article from Wall St. Journal, November 27, 1967	2
Announcement of hearings, list of witnessses, and scheduled times of appearance	4
Letter to Comptroller General Elmer B. Staats	5

CHRONOLOGICAL LIST OF WITNESSES

Staats, Hon. Elmer B., Comptroller General of the United States, accompanied by Frank H. Weitzel, Assistant Comptroller General; Charles M. Bailey, Deputy Director, Defense Division, GAO; William Newman, Director, Defense Division, GAO; Stephen P. Haycock, Assistant General Counsel; James Hammond, Associate Director, Defense Division, GAO; Kenneth Fasick, Associate Director, Defense Division; and Gregory Ahart, Deputy Director, Civil Division	6
Morris, Hon. Thomas D., Assistant Secretary of Defense (Installations and Logistics), accompanied by Paul H. Riley, Deputy Assistant Secretary (Supply and Services); John M. Malloy, Deputy Assistant Secretary (Procurement); Gen. A. T. Stanwix-Hay, Deputy Assistant Secretary (Material); Lt. Gen. Earl G. Hedlund, Director, Defense Supply Agency; G. G. Mullins, Director, Contract Support Services; Dr. R. A. Brooks ASA (Installations and Logistics): also present: Albert F. Sanderson, Deputy Chief, Materials Policy Division, National Resource Analysis Center OEP; William B Petty, Director, Defense Contract Audit Agency	75
Dominick, Hon. Peter H., a U.S. Senator from the State of Colorado	238
Minshall, Hon. William E., a Representative in Congress from the 23d Congressional District of the State of Ohio	244
Knott, Hon. Lawson B., Jr., Administrator, General Services Administration, accompanied by H. A. Abersfeller, Commissioner, Federal Supply Service; Harry Van Cleve, General Counsel; Douglas E. Williams, Commissioner, Transportation and Communications service: Willard L. Johnson, Jr., Assistant Administrator for Administration, William A. Schmidt, Commissioner, Public Buildings Service; John G. Harlan, Jr., Commissioner, Property Management and Disposal Service: and Joe E. Moody, Deputy Administrator	249
Brooke, Hon. Edward W., a U.S. Senator from the State of Massachusetts	256
Caveney, Lewis R., assistant to the vice president, Bryant Computer Products, Division of Excell-O Corp., Walled Lake, Mich	281
Hughes, Hon. Phillip S., Deputy Director of the Bureau of the Budget, accompanied by Tim Russell, Office of Executive Management; Joe Cunningham, Government Management Division	304
Gonzalez, Hon. Henry B., a U.S. Representative from the 20th Congressional District of Texas	339
Staats, Elmer B. [second appearance], Comptroller General of the United States, accompanied by Frank H. Weitzel, Assistant Comptroller of the United States; Charles M. Bailey, Deputy Director, Defense Division; J. Edward Welch, Deputy General Counsel; Stephen P. Haycock, Assistant General Counsel; Jerold K. Fasick, Associate Director, Defense Division; James H. Hammond, Associate Director, Defense Division; and Charles Kirby, Associate Director, Defense Division	351

STATEMENTS AND EXHIBITS

NOVEMBER 27, 1967

Staats, Hon. Elmer B., Comptroller General of the United States: Page

Statement 6

Truth in Negotiations Act, Public Law 87-653 7

Application of Public Law 87-653 to construction contracts 8

GSA construction contracts 9

Training of procurement personnel 9

Matters for further consideration 9

Military supply systems 10

Army's logistics structure 10

Army's supply activities in Vietnam 12

Control over Government-owned property in the possession of Defense contractors 13

Contract versus in-house methods of acquiring goods and services 14

DOD Instruction No. 4100.33 15

Service contracts at Marshall and Goddard Space Flight Centers 15

Table: Marshall Space Flight Center—Functional description of laboratory missions and the support services to be provided by the contractor 17

Table: Goddard Space Flight Center—Functional description of laboratory mission and the support services to be provided by the contractor 18

Basis for pricing service contracts 20

NASA disagrees with GAO 21

Legality and costs of service contractors 22

Lease versus purchase of facilities by contractors 22

Letter of January 18, 1968: Comptroller General Staats to Chairman Proxmire, re contractor names 24

Freedom of Information Act 31

Regulations issued by GAO implementing the Freedom of Information Act 31

Small purchases 34

Small purchases 90 percent of actions, value $4 billion 35

Increase in negotiated procurement 35

Increase in awards to 100 largest firms 35

Access to contractor's records 36

DOD's present position on access to records 36

DOD training seminar 37

Contractors' obligation to furnish data 37

Documentation essential 38

Application of DOD order to subcontracts 38

Documentation should apply to subcontracts 39

Army's inventory records 40

DOD agrees on inventory problems 40

Corrective actions being taken 40

Five areas needing improvement 41

Secretary of Defense memo of November 24, 1967 41

Extent of excess inventory not known 41

Redetermination clauses in contracts 42

Training a supply corps 42

Coordination among contracting, audit, and contract service officers 43

Coordination with renegotiation people 43

Item breakouts for advertised bidding 44

Legal basis for subcontracting 45

Rules governing competitive bid procedures 45

Control over contractor inventory 46

Use of ADPE for inventory records 46

Adequacy of controls 47

Specific use of DIPEC records 47

Contractor reports on use 48

Relocation of equipment 48

Contractor inventory acquired since 1952 48

Staats, Hon. Elmer B., Comptroller General of the United States—Continued
Statement—Continued Page
Total inventory about $15 billion 49
Need for an inventory setup 50
Prices paid subs by primes 50
Furnishing items by the Government 50
GAO recommended that Government furnish material 51
Reaction of DOD 51
Time needed to inventory contractor-held property 51
GAO recommendations on needed controls 51
100 percent Government contractors 52
Points of disagreement with DOD 52
Machine-by-machine records 52
Example of machine-by-machine records 52
Need for larger penalties 52
Favoritism to contractors 53
DOD policy to reduce furnished equipment 53
Penalty for excessive commercial use of equipment 53
"25 percent use" of equipment? 53
Warnings unheeded 54
Strong incentive for contractor to use equipment commercially 54
Need for better reviews and audits 54
Superiors fail to follow up 54
DOD accepts need to do more 54
Examples of penalties assessed by DOD 54
Penalth provisions in ASPR 55
Power to waive penalty 56
Regulations on cost documentation 56
Regulations on postaudit 56
Identification of cost or pricing data with contracts 56
Poor inventory controls 57
Lack of reconciliation of records with stock 58
Adjustment of stock records 58
Reason for lack of inventories 58
Possibility of annual inventories 59
DOD agrees with GAO diagnosis 59
DOD has solutions in motion 59
AMC conducted 900,000 special inventories in 18 months 60
Need for high-level management 60
Need for accurate inventories 60
Accurate inventory records enhance efficiency, economy, and effectiveness 61
Big problem with common items 61
$3 billion annual cost of computers 61
Common items subject 62
$1.1 million additional costs due to poor inventory 62
Slow progress on old problems 62
Taxes on contractor-held inventory 62
Taxes and local benefits 63
Local taxes as a factor in determining Government in-house operations 63
Need to take taxes into consideration 64
Impacted school area bill 64
Table: Taxable status of Federal property in hands of contractors 65
Possible legislation 65
GAO's position on Navy dairy 65
Letter from Comptroller General Staats to Chairman Proxmire outlining agency works program 66

NOVEMBER 28, 1967

Letter: Chairman Proxmire to Secretary McNamara 69
Letter: Assistant Secretary of Defense Thomas D. Morris to Chairman Proxmire 70
Biographical sketches (I & L top staff) 70–76

Morris, Hon. Thomas D., Assistant Secretary of Defense: Page
Statement 76
A. Procurement policies 77
1. Price competition 77
Attachment A: Reporting of procurement statistics on price competition 77
2. Public Law 87-653—Truth in Negotiations Act 80
DOD training seminar on certified cost or pricing data and Public Law 87-653: September 1967 80
Training seminar 81
Attachment B: Access to cost performance records on noncompetitive firm fixed price contracts 135
3. Spare parts breakout program 136
4. Small purchases 136
5. Other procurement management improvements 137
B. Supply management policies 138
Attachment C: Utilization and redistribution of excess materiel in the Pacific area 139
Attachment D: National supply system 141
C. Progress under Budget Bureau Circular No. A-76 146
Attachment E: Recent illustrations of the application of policies prescribed by Budget Bureau Circular A-76 146
Truth in Negotiations Act 147
New regulations ready for release 148
Interpretation of new regulations 148
Apply to all negotiated contracts over $100,000 148
Not applicable to competitive negotiated contracts 148
Adequate price competition 149
Normal negotiation procedure 149
42.9 percent price competitive buying 150
Need for reliance on cost records 150
Nitze order to be incorporated into ASPR 150
Order applies to subcontracts 150
Not applicable in certain cases 151
What assurance of enforcement 151
Enforcement steps being taken by DOD 151
Training and testing program 151
43 training courses 152
Need for public reports on use of Government equipment 153
Machine-by-machine use records and reports 153
DOD committed to machine-by-machine use procedure 153
Need for legislation 154
DOD acknowledges problem 154
System unfair to competitors 154
Adequacy of rental rates 154
Statements by GAO and DOD on supply to Southeast Asia 154
Special agency to manage utilization and redistribution of excesses 156
Article by Congressman Gonzalez 156
"The War Profiteers": reprinted from the Progressive, August 1967 156
$14.8 billion in Government-property in hands of contractors 161
Defense procurement circular No. 57, November 30, 1967 162
Prices primes pay for subcontracted items 192
Prices on all items 192
Maintaining prices with computers 193
$25 million possible savings on small items 193
Total package procurement 193
Procurement of computers 194
Development of specifications by IBM 194
DOD does not object to GAO naming contractors holding equipment 194
Salaries of contracting officers 196
6,094 awards of $2 million or more in 1967 196
Method of making large procurements 196
Property held by contractors 197
Partial list of contractors holding Government property 197
Letter of 1/15/68 from Secretary Morris re listing of equipment held by individual contractors 198
Fact sheet on Olin-Mathieson holdings of facilities and equipment at Saltville, Va 199

Morris, Hon. Thomas D., Assistant Secretary of Defense—Continued
Statement—Continued Page
Contractors required to report on property 200
Developing a special corps 201
Index of courses listed by schools—DOD 5010.9C 202
DCAS has a staff of 23,000 207
1.8 million items under integrated management 208
Common schools for procurement 208
Audit groups separate from procurement and service contract groups 208
DCAA a single agency 208
DCAA has staff of 3,900 209
Rotation of military staff 209
No military people in DCAA 209
Military people in service and procurement areas 210
Price redetermination 210
Team approach to negotiation 211
Need for competent employes 211
Four-day procurement conference 212
Conflict-of-interest laws 212
Defense mobilization order 8555.1 212
Progress statements requested of DOD 217
Adequacy of management improvement programs in DOD 218
Physical inventories at Army depots 219
Discrepancies in inventories 219
Need for Navy dairy 220
DOD program of exchange-sale impact on utilization and donation programs 221
Expect savings of $10 million to $20 million a year 221
Effect of contractor-held equipment on tax base 221
Implementing Circular A-76 222
Cost of U.S. publicity 222
Commissaries 222
Taxes as an element of cost 223
Relation of $15 billion contractor-held inventory on tax base 223
States may tax use or possession of Government property by contractors 223
Rental rates for equipment 224
Inventory as a control 224
DOD dedicated to item control of expensive equipment 224
DSA to maintain inventory control of equipment 225
DSA centrally manages high-value items 225
Review all contractor-held property once a year 225
GAO report seems to differ from testimony 226
GAO addressed itself to 400,000 tools valued at $4.3 billion 226
Secretary Morris considers gap to be in knowledge of use and not of the equipment 226
Inventory control seems lacking 226
DOD plugging utilization gap 227
Buy American Act policy 227
DOD uses a 50-percent differential 227
DOD endeavoring to help balance-of-payments problem 228
Berry amendment 228
Cost of DOD policy 228
Status of IPE inventory 229
DSA reconciliation to be completed December 1968 230
Services to complete reconciliation in 1969 230
DOD's position on 14 recommendations in GAO report 230
Department of Defense comments 231
Identical bidding 235
ASPR Regulation 1-111.2 237
ASPR Regulation 1-115 237

NOVEMBER 29, 1967

Dominick, Hon. Peter H., a U.S. Senator from the State of Colorado:
Statement 239
Minshall, Hon. William E., a Representative in Congress from the 23d Congressional District of the State of Ohio:
Statement 244
Need for postaudit legislation 246

Knott, Hon. Lawson B., Jr., Administrator, General Services Administration: Page
Statement 249
Progress in developing the national supply system 249
Buy American Act 251
Automatic data processing program 253
Role of small producers in supplying ADPE 254
Brooke, Hon. Edward W., a U.S. Senator from the State of Massachusetts:
Statement on Buy America Policy 256
Knott:
Statement (resumed) 261
GSA authority with respect to ADPE (subsequent submission) 263
Public utilities 264
Savings on telecommunications 265
Difficult to control use of system 266
Competitive versus negotiated procurements, Truth in Negotiations Act 268
GSA had 76 percent advertised supply procurement in 1967 268
Procurement of industrial products and services pursuant to BOB Circular A-76 270
Control of short-shelf-life items 270
Excess personal property 272
Excess real property 275
Widnall questions and GSA answers re Buy American Computers 277

NOVEMBER 30, 1967

Caveney, Lewis R., assistant to vice-president, Bryant Computer Products, division of Ex-Cell-O Corp., Walled Lake, Mich:
Statement 281
Illustration on computer costs 283
Article from "Electronic News," Nov. 13, 1967 286
Excerpts from Wall Street Journal, Nov. 22, 1967 290
Letter of Nov. 8, 1967, to Budget Director Schultze re hearings 303
Hughes, Hon. Phillip S., Deputy Director, Bureau of the Budget:
Statement 304
Developments concerning Truth in Negotiations Act 304
Improvements in supply management 306
Maximizing use of inventories 307
Management and acquisition of automatic data processing equipment 310
Complete inventory of ADPE needed 310
Inventory to be completed in a month 310
Government owns about 50 percent of installed computers 311
Authorities of BOB and GSA 311
Progress in computer standardization 311
Standards for data elements and codes 312
Buy American practices 312
Mess due to separate DOD policy 313
Increase of handtool imports from 1948-66 from $169,000 to $14 million 313
The management of Government equipment furnished to contractors 315
Individual use records for contractor-held machines 315
Basis for equipment charges to contractors 316
Need for Government to supply equipment 316
DOD not alone in furnishing equipment 316
Thompson Ramo Wooldridge 316
Need for equitable concern for competitors 317
Lack of adequate use records 317
Commercial use of Government equipment 317
Impact on State and local taxes 317
Favorable position of contractor with Government equipment 318
What criteria on Government furnishing equipment 320
Government procurement policy 320
Criteria for furnishing equipment 321
Competition with business—Circular No. A-76 322
Policy statement 322
State and local taxes 323
Interest rates—cost of money, Government and private 325

Hughes, Hon. Phillip S., Deputy Director, Bureau of the Budget—Continued
Statement—Continued
Page
Progress report on A–76 327
Dr. Stockfish's argument on opportunity cost 327
Real property management 329
Report on real property holdings due June 30, 1968 329
Value of Federal real property steadily increases in DOD 330
Government-wide increase in real property holdings 331
Programs to utilize real property 331
Need for objective evaluation of real property holdings 332
Payment of taxes as a discipline and equity 332
Congressional expression of intent would help 333
Excerpt from July 1967 report, "Economy in Government," III. Real Estate Management 333
GSA's responsibility and capability concerning public utility services 335
Need for legislation on contractor-held equipment 336
Need for better top management 336
Bureau of Budget views on another "Hoover Commission" 336

DECEMBER 8, 1967

Gonzalez, Hon. Henry B., a U.S. Representative from the 20th Congressional District of Texas:
Statement 339
Attachment: "What War Profiteering?—I'm glad you asked" 346
Article: "How Uncle Sam Is Cheated: The Multi-Billion-Dollar Giveaway," Parade magazine, Washington Post, December 3, 1967 347
Staats, Hon. Elmer B.:
Statement 351
Inventory management 351
Effectiveness dependent upon accurate records 352
Twelve reports issued by GAO on inventory control 352
DOD has $37 billion stores inventory 353
Errors in stock locator records 357
Excessively large number of special inventories 359
Program reports needed 361
Inadequate investigation of discrepancies 362
GAO disagrees with DOD on discrepancies 362
Example of inventory adjustments 362
Prescribed physical inventories not taken 364
Army will not be on scheduled inventories until 1969 364
System needs improvement 365
System should be capable of expansion for buildup 365
Use of computers 366
Ninety percent of inventory effort on specials 366
GAO findings reported to Secretary of Defense 367
GAO proposed a high-level study group to study problem 367
Needs for standards for evaluations 369
Conclusions and additional actions required 370
Agency audit rights and recovery from subcontractors 372
Attachment A: Excerpts from Defense Procurement Circular No. 57, November 30, 1967 373
History of negotiated procurement since 1947 374
Position of DOD in May 1967 375
DOD Procurement Circular No. 57 complies in general with GAO recommendations 376
New regulations result of GAO and committee action 378
Test of enforcement of new regulation 379
Review in fall of 1968 379
Recovery from subcontractors 379
Attachment B: Excerpts from Defense Procurement Circular No. 57, November 30, 1967 380
Government property in the possession of defense contractors 380
Increase in contractor-held inventory from 1965 to 1966 381
Financial accounting on special items, etc 381
Table: Summary of material, active real property, and plant equipment in hands of contractors 382

Staats, Hon. Elmer B.—Continued
Statement—Continued
Page
Rise in value due in part to modernization and replacement program 383
Adherence to policy involved 383
Nature of justification required and the criteria used by the Department of Defense for replacing Government-owned industrial equipment in the possession of private contractors 383
Contractors not asked to invest in modern tooling 384
Failure to comply with policy 385
Cost studies on advantage in Government providing equipment 386
Reduced costs for Government-owned equipment 386
OEP approval for commercial use 387
OEP approvals not obtained 387
ASPR not precise as to "25 percent use" 388
Lack of uniformity in rental rates 388
Disposition of Government-furnished property 390
Need for legislation regarding contractor-held equipment 390
Fees for architects and engineers 393

APPENDIXES

Page

Appendix 1. Summary of the status of matters of interest to the Subcommittee on Economy in Government 397
(1) Inventory management 397
Stock control 397
Shelf-life items 398
Inactive items 398
Procedures for long supply assets utilization screening 399
Return of repairable items for repair and reuse 399
Distribution and redistribution 399
Military standard requisitioning and issue procedures 399
Nonexpendable equipment 400
(2) Accounting and reporting system for disposal activities 400
(3) Unfilled orders for air materiel 400
(4) Requirements for aircraft ground support equipment 401
(5) Military Housing Construction 401
(6) Consolidation of Field Organization and Facilities 402
Facilities for recruiting military personnel 402
Motion pictures 402
Military calibration systems and laboratories 402
Service-type activities 403
(7) Competition in procurement 404
(8) Reporting of negotiated procurement actions as competitive or noncompetitive by the DOD 404
(9) Real estate management 405
(10) Savings and economies of the Government as a result of GSA operations 405
(11) Methods of financing agency programs 406
Appendix 2. Truth in Negotiations Act, Public Law 87-653 407
Appendix 3. Secretary Nitze's memorandum of Sept. 29, 1967, and views thereon by the Comptroller General of the United States 409
Appendix 4(a). Comptroller General's report to the Congress, B-140389 on need for improvements in controls over Government-owned property in contractors' plants 411
Appendix 4(b). Replies of contractors to report B-140389 463
Appendix 5. Comptroller General's report to the Congress—Improved inventory controls needed for the Departments of the Army, Navy, and Air Force and the Defense Supply Agency B-146828 513
Appendix 6. List of independent computer peripheral equipment manufacturers and glossary of terms 530
Appendix 7. One hundred companies and their subsidiary corporations listed according to net value of military prime contract awards, fiscal year 1967 535
Appendix 8. Statement of National Aerospace Association re Civil Service Commission opinion on service contracts 546
Appendix 9. Statements on Buy American Policy 550
Appendix 10. Comptroller General's opinion (B-151204, B-157587) on authority of Administrator, GSA re purchase, lease, maintenance, operation of ADPE 556
Appendix 11. Procurement information furnished by Senator Dominick 560
Appendix 12. Special questions referred to witnesses after conclusion of hearings and answers thereto 604
Appendix 13. B&B circular A-76, revised, with analysis 611
Appendix 14. Magnitude of DOD property management activities 619
Appendix 15. References to Subcommittee reports, hearings, and staff studies 624

ECONOMY IN GOVERNMENT PROCUREMENT AND PROPERTY MANAGEMENT

MONDAY, NOVEMBER 27, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room S-407, the Capitol, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire; and Representatives Curtis, Griffiths, and Rumsfeld.

Also present: Ray Ward, economic consultant.

Chairman PROXMIRE. This subcommittee has, for a number of years, investigated and reported on the enormous procurement and other property management activities of the Government and especially of the DOD which had net military procurement actions in the United States of $431 billion from 1951 to 1967 with 86.1 percent, or $371.1 billion by negotiation. The basic law, however, intended that negotiation should be used only in exceptional cases. And the DOD as of the end of fiscal 1966 had real property holdings of $38.4 billion and of personal property costing $145.2 billion, of which $37.7 billion was in supply systems' inventory.

After 4 days' public hearings last May, we concluded that there had been "a disturbing record of loose management," in the procurement and management of these great programs. We accordingly made a number of recommendations in our report of July 1967.[1]

The 4 days' hearings we are starting today are intended to review progress made on those recommendations.

Our first witness, the Honorable Elmer B. Staats, Comptroller General of the United States, with his excellent staff, has made many notable studies and reports on subjects of vital interest to this subcommittee. I want to mention the outstanding and pioneering work on the "Truth in Negotiations Act," Public Law 87-653, which is a monument to the GAO. Of equal importance are reports just issued, which the subcommittee has requested, on the need to improve inventory controls in general over some $37 billion worth of items and of the pressing need to improve the controls over an estimated $11 billion worth of Government-owned facilities, equipment, special tooling, test equipment, and material in contractors' plants.

[1] "Economy in Government," report of the Subcommittee on Economy in Government, July 12, 1967, 54 pages. See p. 24 for listing of subcommittee documents.

But, incidentally, there was a sensational story on this by Noel Epstein, which you may or may not have seen in the Wall Street Journal this morning. Without objection, I will include it in the record at this point.

Mr. STAATS. I do have it.

(The article referred to follows:)

[From the Wall Street Journal, Nov. 27, 1967]

ARMS SUPPLIERS' WINDFALL—GAO STUDY CHARGES FIRMS MISUSE U.S. PROPERTY FOR COMMERCIAL GAIN

(By Noel Epstein)

WASHINGTON.—The Defense Department supplies a $1.4 million forge press to a contractor to turn out jet-engine parts for the military. But over three years the company runs the press 78% of the time for its own commercial production.

Another concern gets $6.1 million of various Pentagon equipment to do Air Force work. In a six-month period, however, it uses the equipment 58.5% of the time to fill its non-Government orders.

A nice windfall if you can get it? It certainly is, says the General Accounting Office, and because of the way the Defense Department manages—the GAO would say mismanages—its property stockpile, such unintended Federal subsidies are precisely what some businesses are getting.

There are more than $11 billion of Defense Department-owned buildings, machine tools, dies, electronic gear, test devices and other equipment in contractors' possession, so this inadvertent handout to industry potentially is vast. Under some circumstances, companies have long received Government permission to lease Federal property to grind out their commercial wares. But the GAO, Congress' watchdog agency, found during a 1½-year investigation that "generally prior approval hadn't been obtained" and that "Government property was improperly being used" in a significant number of such cases without equitable payment to the Government.

The Pentagon says it already is starting some actions and considering others to outflank abusers, but the GAO contends the generals strategy doesn't go far enough to win the battle.

HAVEN'T FULLY REPLIED TO CHARGES

The list of 21 companies and two universities investigated by the GAO is being closely guarded by top GAO officials, who remember well some past Congressional and industry howls when the agency named names in certain reports. In preparing the current report, which will be made available today, GAO officials say they kept the identities secret because the contractors haven't yet fully replied to the charges.

There's a chance, though, that Comptroller General Elmer B. Staats will have to disclose the list today anyway. He is scheduled to testify this morning at the start of hearings by a Joint Economic subcommittee looking into Pentagon buying practices, and would almost surely turn the list over if the subcommittee asks for it.

While the 91-page report doesn't identify offenders, it does say that those investigated included both "large and small prime contractors and subcontractors" doing military work on airframes, aircraft engines, electronic apparatus and ordnance. Together, they had in their hands Pentagon equipment costing about $1 billion.

MAJORITY PROCESSED ON OLDER PRESS

For a look at how some contractors reap unusual dividends from this Government-supplied treasure, consider the operator of the double-duty forge press. The GAO tells the tale as follows:

In late 1961, the 8,000-ton mechanical press was installed at the contractor's plant because a less-efficient, 4,000-ton press, also Government owned, supposedly couldn't handle all of the Pentagon's orders for jet-engine midspan blades. In the three years through Dec. 31, 1965, though, the larger press was used mostly to turn out midspan blades for non-Government customers without Government approval.

What about the Pentagon blades? The majority of them were processed in the older and smaller press whose inefficiency was the reason for installing the bigger model in the first place.

The contractor didn't stop there, though. He also used 10 more Government-owned machines, costing $29,000 to $141,000 each, "100% of the time for commercial work without advance . . . approval."

Contractors aren't taking much risk in such cases. If the misdeed is discovered, Pentagon regulations provide that the company must pay full rent for the equipment even if it wasn't used improperly all the time. But this penalty can be assessed only if the concern fails to "exercise reasonable care to prevent such unauthorized use."

In practice, the GAO found that full monthly rent wasn't charged "because it couldn't be shown that contractors didn't use reasonable care to prevent such use." So abusers only paid the rent they normally would have been charged by the Government to use the equipment commercially.

UNAUTHORIZED COMMERCIAL USE ROSE

Offenders don't seem to be discouraged very much by this system. In one instance, a contractor was "advised" in March 1965 that it had used Pentagon equipment improperly 7.5% of the time in the preceding six months. Although corrective action was promised, the GAO says, the contractor's unauthorized commercial use of the apparatus increased to 10% in all 1965 and to 13.5% in the first nine months of 1966.

The Pentagon has told the GAO that, among other things, it "will consider the need for stronger language" on its regulations to help eliminate such abuses.

But the larger target in this battle is just to find the abusers in the first place. Their elusiveness results from the fact that the contractors themselves are required to maintain the official records of how Government property in their hands is used. And, says the GAO, "utilization data maintained by some contractors aren't adequate to indicate the extent and manner of use."

The GAO's supporting evidence indicates this may well be an understatement. Early in its report, for example, the agency explains that it was "unable to determine the manner of use of many items of equipment at a number of contractor plants we visited because such utilization records weren't maintained."

The Pentagon's main force for finding abusers is its troop of 450 property administrators, who must approve company record-keeping systems. But the GAO found their work doesn't always put the desired information in Government hands.

The agency cites, for example, a case where a contractor's system was first disapproved in July 1962, and then found still to be "sadly lacking detail" in January 1965. "Since approval . . . had already been withheld," though no further action was taken.

Its investigation, the GAO says, had to be conducted mainly by checking records kept by contractors to compute rentals on equipment they were using, with permission, for commercial work. Authority to use Government equipment as much as 25% for private output is given in some contracts when the apparatus otherwise would be idle and isn't needed for defense work elsewhere.

For more than 25% commercial usage, contractors are supposed to get further approval from the Office of Emergency Planning. But the GAO found that since last December, only five such requests had been submitted. "Generally," the agency says, "contracting officers weren't requiring contractors to request and contractors weren't requesting advance approval for commercial work in excess of the 25% restriction."

Partly to blame here, the GAO states, is that it's unclear whether the 25% criterion applies to "total planned use" or "to a certain number of days a week," and whether it means 25% of all equipment in a contractor's hands or 25% of each item.

A major help in finding offenders, the GAO says, would be for the Pentagon to require that contractors keep machine-by-machine records and get approval from the Office of Emergency Planning on the same basis.

REVISION IN REGULATIONS

The Defense Department, however, isn't contemplating going this far. It is revising its regulations so that companies will be required "contractually" to

"establish and maintain a written system for controlling" use of Government property, the GAO says. The department also has "indicated" to the GAO that there will be surveys of contractor bookkeeping "to ensure the effectiveness of such a system."

The department further says it intends to meet with officials of the Office of Emergency Planning to more clearly define "25% non-Government use."

While the Pentagon plans to study further the machine-by-machine recommendation, it argues that to maintain such records for "commingled Government and contractor-owned plant equipment on a contract-by-contract basis is impractical because it would be very time consuming, disrupt the contractor's production planning process and result in the addition of costly administrative burden for both Government and industry."

The GAO, however, disagrees. Some contractors, it says, already keep such records, and others are installing electronic data-collection equipment that can do the job. While the Government would share the expense of these company investments in final prices to the Pentagon, the GAO says, it "doesn't seem unreasonable" to require contractors to keep books distinguishing between Government and commercial use.

The GAO says one contractor that already breaks down its usage figures by machine told the agency that it cost the company $7,400 a year to do this on 880 pieces of equipment. With the help of this company's figures, the GAO estimates that a similar machine-by-machine computing of "the rent at this contractor would increase the contractor's annual rent payment by about $582,600."

It "seems reasonable to expect that, if the Government provides (equipment) to contractors, the contractors should furnish the Government data as to how they are using it," the agency contends.

Such data, it suggests, wouldn't only help the military reduce unauthorized commercial use of its equipment, but also would aid in curbing other cases it found where companies had received permission to use Government property for commercial work while the same equipment was needed for defense jobs elsewhere.

Chairman PROXMIRE. Mr. Epstein's article is reporting in detail on this subject, which concerns us very much, and we will certainly have some questions on the points raised by that story.

At this point, without objection, I will include the announcement of these hearings and schedule of witnesses. I will also insert relevant correspondence in the record regarding GAO's appearance here today.

(The material above-referred to follows:)

CONGRESS OF THE UNITED STATES—SUBCOMMITTEE ON ECONOMY IN GOVERNMENT OF THE JOINT ECONOMIC COMMITTEE

The Subcommittee on Economy in Government of the Joint Economic Committee will start hearings November 27th on Pentagon procurement practices to determine what steps are being taken to tighten up buying policies which have resulted in large overcharges to the Government.

Senator William Proxmire (D-Wis.), Chairman of the Subcommittee, and Congressman Thomas R. Curtis (R-Mo.), ranking minority member, jointly announced the planned four-day probe. Proxmire is also Chairman of the full Joint Economic Committee.

Senator Proxmire, in a statement from his Washington office, said:

"The Defense Department's buying practices have been subjected in recent months to a withering—and quite justifiable—barrage of critisism from Members of Congress.

"During hearings last spring, the Economy in Government Subcommittee uncovered a disturbing record of loose management by the Pentagon of the billions of dollars of noncompetitive negotiated contracts to which it commits the taxpayer annually. We want to see if there has been a genuine improvement in the situation in the 7 months since we last looked at it.

"We found last spring that the Pentagon was virtually ignoring the Truth-in-Negotiations Act of 1962 (PL 87-653), which is the taxpayer's only insurance against blatant overcharges in noncompetitive purchases. Negotiated contracts, as opposed to competitive-bid contracts, account this year for some 85 percent of the $46 billion in Defense procurement.

"The 1962 Act established the requirement that in negotiated contracts over the $100,000 contractors must furnish complete, accurate and current data on their costs as a way of discouraging inflated cost quotations during contract negotiations.

"The Comptroller General of the United States told us at our hearings last spring, however, that his spot checks since the Act went into effect showed that, in only 10 percent of the cases investigated was there any evidence of compliance with the Act. As a result, the taxpayer, in all probability, is losing billions in overcharges on Defense contracts because of Pentagon laxity in enforcing this five-year-old Act.

"Following our spring hearings, Congressman Otis Pike discovered that the Pentagon's record of mismanagement extended to contracts too small to be covered by the Truth-in-Negotiations Act. This completed the circle of mismanagement.

"In September, Deputy Secretary of Defense Paul H. Nitze ordered a clause written into all negotiated Defense contracts giving the Pentagon clear authority to conduct post-award audits of the contractor's books to determine his actual costs during performance of the contract. If fully implemented, this is a big step forward. The subcommittee wants to know if it is being fully implemented.

"In addition, the subcommittee wants to find out from responsible federal officials what is being done to extend genuine competitive bidding to a larger volume of Defense procurement.

"The subcommittee also wants to know what improvements are being made in management of the $11 billion worth of Government property now in the hands of outside contractors. We will also probe the management of the billions of dollars in inventory, including perishable items, where large losses have occurred.

"We want to know if the Budget Bureau has a real program in operation to carry out the President's order of March 3, 1966 to get the Government out of unnecessary competition with private enterprise in the procurement of goods and services. We want to know, also, whether the Bureau has finally initiated a dynamic program to bring control over the annual lease and purchase of $3 billion in automatic data processing equipment.

"Other questions we will seek to answer during the hearings are: Why has not a uniform policy been developed in the cause of differentials under the Buy American Act? What progress has been achieved in the Government to develop a National Supply System to eliminate overlapping in the procurement and management of some 4 million supply items? What is the status of a supply-demand-control system to utilize existing inventories in an effort to avoid concurrent buying and selling of the same items by different agencies? What is the status of the Government's review of its huge real property holdings to determine which are no longer needed, in whole or in part, for the conduct of essential functions.

The schedule of hearings is as follows:

Monday, November 27, 1967, 10 a.m., Room AE–1, The Capitol (S–407): Elmer B. Staats, Comptroller General of the United States.

Tuesday, November 28, 1967, 10 a.m., Room AE–1, The Capitol (S–407): Thomas D. Morris, Assistant Secretary of Defense (Installations and Logistics).

Wednesday, November 29, 1967, 10 a.m., Room AE–1, The Capitol (S–407): William E. Minshall, United States Representative, State of Ohio.
Lawson B. Knott, Jr., Administrator, General Services Administration.

Thursday, November 30, 1967, 10 a.m., Room AE–1, The Capitol (S–407): Phillip S. Hughes, Deputy Director, Bureau of the Budget.

NOVEMBER 8, 1967.

Hon. ELMER B. STAATS,
Comptroller General of the United States,
Washington, D.C.

DEAR MR. STAATS: This will confirm previous discussions that the Subcommittee on Economy in Government of the Joint Economic Committee will hold hearings on November 27–30, 1967 primarily to review developments on the conclusions and recommendations in our report dated July, 1967.

It will be appreciated if your prepared testimony covers in detail:

1. Developments in compliance with the "Truth-in-Negotiations Act" by the Department of Defense and other agencies to the extent of your investigations.

2. Improvements in supply management in the United States and abroad.
3. Adequacy of management of government-owned equipment furnished to contractors.
4. Government competition with the private sector in providing material and services for government use.

A status report on the other subjects covered by the July, 1967 report will also be of benefit as will a review of progress and problems concerning the procurement and management of Automatic Data Processing Equipment (ADPE). Members of the subcommittee have expressed special interest in the identification and improved management of common-type programs such as we have previously discussed, i.e., recruiting, motion pictures, dental laboratories, etc. Any plans you may have or reports to make on these and related subjects will be of assistance to the subcommittee. We are also interested in obtaining your views as to whether or not the Defense Supply Logistics Center (DSLC) at Battle Creek, Michigan, is fulfilling its potential in the utilization of existing stocks in the military and national supply systems.

You are scheduled to testify, in Room AE–1, The Capitol, Joint Atomic Energy Committee Hearing Room, Monday, November 27, 1967, at 10 a.m. Please forward 100 copies of your prepared testimony at least one day in advance and contact the staff consultant, Mr. Ray Ward, Code 173, Ext. 8169 if additional information is required.

Sincerely yours,

WILLIAM PROXMIRE,
U.S. Senator.

Chairman PROXMIRE. Mr. Staats, you may proceed, and please identify your assistants for the record.

STATEMENT OF HON. ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES, ACCOMPANIED BY FRANK H. WEITZEL, ASSISTANT COMPTROLLER GENERAL; CHARLES M. BAILEY, DEPUTY DIRECTOR, DEFENSE DIVISION, GAO; WILLIAM NEWMAN, DIRECTOR, DEFENSE DIVISION, GAO; STEPHEN P. HAYCOCK, ASSISTANT GENERAL COUNSEL; JAMES HAMMOND, ASSOCIATE DIRECTOR, DEFENSE DIVISION, GAO; KENNETH FASICK, ASSOCIATE DIRECTOR, DEFENSE DIVISION; AND GREGORY AHART, DEPUTY DIRECTOR, CIVIL DIVISION

Mr. STAATS. Thank you very much, Mr. Chairman. I would like to introduce my colleagues here at the table: Mr. Frank Weitzel, Assistant Comptroller to my immediate right. To my immediate left, Mr. Charles Bailey, who is Deputy Director of our Defense Division, and Mr. Newman, the Director of our Defense Division.

Mr. Chairman, I would like to say at the outset that we in the GAO feel that the hearings which the subcommittee has held in the past have been extremely helpful to us in relating our work to the interests of the Congress, and calling to the attention of the Congress in a more direct way than can be possible in our reports, the results of the work that we are doing in the defense procurement area.

In the 18 months ending June 30 of this last year, the GAO issued 241 reports in the defense procurement area. Twenty-one of these reports were made to the Congress as a whole, another 21 of these reports were made to committees of the Congress. We therefore have covered a wide variety of problems in the defense procurement area.

With your agreement, we have limited our formal statement here this morning to five of the areas. There are some 11 additional matters

covered in the committee's July report, on which we have filed with the committee a status report. This is a 32-page document. It covers many other very important matters.

If the committee should desire, after you have had an opportunity to review this attachment, we would of course, be most happy to return and address ourselves to any of the points which might be raised in that attachment.

Chairman PROXMIRE. We would very much appreciate that.[2]

Mr. STAATS. As it is, our report today is a fairly long report, for which we apologize. We were not able to reduce the length of it in any substantial way. For that reason, I would invite your questions as we go along, if you have questions, so that we can cover the points that you are most directly interested in.

Chairman PROXMIRE. We may ask questions as you go along. I think it might be a little more orderly if by and large we confine our questions to the end.

Mr. STAATS. As you wish.

Chairman PROXMIRE. Mrs. Griffiths may feel free to interrupt if she cares to do so.

Mr. STAATS. The five topics which we have covered, as indicated in your letter, are as follows:

1. Truth in Negotiation Act, Public Law 87–653.
2. Military Supply Systems.
3. Control Over Government Property in Possession of Defense Contractors.
4. Contractor versus In-House Methods of Acquiring Goods and Services—for the Government's own needs.
5. Small Purchases—which was not covered in your letter, Mr. Chairman, but which we have added on the basis of informal discussions with Mr. Ward and others of your staff.

Chairman PROXMIRE. Yes; we raised that point especially for the defense department.

Mr. STAATS. Right. As I have indicated, we have also filed the attachment which is available to the committee for its use. (app. 1, p. 397.)

TRUTH IN NEGOTIATIONS ACT, PUBLIC LAW 87–653

The Truth in Negotiation Act of 1962, Public Law 87–653, requires submission and certification by the contractor of cost or pricing data prior to the award of certain negotiated contracts and subcontracts expected to exceed $100,000. (app. 2, p. 407.)

It also requires, as a further protection of the Government's interests, that a defective pricing data clause be inserted in each such negotiated contract to provide a contractual basis for a price adjustment in the event the cost or pricing data submitted at the time of negotiation were inaccurate, incomplete, or noncurrent, and as a result the contract price was increased.

During hearings before your committee in May 1967, we discussed the findings disclosed in our reports to the Congress and a draft report to the Secretary of Defense. In these reports we recommended the following:

[2] See pp. 351–395.

1. Obtaining right of access by agency officials to performance cost information.

2. Instituting a regular program of postaward audits, by Defense Contract Audit Agency.

3. Making postaward audits where contracting officers have reason to believe that cost or pricing data used in negotiations may not have been accurate, current and complete, or may not have been adequately verified.

4. Obtaining written identification of data submitted by the contractor in support of pricing proposals.

5. Revising the regulations to make it clear that the mere making available of data to the auditors without identification in writing does not constitute data "submitted," in terms of the law.

6. Documenting procurement files where cost or pricing data were not requested or used to show the basis for concluding that the submission of such data could be waived because of adequate competition or prices that were based on catalog or market prices of a commercial item sold in substantial quantities to the general public.

The foregoing matters dealt not with whether data was being acquired, but with (a) identifying the data obtained, (b) performing adequate analysis and verification of the data and (c) documenting the negotiation files to provide a clear record of the use accorded such data.

The Defense Contract Audit Agency initiated a program for postaward audits, and as you know, Mr. Chairman, on September 29, 1967,[3] the Deputy Secretary of Defense issued a memorandum requiring the inclusion of a clause in all noncompetitive firm fixed price contracts granting access to contractor's records of performance. This memorandum should accomplish by administrative action what would be accomplished by the enactment of bills proposed by you and Congressman Minshall. All other contract types already provide such access.

The Department has revised its regulations to adopt substantially all of our recommendations on the other matters which I have just mentioned.

APPLICATION OF PUBLIC LAW 87-653 TO CONSTRUCTION CONTRACTS

Our reviews of negotiated construction contracts awarded by the Department of Defense led us to the conclusion that—

1. Sufficient cost or pricing data in support of price proposals were not being obtained.

2. Cost analyses of price proposals were not made as required by regulation.

3. Prescribed procedures for utilizing advisory audits were not being followed.

The main reason why the agencies responsible for awarding construction contracts were not complying with the regulation appeared to be their belief that the requirements were not applicable to construction contracts since contractors' price proposals were being evaluated on the basis of comparisons with the agencies' own cost estimates.

[3] See text and GAO comments, B-158193, app. 3, p. 409.

Primary reliance was placed on such comparisons as a means of evaluating the reasonableness of prices.

We have been informed by the Department of Defense that the agencies now recognize that the law does apply to construction contracts and concur in the necessity of obtaining cost or pricing data where appropriate.

GSA CONSTRUCTION CONTRACTS

In a review of a number of construction contracts administered by the Public Buildings Service, General Services Administration, we noted some instances where cost or pricing data was not being obtained for individual contract modifications exceeding $100,000 in amount as required by the Federal procurement regulations. Further, the contracts did not include the prescribed defective pricing data clause. Failure to find fulfillment of these requirements in the contracts we reviewed, we sent a letter in July, 1967, to the Commissioner, Public Buildings Service, and requested his comments concerning this matter.

We have since received assurances from the Commissioner that General Services Administration internal procurement regulations would be revised to require appropriate clauses to be inserted in various types of construction contracts.

TRAINING OF PROCUREMENT PERSONNEL

Officials of both DOD and GAO recognize that changes in regulations, in themselves, will not be effective unless agency procurement personnel receive additional training in implementing the regulations. To this end, we have worked with the Department of Defense and have mutually agreed on material to be used in training programs for Defense procurement personnel illustrating adequate compliance with Defense regulations implementing Public Law 87-653. In this connection, a training film has been produced by DOD and shown to numerous Defense personnel. I understand that this is also now being shown to some of the contractor personnel to enable them to learn more about the effective operation of this law.

Also, a sample case, illustrating adequate compliance, has been published in a Defense procurement circular for the information and guidance of all procurement and contractor personnel involved in price negotiations.

In addition, DOD procurement teams are currently reviewing practices of procurement officials to ascertain whether these regulations are understood, are complied with, or need further clarification.

MATTERS FOR FURTHER CONSIDERATION

Certain other matters remain open and require additional consideration before final decisions are made.

These matters involve:

1. Defense criteria for making determinations that price competition, adequate to assure a reasonable price, exists for complex military work, where the work cannot be clearly defined.

2. Additional guidance to contracting officials on obtaining and verifying information to support exemptions from the requirement to

furnish cost or pricing data on the ground that proposed prices are based on established catalog or market prices of commercial items sold in substantial quantities to the general public.

3. Clearer definition of the Government's right to price reductions under firm fixed-price contracts where prices are increased because subcontractors have submitted defective cost or pricing data.

Military Supply Systems

During the past 18 months, we have assigned a large number of our staff to surveys, studies and reviews of the military supply systems and their responsiveness to military needs.

Primary emphasis has been, and is being, placed on appraising the effectiveness and economy of the supply systems and concurrently identifying and advising military officials of opportunities for improving supply management.

During the period from June 1966 through December 1966, we made a review of the responsiveness of the military supply systems to increased demands generated by the Southeast Asia conflict. We are currently complementing this initial effort with a review of certain aspects of the Army's supply system in Vietnam.

During this committee's hearings held in May 1967, we apprised you of the results of our review of the supply systems in the Far East. This effort, conducted in cooperation with the Department of Defense, resulted in the identification of 82 specific opportunities for improvements in the operations of the individual military supply systems. The effort also identified several broad problem areas requiring high level management attention.

Subsequent to the May 1967 hearings, we have had the opportunity to observe the results of the military services' actions to accomplish improvements in the areas cited. We were pleased and impressed with the results to date.

For example, with respect to the operation of the Army stock fund, we find that procedures have been changed so that units in combat zones no longer need concern themselves with stock fund limitations when ordering supplies and equipment. The fund controls inherent in a stock fund system are being applied at a higher organizational level.

In the area of communications, progress has been made in improving the reliability and accuracy of the communications systems used to transmit requisitions and other logistical data. Automatic transmission and switching facilities have been installed at various locations in the Far East and transceiver capabilities have been increased throughout Vietnam. The services have also improved their systems for reconciling and controlling data transmitted.

We are continuing to keep abreast of developments with respect to the various major problem areas we described to you in May.

Army's Logistics Structure

One of the more significant areas discussed with you in May involves the Army's logistics structure.

In our reviews of the military supply systems we observed that it tends to fragment supply management responsibilities through all

echelons of command. In this regard, we are of the opinion that improvements are needed in order to more effectively and economically support military operations.

In addition to Headquarters, Department of the Army, all of the Army commands in the continental United States as well as overseas are involved in logistics management and/or planning. The Army Material Command has control of stocks only in the depots in the United States. When supplies are issued to the various posts in the United States, the Continental Army Command assumes responsibility. When supplies are issued to overseas theaters, the overseas commands, such as U.S. Army, Pacific, or the U.S. Army, Europe, assume responsibility. The 7th Army, under the U.S. Army, Europe, also has a separate depot complex and supply control point.

We found that major problems inherent in such a logistics structure were:

1. The absence of a reliable asset reporting and control system.
2. A variety of data processing systems for logistics management and a concurrent shortage of skilled data processing personnel.
3. Absence of a focal point for worldwide control of supply transactions.

We made a number of proposals to the Army for improving supply responsiveness. One was the establishment of a comprehensive reporting system designed to furnish Army Materiel Command inventory managers with worldwide asset data. We made a similar recommendation in our report to the Congress in April 1967 on the availability of selected stocks in Europe to meet the requirements of other commands within the Department of the Army. In this connection, the Department of Defense informed us in June 1967 that the Department was instituting a system whereby certain Army overseas depot assets will be incorporated in their entirety in the records of the inventory managers in the United States.

Chairman PROXMIRE. Let me just ask at that point, because it does seem to be appropriate here, does this comply with what you suggested, establishment of a comprehensive reporting system? Is this a comprehensive reporting system?

Mr. STAATS. I think it includes some of the things that we had in mind in our report, Mr. Chairman.

Mr. Bailey?

Mr. BAILEY. It is limited in the number of items that it covers. In other words, instead of covering all items, at this point in time it is limited to certain high value items that are designated for worldwide reporting and control.

Chairman PROXMIRE. I will follow up on that later, and maybe the other members of the committee will.

Mr. STAATS. The Army has various other programs underway to effect improvements in its logistical organization. Earlier this month the Army briefed us on its most recent plan for restructuring the Army logistics organization, particularly in the European theater. In essence, this plan is designed to streamline the organization by eliminating unnecessary levels of inventory management and storage, thereby making for a more direct line of support from using activities to theater

depots. The plan for Europe is to be compatible in format and concept to the logistics organizations and procedures being developed for application in the continental United States as well as in other theaters.

We will follow the progress being made in the implementation of these plans to evaluate the effectiveness of supply operations under the new concepts.

ARMY'S SUPPLY ACTIVITIES IN VIETNAM

In September 1967 we started a review of Army supply activities in Vietnam to complement the work we did last year. Based on our work to date, the Army's supply system in Vietnam appears to be responsive to the needs of the units supported in terms of providing, on a timely basis, the supplies and equipment necessary to accomplish their missions. This responsiveness has been achieved despite adverse conditions in Vietnam, by using special techniques not contemplated in the normal Army supply system. We recognize that special measures taken during the buildup possibly were necessary; however, we believe that current conditions as described below dictate greater attention to effective management to maintain the proper degree of supply support at a lower cost.

The Army is not yet in a position to know, within a reasonable degree of confidence, what stocks are on hand and what stocks are actually excess to their needs. Generally, military officials at various levels are aware of these problems and various projects or programs to alleviate the conditions are being undertaken or planned. We are of the opinion, however, that the economic and supply system benefits involved warrant continuing emphasis and attention at all levels.

Our tentative observations of the principal matters which warrant additional management attention and application of resources are—

1. The identification and prompt redistribution of the large number of excess items in Vietnam. The Army in Vietnam believes, on the basis of admittedly unreliable records, that significant quantities of supplies on hand are excess to established stockage objectives.

2. The establishment of accurate data on stocks on hand and consumed, to facilitate sound determinations of needs and consequently avoid accumulation of further excesses.

3. The application of additional supply discipline to reduce, to a minimum, the use of system disturbing high-priority requisitions.

4. The development of controlled programs which will insure the return of repairable components to the supply system.

5. The establishment of an effective program in Vietnam to insure a maximum degree of inter- and intra-service utilization of supplies.

We are keeping Army officials in the Pacific advised of our findings and observations during the course of our review, and actions are being taken either to correct or study the indicated problem areas. In addition, we have recently briefed DOD officials in Washington on our observations and tentative findings to date so that appropriate attention can be given them at that level. Our review is scheduled for completion in December 1967 and a draft report will be submitted shortly thereafter to the Department of Defense for its comments.

I believe, Mr. Chairman, on this point that the Department of Defense will have further information to supply the committee with respect to its contemplated actions to deal with the problems as we have developed them.

Control Over Government-Owned Property in the Possession of Defense Contractors

Turning to the subject of the report which you referred to, Mr. Chairman, which was released only today, control over Government-owned property in the possession of defense contractors:

At your subcommittee's hearings earlier this year, limited discussion was held on the subject of control over Government-owned property in the possession of contractors. Our review, which was done at your subcommittee's request, covered several property classes. The total value of such property is unknown, but available DOD data shows it amounts to about $11 billion in two major classes.

Since your May hearing, DOD has had an opportunity to comment on our observations and our report was issued to the Congress on November 24, 1967. (Text in app. 4, p. 411.) In general the Secretary of Defense was receptive to our suggestions. Actions have been taken or planned in response to the majority of our proposals which, if properly implemented, should result in significant improvements in the control and utilization of such property.

Briefly, our findings were as follows:

1. Some of the equipment was being used by contractors in their commercial operations without appropriate Government approval and without, in our opinion, equitable compensation to the Government.

2. There was little or no use for extended periods of a portion of the equipment, for some of which there was a current need in other plants.

3. Utilization data maintained by some contractors was not adequate to indicate the extent and manner of its use.

4. The Defense Industrial Plant Equipment Center, the Office responsible for the management of idle industrial plant equipment, permitted the purchase of equipment without screening to determine whether similar equipment was idle and available at other locations.

5. Rental policies, in some cases, were detrimental to the Government's interests, in that various bases upon which rental payments were negotiated resulted in a lack of uniformity in the rates actually charged, inequities between contractors, and, in some cases, reduced rent payments to the Government.

6. In some cases, it was our opinion that the Government's interests would have been better served by foregoing the replacement of outworn or outmoded equipment in favor of the contractors' acquiring new equipment at their own expense.

In the other categories of property—special tooling and test equipment, and material—weaknesses in the control of this property existed due to the absence of financial controls and lack of independence in the taking of inventories by contractors. Also, greater care is needed

to properly classify tooling and test equipment since some items have multiuse characteristics and should be classified as facility-type items.

At nonprofit institutions we observed similar discrepancies in property controls.

Chairman PROXMIRE. How many nonprofit institutions did you investigate?

Mr. STAATS. There were only two in this report.

Chairman PROXMIRE. Two universities; is that right?

Mr. STAATS. I believe that is right.

Financial controls were not maintained for facility-type items of industrial plant equipment. Equipment of the type controlled by the Defense Industrial Plant Equipment Center was being donated to universities without screening the Center's records to see if like equipment was needed at other locations.

A further weakness is that the Government's approval of contractors' property accounting systems is of questionable value since contractor systems are allowed to continue in an approved status even though the Government property administrator had identified significant weaknesses. Also, DOD had made an inadequate number of internal audits regarding the effectiveness of property administration at contractor plants.

As stated earlier, the Secretary of Defense was, for the most part, receptive to our suggestions. However, full concurrence was not expressed by the DOD with respect to—

1. Requiring contractors to furnish machine-by-machine utilization data and to obtain prior Office of Emergency Planning approval on an item-by-item basis for the commercial use of industrial plant equipment.

2. Strengthening the controls over special tooling and special test equipment through the use of financial accounting controls.

We believe that implementation of these proposals or other acceptable alternatives is necessary to effectively administer this property. The Armed Services Procurement Regulation Committee has several alternative proposals under consideration which are directed to the same problem. We will evaluate and make recommendations to the Department on these proposals as they are submitted to us for comment. We have not yet seen these.

CONTRACT VERSUS IN-HOUSE METHODS OF ACQUIRING GOODS AND SERVICES

Earlier this year we advised your subcommittee that we were reviewing the area of contractor versus in-house methods of acquiring goods and services to meet the Government's needs.

The Bureau of the Budget revised Circular No. A–76, effective October 2, 1967,[4] to incorporate some of the changes recommended by the General Accounting Office and other interested Government agencies. There was no change in the Government's general policy, which is to rely upon private enterprise to supply its needs; that is, Government's needs, except under specific conditions, where it is determined

[4] See app. 11, p. 611, for text.

to be in the national interest to provide directly the products and services it uses.

The circular has been modified to clarify the fact that the 10-percent cost differential in favor of private enterprise is not intended to be a fixed figure. The differential may be more or less than 10 percent, depending upon the circumstances in each individual case.

The revision did not incorporate the recommendation of the General Accounting Office that a separate section or a separate circular set forth specific criteria for application of the policy in the support service contract area, which is a very important area.

We feel that such policy guidance is needed. Our position is supported by what we have found in our reviews of support service contracts which I will discuss shortly. The Bureau of the Budget has stated that it intends to give special attention to the adequacies of the guidelines contained in the circular in this regard.

The revision further did not incorporate the recommendation of several Government officials that State and local taxes should be shown in cost comparison as costs of Government products and services. This likewise is a matter of growing importance because of the increase in State and local taxes.

DEPARTMENT OF DEFENSE INSTRUCTION NO. 4100.33

The Defense Department is currently revising its DOD Instruction No. 4100.33, which governs military operation of commercial or industrial activities, to reflect the changes in the circular and other provisions desired by the Department.

Our work in support services contracts in the Department of Defense and the National Aeronautics and Space Administration indicates that it is often less costly if services are performed by civil service employees than by contract employees. The indicated savings are attributable, for the most part, to the elimination of many contractor supervisory and administrative personnel and the elimination of the fees paid to the contractor. For example, our review of the National Aeronautics and Space Administration's Goddard and Marshall Space Flight Centers showed that estimated annual savings of as much as $5.3 million could be achieved with respect to the contracts we reviewed if these services were performed by civil service employees.

SERVICE CONTRACTS AT MARSHALL AND GODDARD SPACE FLIGHT CENTERS

Representative GRIFFITHS. Mr. Staats, who reviews these services at the Space Administration's Goddard and Marshall Space Flight Centers?

Who reviews this?

Mr. STAATS. Who reviewed? The review was done by our staff, Mrs. Griffiths.

Representative GRIFFITHS. I mean you say that the reviews were done by civil service employees, that you can save $5.3 million. Who did review them?

Mr. STAATS. No; if the services had been performed by civil service employees.

Representative GRIFFITHS. Oh, I see.

Mr. STAATS. It would have been that much saving as against the cost for the same service as performed by contractor employees.

Representative GRIFFITHS. Who was the contractor? That is what I am asking.

Mr. STAATS. Who was the contractor in these cases?

Representative GRIFFITHS. Yes.

Mr. STAATS. I do not have the names offhand.

Mr. AHART. I do not have the names available at present. We could furnish those for the record if you wish, Mrs. Griffiths.

Representative GRIFFITHS. Thank you. Please do so.

Chairman PROXMIRE. Yes; I wish you would if it is all right with you. You have no objection to furnishing them for the record, do you?

Mr. STAATS. Let me check.

Representative GRIFFITHS. I would like to know whether you have any objection or not.

Mr. STAATS. If they are in the report. Are they in the report?

Mr. AHART. The names of the contractors are not in the report, but they have been made a matter of public record in previous hearings on this subject, and I would see no objection.

(The information which follows was subsequently filed for the record by the GAO:)

MARSHALL SPACE FLIGHT CENTER—FUNCTIONAL DESCRIPTION OF LABORATORY MISSIONS AND THE SUPPORT SERVICES TO BE PROVIDED BY THE CONTRACTOR

Organization and contractor providing support	Functional description	Description of support services to be provided by contractor
Computation Laboratory, General Electric Co.	1. To plan, establish, and conduct the application of high-speed computers and automation devices to the field launch vehicle research, development, test, fabrication, and launching, as well as to the areas of management and project direction.	1. The contractor shall furnish the necessary management, personnel, facilities, and equipment (except that to be furnished by the Government) to provide technical support services in the performance of the laboratory's assigned mission. 2. Provide support to the resources management, data systems engineering, digital projects, data reduction, simulation, engineering systems, and industrial systems branches and offices.
Astrionics Laboratory, Sperry Rand Corp.	1. To perform research and development, including prototype development, of components or systems in the areas of guidance, control, electrical networks, vehicle-borne tracking, measuring, telemetering, and range safety devices for multistage launch and space vehicles. 2. To design and fabricate electrical ground support equipment for testing, checkout, and launch of multistage launch and space vehicles and to design and fabricate special test equipment associated with vehicle guidance and control components. 3. To analyze and evaluate postlaunch data to establish performance characteristics of all astrionics components and systems and to investigate and correct inadequacies of malfunctions of such components and systems.	1. See No. 1 above. 2. The support services to be provided include applied research, component evaluation and testing, documentation, design, evaluation, qualification, reliability support, flight dynamics, industrial manufacturing support, and special advanced studies.
Propulsion and Vehicle Engineering Laboratory, Brown Engineering Co.	1. To direct and conduct research, development, engineering and technical management in the areas of propulsion, structures, materials, vehicle systems and systems integration, as related to launch and space vehicles and related support equipment. 2. To perform advanced design of future launch and space vehicles including conceptual and feasibility studies in the areas of propulsion, structures, and materials. 3. To operate experimental laboratory and text facilities in support of research and development work being performed. 4. To represent and to function for the director, R. & D. operations, when designated as a lead laboratory, in planning and managing the combined R. & D. operations organizational elements efforts immediately associated with the specific tasks and activities assigned. 5. To perform the technical and R. & D. project management of tasks assigned by designated lead laboratories.	1. See No. 1 above. 2. The support services to be provided include design studies, vehicle engineering, structural research and development, propulsion and mechanical systems research and development, materials research and development, program coordination, documentation, fabrication, and systems, subsystems, and component testing.

GODDARD SPACE FLIGHT CENTER—FUNCTIONAL DESCRIPTION OF LABORATORY MISSION AND THE SUPPORT SERVICES TO BE PROVIDED BY THE CONTRACTOR

Organization and contractor providing support	Functional description	Description of support services to be provided by contractor
Office of the Assistant Director for Technology:		
Spacecraft Integration and Sounding Rocket Division, Fairchild-Hiller Corp.	Provides the Center with project management, engineering, engineering development, and integration of spacecraft, satellites, space probes, and sounding rockets from project initiation through launch; vehicle mechanical electrical systems, and the development thereof, in support of scientific research projects conducted by means of near vertical soundings for the NASA sounding rocket programs; engineering and integration of allied ground support equipment; design and development of electronic subassembly packaging techniques; advanced technical development in the areas of materials, structures, and mechanisms; and a theoretical analysis capability in areas related to the overall division responsibility.	1. The contractor shall supply scientific and engineering services in performance of task assignments by the Goddard Space Flight Center's division. 2. Services shall include electrical and electronic design, testing, drafting, and supporting fabrication services, for flight hardware and ground support equipment; mechanical design and drafting services; aircraft structural design and aerodynamic analysis; miscellaneous scientific analyses and laboratory equipment design.
Systems Division, Melpar, Inc....	Provides the Center with a systems analysis, design, and development capability for present and future project implementation. Provides a consolidated systems capability in the areas of spacecraft systems engineering, stabilization and control systems, auxiliary propulsion, spacecraft design and electronic information systems design. Conducts in-house and contract R. & D. on materials for space use. Will provide a supporting program of SRT for applications and scientific spacecraft and a program of advanced research and technology for the purpose of advancing the state of the art in the above listed disciplines.	1. See 1 above. 2. Services shall include electrical electromechanical design, testing, drafting, and supporting fabrication services for conceptual and prototype models of research and development hardware and special equipment and facilities; mechanical design and drafting services; miscellaneous scientific analysis and laboratory equipment design and testing; other technical services.
Spacecraft Technology Division, Electro-Mechanical Research, Inc.	Provides a capability for and conducts applied research in spacecraft power systems technology and electronic and thermal systems design and development for scientific satellites and space probes. Provides specialized equipment in the field of spacecraft technology. The programs involved include design and development of telemetry encoders, power conversion equipment, space-borne information processing devices, flight equipment for ground communication, and other auxiliary or associated activities. Provides technical assistance and advice to NASA contractors and others in similar activities.	1. See 1 above. 2. Services shall include electrical and electronic design, testing, drafting, and supporting fabrication services for flight hardware ground support equipment and R. & D. hardware; mechanical design and drafting services; miscellaneous scientific analysis and laboratory equipment design.
Office of the Assistant Director for Space Studies:		
Laboratory for Atmospheric and Biological Sciences, Consultants & Designers, Ltd.	Plans, directs, coordinates, and conducts comprehensive research programs in the dynamics, structure, and physics of planetary atmospheres and in the field of bioscience. Conceives, designs, develops, and implements unique optical, electronic, and mechanical techniques required for the in situ and remote exploration of planetary atmospheres and biological phenomena. Provides the complete analysis of resulting experimental data. Interprets the data from experiments to enhance our understanding of the physical, chemical, and biological processes occurring in the atmosphere and at its boundary with planetary surfaces and interplanetary space. Also provides consideration of the practical application of these results to such problems as interaction of launch vehicles and spacecraft with the atmospheric environment, the acquisition of atmospheric observations for meteorological operations, and the biological sterilization of planetary probes.	1. See 1 above. 2. Services shall include electrical and electronic design, testing, drafting, and supporting fabrication services for flight hardware, ground support equipment, and research and development hardware; mechanical design and drafting services; aircraft structural design and aerodynamic analysis; miscellaneous scientific analysis and laboratory equipment design.
Laboratory for Theoretical Studies, Melpar, Inc.	Conducts a broad program of research covering all phases of theoretical physics associated with the exploration of space. Performs fundamental research in the fields of the planetary sciences, astronomy, plasma physics and energetic particles and magnetic fields in space; supports the NASA lunar program by conducting astrogeologic studies. Provides support to other NASA activities in the space sciences by providing criticism of theoretical and experimental projects in the space sciences; by suggesting new fields of research; and by assisting the experimental groups in the interpretation of current results and the planning of new projects.	1. See 1 above. 2. Services shall include miscellaneous scientific analysis and laboratory equipment design.

Laboratory for Space Sciences, Vitro Engineering Co.	Conducts a comprehensive program of basic research in the many physical space sciences. The major areas of research encompass studies of the structure, gross dynamics and transient phenomena of the sun; micrometeorites; the sources, natures, and effects of planetary ionospheres; the sources, natures and effects of magnetic fields and energetic charged particles; and the investigation of extrasolar astrophysical phenomena by electromagnetic radiation measurements. Analyzes and interprets the data obtained and publishes the final scientific results of the project. Develops detectors and payload instrumentation systems.	1. See 1 above. 2. Services shall include electrical and electronic design, testing, drafting, and supporting fabrication services for flight hardware, ground support equipment and R. & D. hardware: mechanical design and drafting services: miscellaneous scientific analysis and laboratory equipment design.
Office of the Assistant Director for Administration and Management: Experimental Fabrication and Engineering Division, Melpar, Inc.	Plans and directs fabrication engineering and supporting developmental fabrication functions for the construction of aerospace experimental, prototype, flight, and laboratory equipment with the following general responsibilities: (1) Plans and conducts fabrication engineering and materials studies aimed at developing new and improved methods for aerospace applications. Provides engineering services to translate research and design performance requirements into realistic fabrication assemblies. (2) Provides and directs an experimental fabrication capability for fabrication services in the fields of machining and instrument assembly, metal forming and welding, electronic packaging, electrochemical processing, and plastics. (3) Evaluates outside source fabrication requests and monitors services by contractors.	1. See 1 above. 2. Services shall include fabrication process laboratory services; design analysis and supporting engineering services; electronic processing services; quality control services.
Office of the Assistant Director for Tracking and Data Systems: Advanced Development Division, Lockheed Aircraft Corp.	Performs planning, analysis, supporting research, technical development and associated engineering for tracking and data acquisition systems and components with primary emphasis on the development and application of advanced technology for improving tracking and data acquisition. Provides technical support to the space flight projects in the form of planning, analysis, design and development liaison, systems engineering and special subsystem design for tracking and data acquisition systems. Maintains prime responsibility for the integration of the tracking and data systems directorate's SRT effort into a coherent program. Supports the STADAN and manned flight network's engineering and operations with design engineering, trouble shooting, and technical consultation in areas of technical specialities. Performs development and engineering in antennas, RF receivers and transmitters, real-time data handling and processing systems, command and control systems, recording, timing systems, station and network automation, optical calibration systems, optical tracking, optical communications, and precision tracking.	1. See 1 above. 2. Services shall include electrical and electronic consulting, design, testing, drafting, operation, assembly and supporting fabrication services for ground- and space-borne developmental equipment associated with communication, tracking, and other data handling systems; mechanical design, drafting, and technician services associated with development of telescopes, antennas and servo systems; analytical services in the fields of physics, chemistry and mathematics, and associated documentation.
Information Processing Division, Lockheed Aircraft Corp.	Analyzes, develops, and implements advanced information processing systems for both ground and, as assigned, spacecraft portions of the systems. On a mission assignment basis, works with all elements of the information system starting with the experiment and spacecraft housekeeping data outputs and including all steps up to and including the provision to experimenters and spacecraft subsystem engineers of data in the proper form for their final interpretation. Utilizes the latest concepts of information theory to analyze, recommend to experimenters and project managers, and implement the most efficient, meaningful, and reliable methods of information processing, considering both spacecraft and ground information processing portions of the system. Operates the ground processing facility in response to project and experimenter requirements. Participates in the preparation of standards to guide the development of future systems. Provides financial, procurement, logistic, and manpower management support for the division.	1. See 1 above. 2. See 2 above.
Network Engineering and Operations Division, Lockheed Aircraft Corp.	Establishes, maintains, operates, and manages the space tracking and data acquisition network for the tracking, command acquisition of data, and control of scientific and applications spacecraft. Manages network operations and provides logistic support. Assures readiness of personnel, facilities, equipments, and systems to meet network requirements. Performs engineering and implementation including control facilities in support of network requirements. Utilizes results from development groups and other sources in advancing network capability. Provides engineering support to other Goddard and NASA networks as required. Obtains, installs, and insures readiness of all network equipment. Participates in planning of future missions and advises on, and sets requirements for, development items to meet mission and network needs. Assures network and station readiness during launch and control operations, and provides specific, individual project capability for unique requirements. Participates in the establishment of and performance of network tests to insure readiness in all major functional areas. Designs, constructs, and improves network facilities for all Goddard networks and other NASA networks as required.	1. See 1 above. 2. Services shall include electrical, electronics, and mechanical design, testing and support fabrication services for the tracking and data acquisition network; computer programing services for real-time satellite orbital, telemetry and attitude information; organize and interpret data; establish standardized procedures; provide technical writing and drafting support; design, fabricate and test specialized equipment and hardware.

Representative GRIFFITHS. Further than that I would like to know what kind of an organization you set up to supply this type of service.

Mr. STAATS. What type of organization is set up?

Representative GRIFFITHS. Is set up to supply this type of service, and when did such organizations come into being?

Mr. STAATS. The idea of having contracts for personal services is, of course, a very old one, but it is a matter of growing importance to the Government because the dollar costs for contracts for these types of services have increased.

In the case of NASA, for example, the projected cost under their original budget was an increase of more than 50 percent for contract services of this kind in NASA over a 2-year period from 1966 to 1968.

BASIS FOR PRICING SERVICE CONTRACTS

Representative GRIFFITHS. How do they write a service contract, so much service for a year or is it a production-line contract?

That is what Thompson-Ramo-Woolridge got away with.

Mr. STAATS. It would be a contract worked out on a case-by-case basis. In some instances it is a simple thing like guard or maintenance services. In other cases, it would be a highly complex technical service, engineering service, testing service, other items of this kind, and each one of them represents a different kind of contract.

Representative GRIFFITHS. In this instance I would like to know exactly what type of an organization it is, exactly how the contract is written, what they are supposed to supply, and why they up the price.

Thank you.

Chairman PROXMIRE. Isn't it true that all this is public record?

Mr. STAATS. I believe it is.

Chairman PROXMIRE. I mean all that Mrs. Griffiths is asking you?

Mr. STAATS. I believe it is in this case. If so, there is no problem.

Mr. WEITZEL. With reference to Mrs. Griffiths' last question, did we find that the contractors upped the price or was this an increase in the amount of services provided?

Representative GRIFFITHS. Or just a simple little change order thought up by the contractors?

Mr. AHART. I think in this particular case, Mrs. Griffiths, it was the question of increasing the level of support required to support some of the increased programs of NASA.

I think one of the particular ones was when NASA undertook the responsibility for the B–70 program. This required them to really take over some of the contract support which the Air Force had previously had to support this program.

Representative GRIFFITHS. Of course, the service contract could require so many people to work so long. The moment you write it like a production contract, you will work on this and this and this, then if you add one single item, you give them a chance to increase the price.

Mr. AHART. I think in these particular contracts most of them were cost-type contracts, cost reimbursement plus an award fee, and in general, they were stated in terms of a general level of effort, the number of man-years which would be provided over a period of time, and the

contractor performed in response to task orders which were placed against the contract during this period.

Representative GRIFFITHS. Thank you.

Chairman PROXMIRE. Go right ahead.

NASA DISAGREES WITH GAO

Mr. STAATS. Although recognizing that we gave consideration to factors other than cost—such as the rapid buildup of NASA's program in the early years—in presenting our conclusions, the Associate Administrator for Organization and Management, NASA, stated that, in the situations discussed in our report, such factors supported the Space Administration's decisions that contracting for the services involved had been in the best interests of the Government.

In other words, they disagree with our conclusions.

We believe that, in contrast to its past rate of growth, the Space Administration has now achieved a relative degree of stability and should be able to better consider relative costs in assessing the extent to which it should continue to rely on the use of support service contracts. In this regard the Associate Administrator advised us that the Space Administration recognized the need for more specific guidance on cost considerations and that such guidance would be part of any redefinition of policy resulting from a current review of agency experience in the use of support service contracts.

Although NASA had planned to increase its expenditures for support service contracts in fiscal year 1968, as I have indicated, we have been advised by the agency that final decisions in this area have had to be deferred pending the outcome of its appropriation bill. Also NASA has been studying the entire support service area over the last several months and the results of this study, according to the agency, may well affect its future plans.

We have recently received a copy of the October 1967, "Opinion of the General Counsel of the Civil Service Commission," regarding the legality of selected contracts at Goddard Space Flight Center, National Aeronautics and Space Administration. It seems evident that this document will be of significant value to agencies in ascertaining the propriety of technical support, or similar service contracts. (Copy in committee files.)

I might add, Mr. Chairman, here, that this matter was referred to the Civil Service Commission by the General Accounting Office as a result of the question that we raised in the course of our review on the cost of doing the support service work at Goddard by contract as against in-house performance, so that the matter was raised with the Civil Service Commission as a result of our review.

As such matters come to our attention during audit activities, we will continue to consult with representatives of the Commission regarding technical support service and similar contracts which appear questionable in the light of the standards set forth in the Opinion.

As I have advised the Chairman of the Civil Service Commission by letter, cases coming to our attention in the future as a result of our work in the contract area will be referred if they appear questionable from a legal standpoint.

I think it is well to keep in mind here, Mr. Chairman, that there are two distinct aspects of this problem. One is the question of legality, which goes to the question of whether or not an employee is actually an employee of the contractor and operating under his supervision and direction, and therefore in the position of rendering a contractual service to the Government, or whether the contractor is in fact only supplying manpower, who for all practical purposes are under the supervision and direction of the Government. In such cases, they are tantamount to being Government employees, although actually being paid through a contract. This is the legal question that the Civil Service Commission addressed and outlined in the course of its opinion some six tests for criteria which the agencies could utilize in judging whether or not there was a contractual relationship, or whether it was actually an employee-employer relationship that existed.

We feel that the six criteria, while they may have to be revised in the light of experience, will for the first time give needed guidance as to legal determinations, but the second part of this problem has to do with relative costs, the cost of providing a service by the Government directly as against providing that service by contract, and this is the area that we have been most directly concerned with.

I think that leads us right into the next point here. We have been interested in the question of lease versus purchase of facilities by contractors.

Lease Versus Purchase of Facilities by Contractors

Government contractors frequently rely on other private enterprises for furnishing, under lease agreements, land and buildings for use in performing Government contracts.

We have performed a review at 20 locations of 17 major contractors for the purpose of ascertaining the effect on costs to the Government of the practice by contractors of leasing land and buildings to be used extensively in the performance of Government contracts. The sales to the Government resulting from contractor operations at these 20 locations amounted to about $4.3 billion in 1966.

In this review we compared the costs to the Government resulting from contractors' leasing arrangements with the estimated cost the Government would have incurred if the contractors had owned the land and buildings directly. In making these comparisons, we used property values based on actual costs, sales prices, appraisals, or other related data obtained from the contractors or local taxing authorities.

We identified 63 leasing agreements which committed the contractors to pay rentals of about $95.3 million during the initial lease periods for land and buildings. We found from our review of these leasing agreements that in every case but one, leasing was more costly to the Government during the periods of the initial leasing.

Chairman Proxmire. In 62 of 63 agreements the leasing was more expensive to the Government than it would have been——

Mr. Staats. If the contractor had owned the property.

Chairman Proxmire. If the contractor had owned it.

Mr. Staats. Right.

The leases involved were executed during the period from 1952 to 1967 and provided for the use of the facilities for periods ranging from 2 to 25 years and included renewal option periods to extend occupancy. If the facilities had been contractor owned, depreciation charges would have amounted to about $35.7 million or about $59.6 million less than the rental costs. Based on 1966 sales, the Government's share of the difference could amount to about $57.7 million.

Chairman PROXMIRE. Could I just ask you at that point, I don't like to interrupt you too much, because we do like to confine our questions to the end, is there any way we can tell whether or not this is typical, whether we can project this kind of a performance saving?

Mr. STAATS. We think it is typical, Mr. Chairman.

Chairman PROXMIRE. Did you select some of the worst examples?

Mr. STAATS. We tried to select representative types.

Chairman PROXMIRE. Representative?

Mr. STAATS. We believe, however, that it is typical. You know you could expand this kind of review to include other cases or people might argue about the particular ones that we selected.

Chairman PROXMIRE. So this was a reduction from $95.3 million down to $35.7 million; is that right?

Mr. STAATS. That is right.

Chairman PROXMIRE. A reduction to about 40 percent, then or less than 40 percent of what it would have been if we had the arrangements you are suggesting instead of the Government leasing?

Mr. STAATS. To my knowledge this is the first time anyone has attempted to make this kind of review, and I think the two examples here may help point up the problem.

Chairman PROXMIRE. Good.

Mr. STAATS. The following is an example of what we found in this review.

In 1958, the contractor involved began leasing land and buildings at three locations for the performance of Government contracts. By the end of 1963, the leased land and buildings at these locations consisted of about 340 acres of land and more than 890,000 square feet of building space which had been acquired by the lessors at an estimated cost of $21.2 million.

Under the terms of the leases which were for 20 and 25 years, the contractor's fixed rental costs will be about $34.1 million, or 160 percent of the estimated acquisition cost. We estimated depreciation on the buildings to be about $15 or $19 million less than the rental charges. The Government's share of the rentals in excess of depreciation will be about $18.1 million.

At two of the three locations, we found that the contractor either had owned, or had possessed a contractual right to purchase the land upon which the leased facilities were ultimately erected, but had sold or transferred its rights to the land to the lessors immediately prior to the construction. The buildings were erected according to the contractor's specifications or renovated to meet its requirements.

Chairman PROXMIRE. Was there collusion involved here?

Mr. STAATS. I think it is purely a case where he found it to his economic advantage to lease because these were the ground rules under which reimbursement was made.

Representative GRIFFITHS. Who was the contractor you are mentioning?

Mr. STAATS. I do not know. I do not believe it was mentioned in the report.

Mr. BAILEY. No.

Mr. STAATS. We have cited these as illustrations.

Representative GRIFFITHS. I don't think it is any problem to find out who the contractor was, if you know all those facts, so would you supply it? In how many instances on this was this a subsidiary and parent company, or some other such arrangement, or vice versa?

Mr. STAATS. We would have no difficulty, I think, in supplying that information. However, Mrs. Griffiths, in supplying the names of contractors, we do not like to do this without giving them an opportunity to comment on our findings.

Representative GRIFFITHS. You supply them. We will invite them all in to explain what they were doing.

Mr. STAATS. We do not think that it is in the interests of the Government or the interests of the Congress to present only one side of a question. Our position here with respect to the contractor is exactly the same as it is with respect to an agency of the Government.

If we are submitting a report on the OEO or any other Government agency, we supply the Congress with their rebuttal. Now, we are not infallible. Sometimes we make mistakes.

Representative GRIFFITHS. If they do not respond to your inquiry, then they are home free; is that right?

Mr. STAATS. If they do not respond to the inquiry, then we go ahead and submit the name anyway.

Representative GRIFFITHS. I see. How long are we going to have to wait?

Mr. STAATS. We give them the opportunity.

(Further information relating to the preceding discussion was subsequently received and appears below:)

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., January 18, 1968.

B-140389.
Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States.

DEAR MR. CHAIRMAN: At the hearings held November 27, 1967, before your Subcommittee on Economy in Government, a question was raised as to the identity of the contractors included in our review of the practice of leasing land and buildings used almost exclusively in the performance of Government contracts.

We are presently receiving contractors' comments on our draft report which will be considered in the preparation of our report to the Congress. We plan to issue our report about the end of March at which time we expect to be in a position to furnish you with the contractors' names.

At the hearings we were also questioned as to whether there was any company or other type of affiliation between the lessors and the lessees. We are presently examining into this matter and expect to furnish you with any information we shall obtain at the same time.

Sincerely yours,

(Signed) ELMER B. STAATS,
Comptroller General of the United States.

Representative GRIFFITHS. How long do we have to wait for the answer?

Mr. STAATS. We try to make it as short as we can. It is seldom more than 60 days.

Representative GRIFFITHS. You will supply these names, then, completely to this committee?

Mr. STAATS. We will supply the names, if the contractor makes no response to our invitation, or if he does respond, then we include, in addition, his difference with us in our report.

If he agrees with us, we simply make note of that, but if he disagrees with us, then we like to present his view, in all fairness to him. We feel that it is a more valuable document to the Congress, if the Congress knows wherein they disagree with us.

Chairman PROXMIRE. Let's see if we understand this. If he agrees with you, you don't——

Mr. STAATS. We simply take note of that fact.

Chairman PROXMIRE. You simply take note of the fact, but you don't disclose the identity of the——

Mr. STAATS. Yes.

Chairman PROXMIRE. You do?

Mr. STAATS. Oh, yes.

Chairman PROXMIRE. All right, fine. (See further statement of Comptroller General, app. 12, p. 604.)

Representative RUMSFELD. Isn't it correct that this is a new policy on the part of GAO within recent years?

Mr. STAATS. I cannot speak beyond the time when I became Comptroller General, but I am firmly of the view, myself, that an opportunity for comment by the contractor is a valuable thing.

Representative RUMSFELD. Are you suggesting that they have not had an opportunity to comment, during the course of your investigation?

Mr. STAATS. Informally; yes.

Representative RUMSFELD. Of course they have.

Mr. STAATS. Informally, yes, but this might be at different levels within an organization, and I think that that is something quite different than when a company has a draft report before them. Ordinarily, the informal contract with the contractor will be through one of our regional offices, and it may cover only one segment of the problem. The contractor may have other operations in other regional offices where the other segments of the contract operation will be looked at.

These are eventually tied together in a draft report in our organization, and it is forwarded to the top level of the contractor's for comment. In this way, the overall position of the company in regard to the problem is obtained. While we may be satisfied we are absolutely correct—and I think we do have a very good record in this regard—we nevertheless feel that it makes a more valuable document, a more useful document, to everyone concerned, aside from the question of fairness to the contractor.

Representative RUMSFELD. Is it really your testimony that you don't know whether or not this is a new policy for GAO?

Mr. WEITZEL. Mr. Rumsfeld, could I answer that question?

Representative RUMSFELD. Go ahead.

Mr. WEITZEL. This is not a new policy for GAO.

Representative RUMSFELD. I was asking Mr. Staats if it is his testimony whether or not that he really doesn't know this is different from say 5 years ago.

Mr. STAATS. I do not believe that there is any change, if my understanding is correct, in the announced policy. I do know that there was a great deal of feeling among contractors that they were not always given a full opportunity to present their views on draft reports.

Representative RUMSFELD. If they now are given full opportunity, isn't that a change of policy?

Mr. STAATS. Let's put it this way. It is my policy, and I really don't feel that I can comment with respect to the practices that prevailed prior to the time I became Comproller General, but to the best of my knowledge, this is not a change of policy.

But I do know, from my visits with many contractors and many contract organizations, that they felt they had not always had a full opportunity to present their views, and that sometimes the reports were issued without their being given advance notice, which we do now.

They have our report by the time that it reaches the press, so they may make additional comments if they wish to do so. But I would like to emphasize that we do not tolerate a situation where a contractor just asks for delays and delays. We have had this experience also.

We feel that if the contractor has a reasonable time—if it is a simple report—we will try to get his reply within a matter of a few weeks. We do not, unless there are very special circumstances, extend this beyond 60 days.

Mr. WEITZEL. Mr. Chairman, it might be helpful if I could clarify the record slightly on that point.

Chairman PROXMIRE. Fine, Mr. Weitzel, go right ahead.

Mr. WEITZEL. We have long had the policy of sending our draft reports to agencies, or to contractors where the material in the report could be construed as being critical of the contractor's operations.

At the hearings before the House Subcommittee on Military Operations of the House Government Operations Committee back in 1965, criticisms were leveled at the General Accounting Office for its alleged failure to completely check these reports with contractors.

For example, it was charged that sometimes we sent the reports in draft form to contractors, got their comments, and then substantially changed the reports before issuance to the Congress. So after the Holifield hearings, we did say that we would emphasize our policy of checking with the agencies and with the contractors any draft reports in which they were concerned.

Now, this was partly for the benefit of the auditors but also for the benefit of the Congress and for the General Accounting Office, to insure that our facts were on line and to insure that our reports were in proper perspective. It is not only a matter of fairness and objectivity, it is a matter of accuracy and completeness in the reports. We follow the practice now of sending our drafts to contractors when they are mentioned in the reports, and we will be glad to furnish the names of the contractors after we have had a chance to do this.

When we are making reports, we do not feel that it is necessary to send the draft to the contractor, if his name is not mentioned in the report. Eliminating this step speeds up sending the report to Congress.

I would like to call attention to the fact that the thrust of this point about the lease versus purchase of facilities is not against the contractor, but in favor of having the armed services procurement regulation amended to differentiate between leased facilities and purchased facilities. Now, it would not be to the interest of contractors in many cases to purchase facilities because they are not any more favorably treated under the weighted guidelines, and because there is no reimbursement for interest on borrowed capital under the armed services procurement regulation.

Chairman PROXMIRE. This is the point Mr. Staats is about to make in his statement, I think.

Mr. STAATS. I would like to make one further point on the matter of releasing names of contractors. If we find a situation, as we did in the Olin Mathieson case, where we feel that there is a specific problem with a given contract, we obviously do not submit our report until we have checked it with the contractor and the contractor is identified in that report.

While we have been attempting to do as much as we could to obtain contractor's comments, if we feel that we have identified a problem which may be a more general problem, we try to go into a large number of contractors to be sure that we are not just taking an unrepresentative group or an isolated case. If we take, say, 15 or 20 contractors and then try to check out with every single one of them before we release our report, our report gets pretty stale.

We feel confident in our ability, if we cover that many contractors, to cite illustrations or cases without checking the contractors, so that we can make our point with respect to the policy or the armed services procurement regulation, without going through this review process with the contractor.

Representative RUMSFELD. Mr. Chairman, if I may pursue this, since Mr. Staats is still on the subject here. The report that I was just handed, that was released today, November 24, I don't see the name of any contractors. Are there any? Does anyone know?

Mr. STAATS. There are no names in that report.

Representative RUMSFELD. No names?

Mr. STAATS. No.

Representative RUMSFELD. So, what you are doing is issuing reports that are protecting completely the names of every single contractor that was involved in any way with the work that you are reporting on in a somewhat critical way?

Mr. STAATS. You see, the trouble with releasing the names of the contractors here, Mr. Rumsfeld, is that anyone who is familiar with the defense contracting business would not have too much difficulty in associating the names with the examples, if we release the name of the contractors, even though we didn't identify them with particular cases.

It is perfectly possible, and feasible, and we would be very glad to go through a further step of checking it out with the individual contractors who were covered in our report, and then making that information available to you.

Representative RUMSFELD. This is what bothers me. You have already checked it out with the contractors because you have been work-

ing with them on the audits in the GAO work that led to the development of the report. This takes a period of months, sometimes years. I serve on the Military Operations Subcommittee of the Government Operations Committee.

Mr. STAATS. Yes; I know.

Representative RUMSFELD. And I happen to disagree with the subcommittee report you referred to and issued dissenting views. I won't go back into that. But, the cold hard facts are, you have been dealing with these people daily to get the information you are commenting on. It certainly would not come as any great surprise or require any long period of months for them to be made aware that their name would be in the report. I am concerned, because I look at the GAO reports and they are sterile. They really don't deal with the problem.

Chairman PROXMIRE. Can you give us a notion of the timing, because as I understand it, and I understand your position very well, and there is a lot of logic to what you say, you feel that you would like to make these reports as promptly and freshly as you can to the Congress, when they are fresh and the information is appropriate and timely, so you can take timely action.

You say after the report has been made, even though you have been dealing with the contractors, after the report has been made, the contractors should have an opportunity to comment on it before their names are disclosed.

Now, what is a reasonable period of time for them to see the report, and I understand the timing on this, on the assumption, No. 1, which you would like to do, is to make the report to this committee and other committees as soon as it is fresh.

Then, No. 2, if the committee desires to know the names of the contractors, or if you desire to disclose their names, you give the contractors an opportunity to read the report, and I can see that might take a few days. I cannot understand why it would take a matter of months or longer.

Mr. STAATS. I don't think it is a matter of months, Mr. Chairman. I think in this case I would be greatly surprised if we would need more than 3 or 4 weeks, but I do think that it is impossible to release the list of contractors here without making it perfectly apparent who the contractors are and the cases which are——

Chairman PROXMIRE. In this case you gave as a draft of the report last May, is that right?

Mr. STAATS. That is right. We have had the report before the Defense Department——

Chairman PROXMIRE. Why hasn't this been cleared with the contractors?

Mr. STAATS. We hadn't really thought it was necessary to the point, because the objection of the report was to report on the Defense Department's administration of this area.

Representative GRIFFITHS. Who are you supposed to be representing, the taxpayers of the country or the contractors?

Mr. STAATS. We are, I hope, representing the taxpayers and the Congress of the United States.

Representative GRIFFITHS. So do I. I mean what is really wrong with knowing who these people are and what they are doing?

Mr. STAATS. There is nothing wrong with it.

Representative GRIFFITHS. I don't think there is either.

Mr. STAATS. We are not saying that there is anything wrong with it.

Representative RUMSFELD. In effect you are, because what you do is you issue a report that has no names, and then unless some Congressman asks for the names, no names will ever be supplied.

If some Congressman asks for the names, then over a period of a month or two, 60 days at the most, the name might be forthcoming. Public officials serve in a goldfish bowl, and there are plenty of people anxious in line to run for public office, and so, too, with contractors. They know when they enter into a contract with the Federal Government that the relationship they enter into is different than it is when they enter into a contract in the private sector, because they are dealing with taxpayers' money and there is no shortage of people standing in line for Government contracts.

Mr. STAATS. Take the case of the report we did under the Truth in Negotiations law. We had 242 different contracts there. We are not interested in a case like that in pointing a finger at individual contractors. We are interested in finding out whether the Government itself is carrying out the regulations which have been issued.

Representative RUMSFELD. You are talking about the other half of the question. I was obviously referring to the other side.

Mr. STAATS. Basically we are interested in whether the Government itself is carrying out its contracting operations adequately and in accordance with the law. We are not interested in trying contractors per se when, as in the case we are talking about here, the Armed Services Procurement Regulation is primarily at fault.

Representative RUMSFELD. I appreciate there are two sides to it.

Chairman PROXMIRE. Why can't we change the regulations or change the policies and simply provide that immediately when the report is made, the contractor specified in the report will be notified and given an opportunity to comment, and within 2 weeks, it will be disclosed.

Representative RUMSFELD. That doesn't solve it because they are not specifying contractors in the report.

Chairman PROXMIRE. You can't very well specify, if the contractors haven't had an opportunity to read the particular report. They may have worked with them right along.

Representative RUMSFELD. You mean the contractor referred to but not specified.

Chairman PROXMIRE. That is right. Two weeks wouldn't make the reports stale. Two weeks would be an ample opportunity to give a reply.

Mr. STAATS. In this case I would be surprised if it would take more than 2 weeks to supply this information. I want to emphasize again, though, Mrs. Griffiths, that if we feel that there has been something wrong with respect to the performance by the contractor himself, we will not hesitate to name the contractor.

I want to make this very clear as a part of my statement of the policy that we follow. We would still give the contractor the right to state his position on it.

The line we have attempted to draw, and again we are not infallible, is that if we are trying to get at a basic problem of the regulations, of

the law, or the administration of Government contracts, we want to take as large a number of cases as we can, in order to be sure that our sample is representative, and that we are not giving anyone erroneous information with respect to what may be an isolated case.

Representative GRIFFITHS. I agree with you that you need some general information, but general information is never going to make purchasers out of the Defense Department. You also need some specifics and if you would now point out the contractor that leased his own land and so forth and so on and paid the lease price, thus running up the cost, I would say it would have a very good effect upon the purchaser who had entered into that deal. Anybody that is purchasing for the Government that doesn't have much better sense than that shouldn't be purchasing. That is the whole problem. You aren't just protecting the contractor.

Mr. STAATS. As we see it, the problem is on the Government side.

Representative GRIFFITHS. We are protecting the Government itself and I really don't think they deserve protection. I feel that anybody that wasted this type of money should be at one time or another asked to account for it. You are never going to improve the quality of purchasing unless you do something about it.

Representative RUMSFELD. You say that if you feel a contractor has done something improper with respect to his procedures, GAO makes the name public. Let's take this example, in your report. You say:

> One year after an 8,000-ton forge press, costing $1.4 million, was installed it was used extensively for commercial production of a jet engine midspan blade. In the 3-year period ending December 31, 1965, the 8,000-ton press was used 78 percent of actual production time for commercial work while the majority of government procurement of midspan blades was processed on old 4,000-ton presses.

(See app. 4(a), p. 411.)

Now, looking at both sides of the equation, you could say that that is improper on the part of the contractor.

Turning it around, you could say that the fact that the Government, in entering into the contract, did not specifically provide against that, did not specifically impose penalties for that course of action, that it is the Government's fault.

Ultimately everything could be the Government's fault in every single aspect of procurement for not writing into the contract some prohibition. Isn't this true? Is that improper? You cited it as a finding that you feel is improper, and yet you have not mentioned the contractor's name.

Mr. STAATS. I feel that the Government—and I agree with what Mrs. Griffiths says here—I think the Government as a responsible buyer has the obligation to enforce its own laws and its own regulations. I think we as an agency of the Congress have the responsibility to point out where this is not being done.

There is always a question of how much of this blame rests with the contractor and how much of it rests with the Government. It seems to me that basically what we are after is to find out whether the Government itself is administering its laws and regulations adequately. In this case I believe the difficulty we have pointed out clearly was a fault on the side of the Government. There are rules and regulations which were not enforced, that were not applied.

FREEDOM OF INFORMATION ACT

Representative RUMSFELD. Could you supply for the record a copy of the General Accounting Office's new regulations in compliance with the Attorney General's recommendations after the passage of the freedom of information, public records law?

Mr. STAATS. Yes; that information is available.

Representative RUMSFELD. Specifically, how it deals with this question.

Mr. STAATS. We could give you our preliminary regulations. I should point out, though, that while we are not covered under the law, we have taken action on our own.

Representative RUMSFELD. I understand you have.

Mr. STAATS. We think this was only proper on our part, being an agency of the Congress.

Representative RUMSFELD. Right.

Mr. STAATS. But we could also relate our regulations to the specific problem you have raised here.

Representative RUMSFELD. Thank you.

(The following material was supplied by the GAO:)

The regulations issued by the General Accounting Office implementing the Freedom of Information Act are not applicable to the availability of information in the General Accounting Office to Committees of Congress.

Furnishing to the public the names of contractors involved in General Accounting Office audit reports, when the contractors are not identified in the reports, would be prohibited under the paragraph of the regulations governing information contained in the investigative files by GAO (Paragraph 5(7)).

The procedure for obtaining comments of contractors concerned in GAO audit reports is contained in our booklet, "Audits of Government Contracts."

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., July 3, 1967.

B-161499.

Heads of Divisions and Offices:

1. While the General Accounting Office is not subject to the Administrative Procedure Act, we nevertheless, as a public agency, have taken cognizance of and adopted in practice, to the extent appropriate to the functions and duties of our Office, the public information section of that act (section 3; 5 U.S.C. 552). A continuation of that policy with respect to the revised public information section which is to go into effect July 4, 1967 (Public Law 90-23, approved June 5, 1967), is deemed appropriate; and it will be our policy to make the fullest possible disclosure of information consistent with our responsibilities as an agency of the Congress. The implementation and administration of the foregoing policy shall be the responsibility of the Director, Office of Administrative Services.

2. The head of each division and office, separately or jointly if appropriate, shall submit as soon as possible to the General Counsel information necessary for the preparation and the publication in the Federal Register of a current and complete statement of the General Accounting Office containing the following:

(A) Descriptions of its central and field organization and the established places at which, the officers from whom, and the methods whereby, the public may secure information, make submittals or requests, or obtain decisions.

(B) Statements of the general course and method by which its functions are channeled and determined, including the nature and requirements of all formal and informal procedures available.

(C) Rules of procedure, descriptions of forms available or the places at which forms may be obtained, and instructions as to the scope and contents of all papers, reports, or examinations.

(D) Substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the Office.

3. (a) There shall be established and maintained in the General Accounting Office Building, Washington, D.C., under the supervision of the Chief, Legal Reference Services, Office of the General Counsel, a public reading area.

(b) In the reading area there shall be available for public inspection, and copying, final decisions, opinions, statements of policy, and instructions (including staff manuals) which may be relied upon, used or cited as precedent in the determination of rights, privileges, and obligations of members of the public.

(c) The materials to be available in the public reading area shall be selected by the General Counsel after consultation with the divisions or offices which may be concerned.

(d) To the extent required to prevent a clearly unwarranted invasion of personal privacy, the Chief of Legal Reference Services shall delete identifying details from materials made available in the public reading area. The justification for any such deletion shall be fully explained in writing.

(e) There shall be maintained in the public reading area for public use a current index of materials issued, adopted, or promulgated after July 4, 1967, which are to be made available in the reading area for public inspection and copying.

(f) The index (and current supplements) of materials made available in the public reading area at Washington should be distributed to the various regional offices for guidance in determining what information or documents may be readily made available to the public.

4. (a) A request of a member of the public for an opportunity to inspect or for a copy of an identifiable record of our Office not otherwise publicly available should be forwarded to the Director, Office of Administrative Services, who shall promptly acknowledge and record the request. A request received by a division or office concerned with a record sought should be forwarded to the Director, Office of Administrative Services, with an expression of views and recommendations as to the disposition.

(b) The Director, Office of Administrative Services, after consultation with divisions or offices (or other Government agencies where appropriate) having a continuing substantial interest in the record sought, shall promptly honor the request if no valid objection or doubt arises as to the propriety of such action and the requester is willing and able to pay the costs of locating the record and making it available for inspection or being furnished a copy. In making records available for inspection, General Accounting Office field offices may be used.

(c) In the event of an objection or doubt as to the propriety of honoring a request, the matter should be immediately referred, with an explanation, to the General Counsel for an opinion as to whether a valid basis exists for denial of the request. If the General Counsel agrees that there is a basis for withholding the record, the Director, Office of Administrative Services, shall deny the request.

(d) A person whose request is denied should be informed that he may submit a written request to the Comptroller General for reconsideration.

(e) Fees for furnishing copies of records and certifications of authenticity shall be collected in accordance with the schedule of rates prescribed in paragraph 7 of Comptroller General's Order No. 1.10. To the extent personnel is available, a records search will be performed for reimbursement at the following rates:

(1) By clerical personnel at a rate of $4 per person per hour.

(2) By professional personnel at an actual hourly cost basis to be established prior to search.

(3) Minimum charge, $2.

There should also be collected any incidental expenses such as the cost of transportation, if in excess of $0.50, incurred in making records available or the furnishing of copies.

5. The public disclosure of information and inspection of records contemplated by the foregoing instructions shall not be applicable to matters that are—

(1) specifically required by Executive order to be kept secret in the interest of the national defense or foreign policy;

(2) related solely to the internal personnel rules and practices of any agency;

(3) specifically exempted from disclosure by statute;

(4) trade secrets and commercial or financial information obtained from any person and privileged or confidential;

(5) inter-agency or intra-agency memorandums or letters which would not be available by law to a private party in litigation with the agency;

(6) personnel and medical files and similar files the disclosure of which would constitute a clearly unwarranted invasion of personal privacy;

(7) investigatory files compiled for law enforcement purposes except to the extent available by law to a private party;

(8) contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of any agency responsible for the regulation or supervision of financial institutions; and

(9) geological and geophysical information and data (including maps) concerning wells.

NOTE.—See Attorney General's Memorandum on the Public Information section of the Administrative Procedure Act, June 1967, for a general discussion of the above exemption clauses.

6. The foregoing instructions shall control insofar as they are at variance with existing orders, and the latter should be considered as modified to that extent. But nothing herein should be considered as authorizing the changing of existing practices with respect to congressional correspondence.

7. The Director, Office of Administrative Services, and the General Counsel shall immediately undertake in light of the foregoing instructions, as a joint project, the revision of Comptroller General's Orders No. 1.10, Safeguarding Official Documents and Papers of the General Accounting Office, No. 1.3, Intra-Office Decisions and Instructions, and any other order modified by the instructions herein. The Office of the General Counsel shall be responsible for the preparation of any revised order as a codified document in the event publication in the Federal Register is decided to be appropriate.

8. This memorandum shall be effective immediately.

ELMER B. STAATS,
Comptroller General of the United States.

Chairman PROXMIRE. Go right ahead, Mr. Staats.

Mr. STAATS. To continue on this subject of lease versus purchase by contractors of facilities and equipment.

In addition to the fixed annual rentals, the contractor obligated itself to provide maintenance and insurance protection and to pay all real estate taxes and assessments. Since the contractor assumed the obligations normally associated with ownership of real property, it appears that the principal function performed by the lessors was to finance the construction of the facilities.

We believe that the armed services procurement regulation—and this is our main point—encourages contractors to lease facilities. Contractors who lease their facilities and contractors who purchase their facilities receive the same fees under profit guidelines in the regulation. On the other hand, a contractor that utilizes Government facilities may be penalized by a reduction in the rate of profit of up to 2 percent. Further, the ASPR does not allow reimbursement of interest costs for borrowed capital if the contractor decides to acquire real property through purchase rather than lease.

It is our view, therefore, that the contractor which purchases its facilities contributes more to the performance of Government contracts than the contractor that leases such property and that this should be recognized in contract negotiations.

We believe the armed services procurement regulation should be revised to distinguish between owned and leased facilities in establishing profits or fees. We previously made a report on long-term leasing of buildings and land by another Government contractor. In reply to our report we were advised that the Department's Armed

Services Procurement Regulation Committee has been asked to review the rental cost principle particularly as it relates to long-term noncancellable leases. Our current review, we believe, offers further substantial evidence of the need for revising the Department of Defense regulation.

Accordingly, in a recent draft report, we have recommended that action be taken to promptly complete this review by the Armed Services Procurement Regulation Committee and to reach a conclusion on this matter. We have not yet received the Department's comments. I am sure that the Department, when they testify before the committee, will advise you as to the status of their review.

Small Purchases

Mr. Staats. Turning now, finally, to small purchases, on August 3, 1967, in hearings before the Subcommittee for Special Investigations, House Committee on Armed Services, we stated that present and future plans for our procurement work included reviews of procurement systems—small purchases. At about the same time a member of that subcommittee, Congressman Pike, requested our assistance in determining the reasonableness of prices paid for a number of small purchases by Department of Defense procurement offices.

In view of the above congressional interest an examination into the reasonableness of prices paid by selected Department of Defense procurement offices was given top priority for our initial work in the area of small purchases.

In addition, because of the attention drawn to this area, the Assistant Secretary of Defense, Installations and Logistics, on August 18, 1967, requested that the Army, Navy, Air Force, and Defense Supply Agency appraise the adequacy of performance in the small purchase area by reviewing the staffing, training, supervision, and accomplishment of daily tasks. He requested that the appraisals be accomplished within 60 days and that a summary of the results, including action taken or planned, be submitted to him.

The summary report submitted by the Defense Supply Agency pointed out that the Agency has several problems in the small purchase area, most prominent of which are: (a) lack of descriptive data concerning items to be procured as small purchases, (b) need for training of procurement personnel who handle small purchases, and (c) need for improved supervision and review of buyers' actions.

The Agency has taken or plans to take action to obtain better data, to increase training, and to improve supervision and review. Other actions are being considered. We have not yet had the opportunity to review the reports submitted to the Assistant Secretary by the Army, Navy, and Air Force.

At the present time we are working with agency representatives who made these appraisals. We are reviewing the cases considered, including their findings, and actions being taken to correct the deficiencies disclosed.

We have examined a sufficient number of individual cases to assure ourselves that a need exists for improvements in establishing the reasonableness of prices to be paid for small purchases. We believe that

by the early part of next year we will have completed our tests of the work performed by the military services, reviewed the actions that they have taken or plan to take, and be in a position to reach a conclusion as to what further actions are appropriate.

In addition, we intend to apply our resources to overall reviews of purchasing systems for small purchases. These reviews will include (*a*) size and frequency of buys, (*b*) automation of procedures, (*c*) paperwork routines, and (*d*) their effect on administrative leadtime and each other.

I should add here, Mr. Chairman, that we contemplate a report to the Congress on the subject of small purchases early in the year, we hope by February or March. This is an important area.

SMALL PURCHASES 90 PERCENT OF ACTIONS, VALUE $4 BILLION

In terms of transactions, the bulk of transactions are in the small purchase area. In terms of total amounts if you consider actions of $10,000 and under as small purchases, it amounts to something over $4 billion of our total procurement bill. In terms of numbers of procurement actions, it is more nearly 90 percent.

Mr. NEWMAN. About 11 million transactions.

Mr. STAATS. So this is a very important area, and we plan to be reporting to the Congress on the subject in February or March.

Chairman PROXMIRE. Mr. Staats, I want to thank you for your usual very, very competent report, and I want to say once again, thank heavens for your GAO and for the fine leadership you and your outstandingly able staff have been giving in this area.

I hate to think of the kinds of situations we would have without you. We certainly need you and we are very grateful for the work you are doing, and have done. Our questioning, of course, sometimes is critical. I am sure you understand that. Questioning has to be, often, but I am sure all members agree that we have great confidence in you, and we are grateful for the job you are doing.

INCREASE IN NEGOTIATED PROCUREMENT

Now, I would like to ask about the procurement area which you sketched out so well at the beginning. You pointed out that a very large proportion of all our procurement is not by competitive bidding, but by negotiation, and the staff has told me that that area of procurement, Government buying, has gone up 1 percent; in other words, from about 84—nearly 85 percent—to over 86 percent in the last year.

INCREASE IN AWARDS TO 100 LARGEST FIRMS

They also tell me that the share of procurement of the 100 largest firms has also increased.[5] That has increased 1.7 percent, I understand.

So, obviously, it is even more important than it has been in the past for us to make sure that the Truth in Negotiation Act, for example, and other regulations are enforced so that this procurement can be as efficient as possible.

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[5] See app. 7, p. 535.

ACCESS TO CONTRACTORS' RECORDS

In this respect, I notice that you say on page 3 that the Secretary of Defense has issued, the Deputy Secretary has issued, a memorandum granting access to contractors' records of performance, and you feel that this makes it unnecessary for the Minshall bill, or the Proxmire bill to be enacted, because this complies with the intent of our proposals. (See Congressman Minshall's statement, p. 244.)

Now, I would like to ask in this connection, have these new regulations been finally adopted?

Mr. STAATS. No.

Chairman PROXMIRE. This is just a memorandum. It doesn't have much force.

Mr. STAATS. This is a memorandum, and the memorandum has been incorporated in a draft of an armed services procurement regulation which is now out to the industry for comment.

Chairman PROXMIRE. What is the timing on this kind of thing?

Mr. BAILEY. The last information I had was they expected comments, I think, the end of this month.

Chairman PROXMIRE. And then what happens?

Mr. BAILEY. Then the Defense procurement circular will probably go to the printer. It would have to be printed and sent out to all of the buying officers of the Department of Defense for implementation.

Chairman PROXMIRE. When do you expect that this will become effective?

Mr. BAILEY. Well, it is rather hard for us to give an estimate, Mr. Chairman.

Chairman PROXMIRE. On the basis of past experience, and so forth, what would be a reasonable time—a year?

Mr. NEWMAN. Mr. Chairman, this is a highly controversial item.

Chairman PROXMIRE. Six months?

Mr. NEWMAN. I would not want to estimate anything under 6 months.

Mr. STAATS. I believe that Mr. Morris will probably be in a better position to give you definite information. (See p. 162.)

Chairman PROXMIRE. It is hard for this Senator to understand why it is controversial. It seems logical that DOD should have access to the contractors' records.

Without this, in view of the fact that the bidding isn't competitive, on the basis of advertised competition, there is no way that DOD could be sure that the procurement is at a reasonable cost and that the procurement doesn't result in excessive profit.

DOD'S PRESENT POSITION ON ACCESS TO RECORDS

Mr. STAATS. Mr. Chairman, as you know, the Department of Defense did not fully agree with the conclusions we made in our report, and which we reported on at our May hearing.

Chairman PROXMIRE. I understand; but they did issue this memorandum indicating that they did agree in general with the thrust of what you were trying to get at.

Mr. STAATS. I think that even though they disagreed in part, they have now—we give them great credit—moved forward in a very

affirmative way in the actions which I have summarized in my testimony in terms of trying to deal with the problems, and I think the fundamental point that we would make, even though there may be some disagreement on details and specifics, is the fact that 86 percent of our procurement is in the negotiated area, and the fact that the total of our Defense expenditures have grown so rapidly——

Chairman PROXMIRE. Right.

Mr. STAATS (continuing). Which means that we should not leave any stone unturned with respect to being sure that we have the kind of information that we need in the negotiation of these contracts.

Chairman PROXMIRE. So, No. 1, it will take 6 months at best, probably, before we can get action; and No. 2——

Mr. BAILEY. If I may interrupt here and clarify a bit, I am advised by my colleagues that this particular procurement circular went to the printer 2 weeks ago.

Chairman PROXMIRE. Oh, good.

Mr. BAILEY. And it should be issued very shortly.

Chairman PROXMIRE. Well, that is great news. I am delighted to have that correction. It is most helpful. What has been the DOD record on enforcing their regulations? What can we expect here?

Mr. STAATS. We have no reason to believe the regulations will not be effective, and in this case, if they go through with the training program that they have outlined——

Chairman PROXMIRE. You told us about, incidentally, I thought, in the presentation, it was interesting and helpful, but it suggested (a) they have a film, and then (b) they send out information, but I didn't see any effort to put the procurement officials through a training program, courses, examinations, and so forth.

DOD TRAINING SEMINAR

Mr. STAATS. Here is an outline of the training seminar on certified costs or pricing data, Public Law 87–653, which is dated September, and which has been used in their training program. The film itself is designed to serve as a training purpose. We have the script and we have seen the film.

Chairman PROXMIRE. Do you think that this is sufficient, in your judgment, to provide the kind of competence that is necessary?

Mr. STAATS. We can't be sure that it is, Mr. Chairman, but we feel that the actions which have been taken to date, if they are carried through, should be extremely helpful in meeting the problems which we have identified.

Now, the area which has been most controversial between the Defense Department and ourselves, has to do with the feasibility of documentation of the cost data supplied by the contractors, and whether it is desirable or necessary in fact to supply all of the data which we have indicated in order to be in compliance with the law.

CONTRACTORS' OBLIGATION TO FURNISH DATA

The obligation, as you well know, in the law was placed on the contractor to supply this information. We do not feel it is adequate

simply to have an auditor's report saying that he has seen all this information, and that it is all current and complete.

Chairman PROXMIRE. Well, the crux of it is the access to the information; isn't that right?

Mr. STAATS. That is right. There has to be more than that. That auditor may be off in some different part of the world when the performance of the contract has been completed. There has to be some audit trail, as the auditors call it, some adequate documentation of the specific data on which the price negotiations were based and which the contractor submitted and certified.

Chairman PROXMIRE. Because there is a flagrant record of violation of the Truth in Negotiation Act of the requirement for making this information available, having it available, on the basis of your study which you had made clear to us last spring, no question about it.

Mr. STAATS. Well, I don't know whether it would be accurate to call it a violation of the law so much as it is the failure to fully implement the regulations issued pursuant to the law, which required the contractor to submit the cost data that went into the negotiation.

Chairman PROXMIRE. At any rate, there is no protection, it would seem to me, for the taxpayer against a contractor who, on the basis of the practices of the Defense Department, wants to charge an excessive price.

DOCUMENTATION ESSENTIAL

Mr. STAATS. The documentation has to be there.

Chairman PROXMIRE. It has to be there.

Mr. STAATS. And reasonable people may differ in specific cases. But, this is the crux of what we are talking about here.

As Mrs. Griffiths has pointed out, we are dealing with procurement people and audit people down the line, and if they don't have this information, if they don't know what the story is, they don't know what the policy is, then the Government is just as bad off as if it had been done willfully, as far as the end result is concerned.

APPLICATION OF DOD ORDER TO SUBCONTRACTS

Chairman PROXMIRE. Now, let me ask: Does this apply to subcontracts?

Mr. STAATS. There are three points.

Chairman PROXMIRE. Does the order extend to subcontracts, the memorandum?

Mr. STAATS. No; it does not.

Chairman PROXMIRE. It does not? Shouldn't it? Don't subcontracts represent a very large proportion of this? Yes?

Mr. BAILEY. The document that I saw, that was proposed, indicates that the clauses will provide a flow down of audit rights to the subcontracts. Is this correct, Mr. Hammond?

Mr. HAMMOND. Yes.

Chairman PROXMIRE. You say, then, it does apply to subcontracts?

Mr. BAILEY. The document that I saw; yes, sir.

Chairman PROXMIRE. Will you revise your response, then, with that in mind, Mr. Staats?

Mr. STAATS. Well, it is my understanding that the memorandum of the Deputy Secretary does not extend to subcontractors, in terms of performance cost.

The objective is to have the documentation extend to the subcontractor level, but my understanding is that we have not yet agreed between us and Defense as to the way in which we would have to document the case of the subcontractor in order to be able for us to say fully that the documentation is adequate.

DOCUMENTATION SHOULD APPLY TO SUBCONTRACTS

Chairman PROXMIRE. You certainly would agree that it should apply to subcontracts?

Mr. STAATS. It should.

Chairman PROXMIRE. Then, in further consultation with the staff, if you would, in the next day or so feel that you would like to revise your initial response, I would appreciate it if you would do so.

Mr. Weitzel, did you want to read something?

Mr. WEITZEL. We can supply this for the record, Mr. Chairman.

Chairman PROXMIRE. All right.

(See Defense Procurement Circular No. 57, p. 162.)

Mr. WEITZEL. But the latest version of this which we have here this morning does require the contractor to insert the clause in all subcontracts which when entered into exceed $100,000, with the same exemptions as the contractor has. Is this your understanding, Mr. Bailey?

Mr. BAILEY. Yes.

Chairman PROXMIRE. Mr. Staats, why wouldn't this mean that it would apply to subcontracts?

Mr. WEITZEL. There has been a lot of discussion of this point.

Chairman PROXMIRE. The contractor is required to insert this in his subcontract agreements.

Mr. NEWMAN. Mr. Chairman?

Chairman PROXMIRE. Yes.

Mr. NEWMAN. Pursuant to your question about the problems that are facing DOD with regard to getting performance records and adequate records of cost data under Public Law 87–653, we have instituted a program where we are working very close with the internal auditors in the Services who have the responsibility of reviewing the contracting officer's negotiation files and records, and DCAA, who have the new authority to post audit contractor's performance records. It means a major revision in their audit programs. Up to now their programs, to a great extent, have been limited only to verifying pricing data submitted or acquired from contractors.

Mr. WEITZEL. Mr. Chairman, there are two things involved here in addition to the question of audit of subcontractor's performance. One is the access-to-records clause. The other, to which Mr. Staats was referring, and on which we haven't reached agreement with them and which they are still studying, is, what penalty a subcontractor or a contractor will be subjected to in the event the subcontractor has not furnished current, accurate, and complete pricing data to the contractor.

This has been reserved for further study in this Defense Procurement Circular No. 57, the same one which prescribes the new access-to-records clauses. Is that correct, Mr. Bailey?

Mr. BAILEY. Yes; that is right.

ARMY'S INVENTORY RECORDS

Chairman PROXMIRE. I would like to ask you this. You made a statement as follows:

"The Army is not yet in a position to know within a reasonable degree of confidence what stocks are on hand and what stocks are actually excess to their needs", in Vietnam this is.

Then you go on to suggest various actions that can be taken. You say, "The identification and prompt distribution of large excess numbers of items in Vietnam."

Why is this as difficult as it is? I understand that we are in a war there, this is always a problem, of course, but this has been going on for a long, long time now. We have been pretty much on a level of escalation for the last year or so, and it sounds as if, from what you say, as if there could be enormous waste if they don't know what they have got over there and if they don't know what they need.

DOD AGREES ON INVENTORY PROBLEMS

Mr. STAATS. I think that the Defense Department agrees now that there is a serious problem here. Mr. Fasick of our staff, who has just returned from Vietnam, is here, and if you would like, he would like to give you a brief summary of what our findings have been there.

Chairman PROXMIRE. Fine.

Mr. Fasick?

CORRECTIVE ACTIONS BEING TAKEN

Mr. FASICK. In general, for the past 2 years the Army has been working on a push system in which they were in effect escalating logistics support at the same time that they were escalating tactical operations.

During the course of this, they were improvising and developing a logistics structure to support their logistic needs. In the course of doing this, they never did get adequate records in terms of what they had or where it was. It was a question of expeditiously trying to unload ships and storing it in improvised storage areas, and for the past 2 years they have been under rather emergency type conditions.

It is just recently, and in some respects it is a little bit difficult to take issue with this considering the nature of the operations in Vietnam, that the command itself over there has identified the problems, and are trying to take as many actions as they can within the framework of the resources they have available to them, to get control of the stock and to find out where it is.

When I returned from Vietnam, we had occasion to talk with the Assistant Secretary of Defense, and immediately after our discussion of some of our tentative observations they were sufficiently concerned to take a trip themselves. I think Mr. Morris will address himself to some of the actions they plan to take as a result of his observations.

FIVE AREAS NEEDING IMPROVEMENT

He, in effect, did confirm the five areas that we identified as needing improvement. The Army doesn't know what it has, and it doesn't know where it is in many cases. They involve large amounts of supplies that are not on the records, but they are undertaking a crash-type program to get control of this.

Chairman PROXMIRE. Thank you very much.

SECRETARY OF DEFENSE MEMO OF NOVEMBER 24, 1967

Mr. STAATS. Mr. Bailey has a memorandum issued by the Secretary of Defense dated November 24 which would be Friday, and which I believe is relevant to what we are talking about. (See p. 139.)

Mr. BAILEY. In this memorandum the Secretary of Defense states that:

"The following steps will be taken effective at once:

"First. The Secretary of Army is designated executive agent for the Department of Defense to assure that Southeast Asia excess material of all services is promptly identified and made available for redistribution. A general officer will be designated the project coordinator.

"Second. The commander-in-chief, Pacific, will establish a special agency to (1) maintain an inventory of excess material identified in the Pacific area, (2) supervise redistribution or disposal of such material within his area and (3) report the availability of material which cannot be utilized in the Pacific area to other Defense activities, in accordance with procedures developed by the project coordinator."

EXTENT OF EXCESS INVENTORY NOT KNOWN

Chairman PROXMIRE. Do you have any idea what this amounts to in terms of dollars?

Mr. STAATS. I don't have that information.

Mr. FASICK. They have no financial inventory records in the Army in Vietnam, so they have no idea of how many dollars are involved.

Chairman PROXMIRE. Can you give us any notion of the proportion of this? Is this several billion dollars worth of equipment that is in excess?

Mr. FASICK. It would be very difficult, Mr. Chairman, to estimate it. The Air Force does have a figure on the total inventory in Vietnam and it comes to $250 million. The Army undoubtedly has considerably more stocks in Vietnam than this.

As to the amount of materiel that really is excess to the needs in Vietnam, no one can cite an estimate of the value of such excesses. We did at one time, during my visit—and these figures have since been adjusted—obtain from the Army which indicated that figures out of 120,000 items over there, they had about 45,000 items that were in excess of three times the requisitioning objective. A requisition objective is 195 days of supply.

Chairman PROXMIRE. Is it fair to say this means they have three times as much as they need with respect to these particular items?

Mr. FASICK. For these items. But remember, sir, these records are admittedly unreliable. In several cases where we have attempted to

check what is so-called excess, to go out and find the material and see to what extent the records were accurate, in many cases the material wasn't there. The records are so unreliable that this figure that I am giving you of 45,000 items out of 120,000 is to say the least suspect. I think you will find the Department of Defense officials will admit, however, that the amount of excess is sizable. I don't think they will be in a position to give you a figure either.

Chairman PROXMIRE. Unfortunately my time is up. I will be back. I have got some other questions.

Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman. Let me add my expressions of appreciation to your office, Mr. Comptroller General, for what I think is a very good progress report. I think that you view it in that nature more as a progress report.

Mr. STAATS. We do; yes.

REDETERMINATION CLAUSES IN CONTRACTS

Representative CURTIS. It is a never-ending area of work, of course. Let me ask some questions on specifics here.

You say in your statement—

> It also requires as a further protection of the Government's interests that a defective pricing data clause be inserted in each such negotiated contract to provide a contractual basis for a price adjustment in the event the cost or pricing data submitted at the time of negotiations were inaccurate, incomplete or noncurrent, and as a result the contract price was increased.

I had thought from testimony that I had been receiving mainly when the Ways and Means Committee was looking into the question of extension of the Renegotiations Act that most contracts included these redetermination clauses; is that true?

Mr. STAATS. They do; yes.

Representative CURTIS. Have they not been utilized, these price adjustment clauses, or what is the——

Mr. STAATS. I think the basic point that we were making in our report, Congressman Curtis, was that absent the kind of record, absent the documentation of what information was available to the procurement officer at the time the price negotiations were taking place, there was no way to be sure that clause could be made effective.

Representative CURTIS. Yes.

Mr. STAATS. I think that is the basic point we make.

TRAINING A SUPPLY CORPS

Representative CURTIS. In other words, it does bear on the question of whether they were utilizing the clauses even if they were in there.

Mr. STAATS. That is about what it amounts to; yes.

Representative CURTIS. Maybe the way to get at this is to proceed to where you talk about training of procurement personnel to determine who are the procurement personnel we are talking about. Let me expand on this a bit, so you can answer my question a little better.

I have followed with a great deal of interest the development of what the administration or the Defense Department calls the Defense Contract Administration Service, which is to create a corps as I understand

it, of the contract administration service officers, those who actually service the contract, who are stationed at the munitions plant or the private industries that are delivering goods to the administration, and I applaud that and I have been following with a great deal of interest the development of such a corps and practice.

COORDINATION AMONG CONTRACTING, AUDIT, AND CONTRACT SERVICE OFFICERS

Now, in my interrogation I have been asking, well, who do you include in this category of contract service officers, and how much do these contract service officers have to do with making the original contracts the original negotiating or letting of these contracts.

Well, apparently there is a different group of people that actually make the contracts, and I do raise the question of how much coordination there is.

And then jumping over the contract administration service officer to this business of who conducts these renegotiations for price adjustments and so forth, is it the contract service officer, is it the original procurement people, or is it a third category?

And in this interrogation I found out that they also have an audit group which is separate from the contract service officers. I am not quite sure whether that is the group that does the renegotiation. The contract service people apparently don't, but I am not clear as to whether it is the original procurement people who do.

Could you expound on this?

Mr. STAATS. I wonder if it is all right to let Mr. Bailey comment on this, if I may?

Representative CURTIS. Yes.

Mr. BAILEY. Mr. Curtis, at the time a procurement is negotiated, in other words, the initial buy, this is done by a procurement contracting officer, who is not the man that is charged with the administration of this contract while it is being performed in the contracting officer's plant.

COORDINATION WITH RENEGOTIATION PEOPLE

Representative CURTIS. He is not the servicer? Does he then do the renegotiation?

Mr. BAILEY. He represents the service who does the buying, in other words, the Army, the Air Force, or the Navy?

Representative CURTIS. Yes.

Mr. BAILEY. This is where the procurement contracting officer is involved.

Representative CURTIS. Yes.

Mr. BAILEY. Then if the contract is in a plant where plant cognizance is not assigned to a particular service, the Defense Contract Administration Service will provide the administrative contracting officer.

Representative CURTIS. Yes; but he will be a different one.

Mr. BAILEY. Sir?

Representative CURTIS. Let me pause on this to understand it.

One of the problems of course that has existed is that a Navy or an Army or Air Force person, or all three of them might be in the

same plant. Before they established this service, there was very little integration between their activities. Now this apparently will help correct it, but to come to the key question, who would do the price adjustment?

Mr. BAILEY. It is my understanding that this is done by the administrative contracting officer in final settlement of a particular contract.

Representative CURTIS. You mean the original people that did the contracting in the beginning?

Mr. BAILEY. I beg your pardon; the original one, yes, sir, the procurement contracting officer rather than the administrative contracting officer.

Representative CURTIS. That is right; yes.

Well, I have gone over it. This is something I think that is very important in talking about it as you do—training of procurement personnel.

One of the great things to me I think is that they talk with each other. Frankly, I think the contract administration service officer ought to be very much involved in any renegotiations.

In fact, there ought to be a very close coordination between the original procuring officer and the servicing officer, and I think that we have got some weakness there. But I wanted to explore that briefly because I think this is one of the problems here, getting our personnel trained, and then being certain that those in various specialties don't become so specialized that they don't coordinate with each other, because this is a big operation.

Finally on this one subject, I would hope that sometime GAO would look into this system we have with the Renegotiation Board, which I think is really very stupid.

It is on the assumption that procurement servicing and adjustment are going to be done on a crash basis rather than on a planned basis, or on the assumption that there is a bunch of crooks involved, and I think the Renegotiation Board process, which comes under Ways and Means jurisdiction, is a very irrational way of proceeding, and I have argued it for years.

But other than some people that have to put up with it; namely, Defense contractors, we don't seem to be able to get much attention paid to it, the reason being this lack of coordination, not that the Renegotiation Board people aren't fine people. But they are dealing in subjects that they have had no experience in, the details of the contract.

Most of the reason for renegotiation is that you are dealing with some item that is new, that no one has had any experience with, and so they don't have their cost figures. But if that is the problem, then those who are best able to do the price adjustment are those who have been involved in it, rather than an independent board that has had no experience with it, at least those are arguments that I would advance.

ITEM BREAKOUTS FOR ADVERTISED BIDDING

Let me ask this: Following through on this Truth in Negotiation Act, and also what is negotiated, did you pay any attention to the caveat that they should to the extent possible, there should be component or item breakouts from negotiated contracts into which in turn can be procured on an advertised bid basis?

Mr. BAILEY. Not specifically in connection with these particular contracts, Mr. Curtis, although we have done work in this area, and we continue to do work in this area. This is an area where additional competition and additional savings can be obtained to the extent that it is feasible to separate the item being purchased, as you well know.

LEGAL BASIS FOR SUBCONTRACTING

Representative CURTIS. Yes. I think you would agree—I am trying to think whether we have actually said it in any laws, and I hope we have, but it should be public policy I think most everyone agrees—that the big negotiated contract, if it is necessary, and frequently they are, that there be efforts to break them into subcontracts, and as much as possible on an advertised bid basis.

Mr. BAILEY. Yes, sir.

Representative CURTIS. You would agree that that is good public policy. If this is in accordance with law, you would just save me a little work if you could insert in the record where we specifically require it by law. Do you know, do we require that by law?

Mr. STAATS. I would like to suggest we put that in the record.

Representative CURTIS. Yes. I should like to know.

Mr. STAATS. And spell that out a little more.

(The document referred to follows:)

The rules governing competitive bid procedures which are imposed by the public advertising statutes are not applicable to prime contractors in the award of subcontracts unless required by the terms of the prime contract. See B–148430, May 28, 1962, and cases cited. There is no statute which prohibits a Government prime contractor from awarding a subcontract to other than the low bidder. B–160186, November 8, 1966. In the case of firm fixed-price contracts, competition in subcontracting affects the cost to the Government only where such competition takes place before the prime contract price is agreed upon. There are statutes and regulations which have some effect on the extent of competition in subcontracting under cost-type contracts, where the costs are passed on to the Government.

Under 10 U.S.C. 2306(e) and 41 U.S.C. 254(b), cost-type contracts must provide for advance notice by the contractor to the procuring agency of any cost-plus-fixed-fee subcontract and of any fixed-price subcontract exceeding $25,000 or 5 percent of the estimated cost of the prime contract. ASPR 3–903.2 and FPR 1–3.903–2(b)(1), respectively, implement these statutes. Contracting officer approval of certain subcontractors is also required under fixed-price redeterminable or fixed-price incentive prime contracts. See ASPR 3–903. Pursuant to ASPR 7–203.8 and 7–402.8 subcontract approval is required for certain other subcontracts not mentioned above. Competition in subcontracting is required, at least to some extent, by other regulations. See ASPR 3–901, *et. seq.*, and similar provisions in FPR 1–3.900, *et. seq.* These regulations concern review and approval by the Government of proposed "make-or-buy" programs, purchasing systems, and proposed subcontracting. In general, these regulations provide for detailed review and evaluation of proposed subcontracts and subcontracting systems to assure proper subcontracting methods, including competitive bid procedures, adequate participation by small business, and opportunities for labor surplus areas to compete for subcontracts. ASPR 3–807.10 also expresses DOD policy in requiring competition in subcontracting and places responsibility on the contracting officer for implementing this policy. With respect to contracts requiring Government approval of subcontracts, our Office has held that the contracting officer may not approve a subcontract which is prejudicial to the interests of the United States. 41 Comp. Gen. 424.

We have also held that a contracting officer, in the proper exercise of his discretion, is justified in refusing to grant approval of a subcontract if the internal regulations of the procuring activity require that subcontracts be awarded by competitive bidding and such procedures are not followed. B–149602, January

11, 1963. As an example of an agency's internal regulations, see AEC regulations in subpart 9–1.52 and part 9–2, 41 CFR, and AEC PR 9–2.102(b) and 9–1.353(h).

10 U.S.C. 2306(f) as amended by Public Law 87–653, might be said to encourage competition in subcontracting by its requirements for the furnishing of certified price or cost data by the proposed subcontractor unless there was adequate competition.

The small business subcontracting program prescribed by 15 U.S.C. 637(d), as implemented by ASPR 1–707, *et. seq.*, and FPR 1–1.710 *et. seq.*, would also seem to have some effect on encouraging competition in subcontracting.

CONTROL OVER CONTRACTOR INVENTORY

Representative CURTIS. Now, on this business of the control over Government-owned property in contractor plants, you state, on page 13, "Total value of such property is unknown, but available DOD data shows that it amounts to $11 billion in two major classes." Is that $11 billion figure an adjusted figure for depreciation or is that cost?

Mr. STAATS. This would be acquisition cost.

Representative CURTIS. Do they have an actual inventory of this equipment that might be on a data processing machine?

Mr. BAILEY. In two major areas the Department of Defense does have records that indicate what they have, particularly with respect to the largest—the facilities area. Every piece of equipment in excess of $1,000 is supposed to be reported to the Defense Industrial Property Equipment Center.

USE OF ADPE FOR INVENTORY RECORDS

Representative CURTIS. Well, the specific question, Do they actually have it on an inventory for that sole purpose, and do they have this inventory on tape on a data processing machine?

Mr. BAILEY. The nature of the record I will have to ask about. I think I can supply the answer. Do you want to respond to that?

Mr. HAMMOND. At the contractor's plants there are property records.

Representative CURTIS. I know that. I am talking about a control inventory at the Federal level in the Department of Defense.

Mr. HAMMOND. Yes; they do, at DIPEC.

Representative CURTIS. What do they do with it. If it is on tape, how do they use it in a controlled fashion so that they can check the items in this inventory, that which goes out is phased out of it, and that which comes in, other check points in good inventory control. How do they do it, or don't they do it?

Mr. HAMMOND. There is need for improvement in it, but basically they have an inventory of the individual items that are in stock, and as new items are acquired they are put on the inventory.

Representative CURTIS. If they have it, and here is what I am leading up to, if they have it, why don't we have a dollar figure, or it must not be a very good inventory, if they don't even have the acquisition cost opposite each item so that it can be totaled up.

Mr. BAILEY. DOD does have a dollar figure on this, Mr. Curtis.

Representative CURTIS. What?

Mr. BAILEY. DOD does have a dollar figure on this.

Representative CURTIS. No; you said, "the total value of such property is unknown but available DOD data shows it amounts to about $11 billion."

Mr. BAILEY. With respect to these types of facilities that are reported to DIPEC, we do have a figure of $6.2 billion. This is part of the $11 billion, one of the major property classes that are involved here.

ADEQUACY OF CONTROLS

Representative CURTIS. I hope you can see the purport of my question. I am trying to test out just how good an inventory they have to see whether or not it is a satisfactory one to exercise the kind of control that I think any business or certainly a Government with this amount would exercise over this item, and very clearly the specific cases you have brought to our attention indicates that there is something lacking.

In fact, I suspect there really isn't any inventory such as I have been seeking to inquire about, which is available for controlling this kind of equipment. The fact that you say that the total value of such property is unknown leads me to that conclusion. I think one of the first things that has to be done here is to get such an inventory.

Mr. STAATS. Mr. Curtis, I believe that what we are saying is two things. One is that there is no overall figure which includes all types of equipment. The $11 billion figure refers only to two types.

We refer to some other types of equipment which we do not have an adequate inventory on, so that we are accurate earlier where we say there is no total.

Representative CURTIS. In other words, you think there are some components that do have adequate inventory so that it can be used as a control, some of the components that go to make up the total; is that what you are saying?

Mr. BAILEY. Mr. Curtis, in the facilities area, which includes real property, buildings, plant equipment and so on, the DOD record shows that the facilities that are in the hands of contractors amounts to about $6.2 billion. This does not include special tooling, special test equipment or military property that may be loaned to contractors.

Representative CURTIS. Well, now, what about that other item, then? Is that the item on which you have no inventory?

Mr. BAILEY. No; the material inventory.

Representative CURTIS. What?

Mr. BAILEY. The material—Government-furnished material—in the hands of contractors amounts to about $4.7 billion. Those two items comprise the $11 billion, but we don't have a DOD inventory record on such things as special tooling, special testing equipment, and military property in the hands of contractors.

Representative CURTIS. That would be in addition to the $11 billion.

Mr. BAILEY. Yes, sir.

Representative CURTIS. My time is up.

Chairman PROXMIRE. Mrs. Griffiths?

SPECIFIC USE OF DIPEC RECORDS

Representative GRIFFITHS. Thank you. I would like to ask you, Could DIPEC, is its account good enough that it could locate the 8-ton

press that the contractor is using for his own commercial equipment and find that it is being used properly and, therefore, set it some place else?

CONTRACTOR REPORTS ON USE

Mr. HAMMOND. The press is on the DIPEC inventory, but as far as DIPEC is concerned, they would rely upon reports from the contractor's plant as to the use that is being made of it.

Representative GRIFFITHS. And the contractor shows that it is being used really for his own equipment?

Mr. HAMMOND. Yes.

Representative GRIFFITHS. Does DIPEC show that?

Mr. HAMMOND. Yes.

Representative GRIFFITHS. So, you can go out and read from DIPEC——

Mr. HAMMOND. The local contract property administrative officers know it is being used for commercial work and rent is being collected.

Representative GRIFFITHS. And it is on the DIPEC register?

Mr. HAMMOND. Yes.

RELOCATION OF EQUIPMENT

Representative GRIFFITHS. So that the next time you need an 8-ton press you can find that one; is that right?

Mr. HAMMOND. It would not be reported to DIPEC. This particular one is not reported to DIPEC as available for relocation. It is reported as being used by the contractor.

Representative GRIFFITHS. Well, why isn't it available for relocation? He is using it on his own production, and you are not getting any pay for it. Why isn't it available for relocation?

Mr. HAMMOND. We believe that it should be reported, but it is not at the present time.

Representative CURTIS. Why isn't it?

Mr. HAMMOND. Because it is being used commercially.

Representative CURTIS. What do you need to do to make it reportable?

Mr. HAMMOND. We have recommended that Defense consider doing this, so that they will know how much equipment is being used on Defense work, and be in a position to relocate it.

CONTRACTOR INVENTORY ACQUIRED SINCE 1952

Representative GRIFFITHS. How many years did it take to acquire this inventory, Government-owned inventory, in the hands of contractors, and what in your estimate is the total amount of such inventory, facilities, equipment, anything?

Mr. HAMMOND. Facilities generally were acquired since 1952, I believe. Most of it has been acquired since that date, some earlier.

Representative GRIFFITHS. So that a period of 15 years, in a period of 15 years all of this was acquired?

Mr. HAMMOND. Most of it.

Representative GRIFFITHS. And we are talking about $11 billion or $20 or what?

Mr. HAMMOND. We do not have a figure, and I don't believe Defense does either, of the special test equipment and special tooling.

Representative GRIFFITHS. What is your estimate?

TOTAL INVENTORY ABOUT $15 BILLION

Mr. HAMMOND. Well, at the plants we visited special tooling and test equipment amounted to about a third of the equipment in the contractors' plant, so if you apply a third increase to the $11 billion, add about another $4 billion. (See app. 4(a), p. 462.)

Representative GRIFFITHS. So that in a period of 15 years that we are talking about, $15 billion, during that 15 years, what was the total expenditure of the Defense Department for everything; anything they bought.

Mr. STAATS. You are talking about procurement now?

Representative GRIFFITHS. Yes.

Mr. STATTS. I think we would have to supply that. I wouldn't know what it would be.

Representative GRIFFITHS. But it is something astronomical—an astronomical sum, isn't it?

Mr. STAATS. It is very large.

Representative GRIFFITHS. So that in reality they really don't care. The fact that there are billions of dollars worth of equipment out here that is being illegally used, being used without any payment being made for it, is a matter of no consideration to them at all. They don't care about it, because the truth is they are spending hundreds of billions of dollars.

But what if you were looking at it from the standpoint of HEW? Think what could be done with $20 billion in education. You know I want to say again, and I have already said it, I am not voting for any tax increase as long as this type of stuff is going on, and I know that it is going on.

Now, I would like to ask you on this matter, you pointed out that the Government does better on a purchase where the equipment is Government owned, that there is about a 2 percent profit that the manufacturer can make. Now, this is because he applies a percentage of cost as profit; isn't it? And since you supply the equipment, he can't apply that percentage of cost against that equipment; is that not right?

Mr. STAATS. That is right.

Mr. BAILEY. He actually may be given a higher profit rate if he supplies the necessary capital equipment, Mrs. Griffiths. Under the weighted guidelines principles he can receive additional consideration for profit purposes. Actually what it amounts to is that the regulation provides that he will receive a minus profit factor if the equipment is Government supplied.

Representative GRIFFITHS. Well, I never tell a joke, but when you read off that business that the poor contractor that is having to use Government-owned equipment is getting a bad break on the profit, I was reminded that one time a mother took a little boy, her little son, to see one of these Roman spectacles where they were feeding the Christians to the lions, and the child began to cry, and was making so much noise she had to take him outside. And she said:

"Now, dear, they didn't really eat them. It is all make-believe."

And when he could talk he said, "That one poor lion didn't get a Christian."

NEED FOR AN INVENTORY SETUP

Well, you know, I am not worrying over the contractors that are not getting that type of profit. What I am worrying over is whether we have an inventory setup here, whether we can locate all the Government-owned equipment, put it in these plants and reduce the prices we are paying, and if we can't do it, why can't we do it?

Mr. STAATS. This is what our report is directed to, Mrs. Griffiths.

Representative GRIFFITHS. Now, when are you going to get it done? I have been worrying about this for about 10 years.

Mr. STAATS. The fact that this committee is interested in our report I am sure will be helpful in getting it done.

PRICES PAID SUBS BY PRIMES

Representative GRIFFITHS. And I would like to say to you folks right now that you don't have a chance in the world of getting the Defense Department to agree that you have a right or that the purchaser has a right to have a breakdown on subcontractors' costs.

I have had a bill in here for at least 13 years that says that the subcontractor should supply—the prime contractor should supply, rather, the price he pays the sub for the item. You should hear the screaming and see what has been done about that. That is not a breakdown of the costs. I think you could do the purchasing better if you just know what the prime pays the sub. Wouldn't you agree?

Mr. STAATS. I agree.

Representative GRIFFITHS. Somebody came in here from Chicago one time to tell me that he supplied an item to the Cape for General Electric, boxed, and he charged them a little more than $300. GE charged the Government a little more than $800. How do you stop that? Can you stop it now? F.o.b. Cape Kennedy.

Mr. STAATS. If it is a known cost, then it should be supplied by the prime to the Government at the time the negotiation takes place, in terms of Public Law 87-653.

FURNISHING ITEMS BY THE GOVERNMENT

Mr. BAILEY. This also, Mrs. Griffiths, gets back to Mr. Curtis' point about breakout. If you can break it out from the prime contractor's cost so that the Government buys these things and furnishes them as Government-owned material.

Representative GRIFFITHS. In many instances the Government would do a far better job if it would buy the item and supply it to the assembler, it would be much cheaper.

Mr. BAILEY. It would be much cheaper.

Representative GRIFFITHS. Although I agree with Mr. Curtis that what you really have in renegotiation, that what you make of a contract is cost plus a percentage of cost. That is what renegotiation really does in the whole thing.

GAO HAS RECOMMENDED THAT GOVERNMENT FURNISH MATERIAL

Mr. WEITZEL. Mrs. Griffiths, we completely agree with you that in some cases it would be better for the Government to furnish this material as Government-furnished material, and we have made strong recommendations to this effect to the Congress and to the Defense Department, and we feel that some progress has been made in this direction.

Representative GRIFFITHS. Tell me, how did Defense react?

REACTION OF DOD

Mr. WEITZEL. It was a mixed reaction. They had some problems on complex military items, in effect taking away some of the responsibility of the prime contractor, when he had to put together all of these very sophisticated and complex systems, but notwithstanding this concern, they have increased the amount of Government-furnished material in several of their weapons systems, or are in the process of doing it.

Representative GRIFFITHS. I understand they could reduce the price of computers perhaps 50 percent if they would do it that way.

Representative CURTIS. Would the gentlewoman yield?

Representative GRIFFITHS. Yes.

Representative CURTIS. Admiral Rickover testified that in the procurement of Polaris submarines I think that something around 70 or 80 percent of that was breakout contract. This is the answer to the Defense Department people who say a peculiar military item, et cetera, et cetera. I just thought we ought to be reminded of that.

TIME NEEDED TO INVENTORY CONTRACTOR-HELD PROPERTY

Representative GRIFFITHS. Thank you. The Director of DSA last spring indicated that it would take about 2 years to inventory contractor-held property.

In your judgment, is this realistic?

Mr. STAATS. I would have no personal basis for estimating one way or the other on this.

Representative GRIFFITHS. In your report you point out that one contractor said that it would take 20 years to inventory it in his plant.

Mr. STAATS. He said it would take 20 men for a year.

Representative GRIFFITHS. That would be 20 man-years?

Mr. STAATS. Yes.

GAO RECOMMENDATIONS ON NEEDED CONTROLS

Representative GRIFFITHS. Under your authority to prescribe, what do you think is needed in the way of inventory, use, maintenance, and other records to protect the public interest in the matter of this Government-owned equipment?

Mr. STAATS. We think we have spelled this out pretty carefully in our report. Obviously adequate property accounting records are not available in all of the plants. That is one thing, and this can be improved.

The idea of a central inventory on computers obviously is a desirable thing, and this should be extended in our opinion to include some other categories of equipment in addition to those that are centrally inventoried at the present time.

I think another point we are making in our report in general terms is that there should be better identification in the reporting as to what is then commercial use, so that it can be put on productive military use if there is a need for that particular type of equipment.

Now the Office of Emergency Planning plays a role here, and we have not talked with them directly, but I think that the committee might wish to hear from them with respect to the role that they play in the approval process, the policies which apply to the approval process, I should say, in giving a contractor permission to use this equipment on civilian work.

100 PERCENT GOVERNMENT CONTRACTORS

Representative GRIFFITHS. How many contractors now supply the Government only?

Mr. STAATS. One hundred percent Government?

Representative GRIFFITHS. Yes.

Mr. STAATS. I couldn't tell you without checking.

POINTS OF DISAGREEMENT WITH DOD

Mr. WEITZEL. Mrs. Griffiths, two of the things we have recommended to the Department of Defense along the line you are speaking of they have not wholly agreed with us on.

MACHINE-BY-MACHINE RECORDS

One is the machine-by-machine permission from OEP for them to use their Government-furnished equipment when they are having a large commercial use, and the other is machine-by-machine utilization records.

As you know, some of the contractors and the Defense people have estimated that it would cost a lot of people and a lot of time and a lot of money to do this. We don't agree with their computations on this, and we have cited the case of one contractor in our report, that reports machine-by-machine utilization broken down by Government and commercial use.

EXAMPLE OF MACHINE-BY-MACHINE RECORDS

He has given us an estimate of the yearly cost to provide this data on 880 machines for a total annual cost of $7,400, and we think that using that information broken down machine by machine as to this contractor could raise the annual rent payment by about $582,000, which is a handsome return on the $7,400.

Representative GRIFFITHS. And I will bet one person could have done the whole thing.

NEED FOR LARGER PENALTIES

Mr. WEITZEL. Also we feel that there is not enough penalty when a contractor does use Government-furnished equipment on commercial

work. He may end up paying the rent for that equipment, as if he had gotten the permission, or he might possibly escape even that, so that there is not an incentive there.

FAVORITISM TO CONTRACTORS

Representative GRIFFITHS. The Government is doing the contractor who uses our equipment free a sweet little favor. It is not a matter of no concern to his competitor.

The Government is subsidizing him against his competitor. That is really what it amounts to. And frankly I think it is wrong.

I think it is a sort of collusive stealing, and I think they are stealing it both ways. They are stealing it first from the taxpayer, and secondly from the competitor. Personally I don't approve of it, and I think that the Defense Department should do something about it, and do it quickly.

DOD POLICY TO REDUCE FURNISHED EQUIPMENT

Mr. WEITZEL. The Defense Department has a policy to reduce Government-furnished equipment, but we feel that this has not been fully implemented.

Representative GRIFFITHS. Well, they have lots of policies that they aren't doing anything about.

Thank you.

Chairman PROXMIRE. We will have a lot of fun tomorrow with Mr. Morris, who will appear, and we will follow up on this with him.

Now I would like to ask you this question along the same line to make sure that we understand the situation.

PENALTY FOR EXCESSIVE COMMERCIAL USE OF EQUIPMENT

The example given in your report, which was reported in the Wall Street Journal this morning, was that you take a $1.4 million forge press bought by the Federal Government and provided to a contractor, to turn out engine parts; 78 percent of the time that this press was used it was used for commercial, not defense work. And, an old press, the purpose of the Government purchase was to replace it, was very largely used for the jet blade which was the Government procurement.

Is this a fair description of what happened? (See p. 2.)

Mr. STAATS. I believe so.

Chairman PROXMIRE. Now what kind of restrictions are on this now? What can be done to penalize a contractor for doing this? Is it illegal? After all, if it is not illegal, there is a big incentive for a contractor to do it. Why shouldn't he do it?

Mr. NEWMAN. Under existing ASPR's he can do it.

Chairman PROXMIRE. He can do it?

Mr. NEWMAN. Yes, sir.

"25 PERCENT USE" OF EQUIPMENT?

In other words, he may have equipment in that plant that is completely idle, but this one press he may use 78 percent on commercial work. If it averages around 25 percent for all equipment utilization on Government work, he is home free.

WARNINGS UNHEEDED

Chairman PROXMIRE. Not only that, but there is another example in here as I understand it of a contractor who used his equipment in this way 7½ percent of the time. He was warned that he shouldn't do it, or warned that this was wrong, at least from the standpoint of the Government. The next year he used it 10 percent of the time, the following year 13 percent.

STRONG INCENTIVE FOR CONTRACTOR TO USE EQUIPMENT COMMERCIALLY

Under these circumstances, it looks as if the warning means nothing, and there is a strong incentive for a contractor to use this equipment, as Mrs. Griffiths properly said, as a subsidy to compete unfairly with others who have to buy their own equipment, and to produce at a lower cost and to make excessive profits subsidized by the Federal Government.

NEED FOR BETTER REVIEWS AND AUDITS

Mr. NEWMAN. Mr. Chairman, until we have sufficient independent reviewing staffs in the procurement area, and internal auditors who will go out and see what is happening, cases of this kind will exist. You cannot just issue regulations without close followup to assume enforcement.

Chairman PROXMIRE. It is not a matter of seeing what happens. Even if you know what happens, it looks as if there isn't any provision in regulation or in law that would either prohibit or inhibit the contractor from taking advantage of Government-owned equipment.

SUPERIORS FAIL TO FOLLOW UP

Mr. NEWMAN. You take the property administrator. He uncovered in these cases, what was going on, but his superiors did not do a thing about it, and this is a basic weakness in the administration.

Chairman PROXMIRE. Yes; but in the case I have cited, they knew what was going on. They knew the precise percent. It was stipulated to, and it grew each year anyway.

Mr. NEWMAN. Right.

Chairman PROXMIRE. Now, isn't it up to the Congress, or up to the Defense Department, to provide a limitation on this?

Mr. NEWMAN. It is.

Chairman PROXMIRE. So, the Federal Government doesn't, in the future subsidize unfair competition, and misuse the taxpayers' money.

DOD ACCEPTS NEED TO DO MORE

Mr. STAATS. Mr. Chairman, you will note that in our testimony we made two recommendations that the Defense Department disagrees with, but I believe that they have accepted the principle of the need to do more than they are now doing.

EXAMPLES OF PENALTIES ASSESSED BY DOD

Chairman PROXMIRE. Is there any example that you know of? Can you give us any in which the Defense Department has penalized a contractor who is using Government-owned equipment in this way?

Mr. STAATS. I do not know of any.

Mr. HAMMOND. I don't know of any case where they have penalized them. The cases we found where a contractor was using equipment without approval, the contractor was charged rent for the day that he was caught using it without approval.

Chairman PROXMIRE. He was what, again?

Mr. HAMMOND. He paid rent for the day that he was found to be using it.

Chairman PROXMIRE. On that particular day?

Mr. HAMMOND. We didn't find any cases where a contractor was penalized. For example, charged a month's rent when he was caught.

Chairman PROXMIRE. Now this is done on a massive scale. You say there are roughly $11 billion, more or less, depending on depreciation, and so forth, $11 billion of this equipment throughout American industry that is being used, owned by the taxpayer, owned by the Federal Government, and being used at no cost, virtually no cost by private firms to produce private commercial production.

Mr. HAMMOND. In most cases where the contractors obtained approval, they did pay rent in accordance with the rental arrangement with the contractor.

Chairman PROXMIRE. But, in the overwhelming majority of cases, apparently they did not pay, and there is little or no record to know how much they are using this.

You have some samples, some excellent demonstrations of the abuse here, but you don't have any comprehensive record of how much this is being used or abused. In one case it is 78 percent of the commercial time, 22 percent Government time; in another case you have a 58-percent example.

Mr. HAMMOND. Yes.

Chairman PROXMIRE. Apparently it is being used a great deal.

Mr. WEITZEL. Mr. Chairman, one of the biggest problems is a lack of machine-by-machine utilization recording and reporting system.

Chairman PROXMIRE. Then what we have, the contractor keeps the records.

PENALTY PROVISIONS IN ASPR

Mr. WEITZEL. The ASPR provisions provide for a penalty for the full monthly rental without credit for each item for each month or part thereof in which an unauthorized use occurs.

However, and here is the hooker in it, "The contracting officer can waive the contractor's liability, if he determines the contractor exercised reasonable care to prevent such unauthorized use."

And then, he is only liable for the rental that would otherwise be due as a regular rental, so that in the few instances where the unauthorized use was detected, the penalty wasn't imposed because of the reasonable care limitation.

So, we have asked them to consider a more stringent provision in the ASPR's, and also the feasibility of applying this rent on a machine-by-machine basis.

Chairman PROXMIRE. And, you have already testified that you have an example of a case in which a contractor did keep records. It cost $7,400. You feel that the rental would have been increased half a million, a return of about 80 to 1, if this is a fair example of the situation.

Mr. WEITZEL. That is the contractor's estimate of how much it would cost.

POWER TO WAIVE PENALTY

Chairman PROXMIRE. OK, fine.

Now I would like to ask who has the power to waive the penalty.

Mr. NEWMAN. The contracting officer.

Chairman PROXMIRE. The contracting officer has the power to do so.

Is there any discipline on him to provide the penalty not being waived? And, what is the penalty, incidentally?

Mr. BAILEY. A month's rent.

Chairman PROXMIRE. They used it for a full year, and when they catch him they pay only for a month.

Mr. WEITZEL. They pay for a month every month or part of a month they use it; that is the penalty.

Mr. NEWMAN. If they catch him.

Chairman PROXMIRE. But you feel that at any rate this is an inadequate system. What they should do is keep records and then charge them for each day that they use it.

Mr. NEWMAN. Right.

REGULATIONS ON COST DOCUMENTATION

Chairman PROXMIRE. Perhaps we were not clear enough when asking about the Truth in Negotiations Act before. I understand that DOD did issue proposed regulations in regard to cost documentation on contracts.

Mr. BAILEY. Yes.

Chairman PROXMIRE. And, that was done in June.

Mr. STAATS. Right.

REGULATIONS ON POSTAUDIT

Chairman PROXMIRE. It was in September that the provisions for postaudit came out. Now, I want to know whether or not this June cost documentation provision has been adequately followed through and enforced.

Mr. WEITZEL. Mr. Chairman, they did send to us and to others for comment in June a proposed regulation. I think this was included in Defense Procurement Circular 57, and it does require the contractor to submit either actually or by specific identification in writing cost or pricing data. (See p. 162.)

Circular 57 includes proposed requirements for cost or pricing data, which is intended to supply the need for identification or documentation of what was furnished so that the contracting officer and the Defense Contract Audit agencies and the GAO auditors will be able to relate what was furnished with what was used at the negotiating table. and you can bear in mind that the Defense Department——

Chairman PROXMIRE. This is absolutely essential data; isn't it?

IDENTIFICATION OF COST OR PRICING DATA WITH CONTRACTS

Mr. WEITZEL. Well, the Defense Department has said, and correctly, that they do require the submission of costs or pricing data, that is to

say, they have access to cost and pricing data. They have conducted actually several thousand audits of cost or pricing data of contractors.

The burden of our report was that there was insufficient identification so that the contracting officer or an auditor attempting to determine how much the Government might be overcharged by reason of failure to furnish proper cost and pricing data would be able to determine what actually was before the contracting officer at the negotiating table, and this ability is impeded by not having an adequate record.

So what the Defense ASPR regulation amendment proposes to do is to make it certain that there will be an identification, a description of the documentation which is actually furnished by the contractor, and which the contracting officer and all others concerned in the Government can put their fingers on later, in attempting to apply the cost-reduction part of the clause in the certificate which is furnished pursuant to Public Law 87–653.

Chairman PROXMIRE. Has this June proposal been adopted?

Mr. WEITZEL. It has been issued, but I cannot say it has been actually adopted yet.

Mr. BAILEY. I understand that Circular 57 is the one that is at the printers and should be issued this week.

Chairman PROXMIRE. And this is in line with the GAO recommendations?

Mr. BAILEY. This covers the area that Mr. Weitzel has been talking about.

Representative CURTIS. Would the chairman yield for a question?

Chairman PROXMIRE. Yes; I will be happy to yield.

Representative CURTIS. When you used the words, "contracting officer"; did you mean the contracting officer or the procurement officer?

Mr. WEITZEL. It would be the contract price analysts of the Defense Department, the Defense contract audit agency people, the procurement contract officer that signs the contract, and the administrative contracting officer that administers the contract, all of the people in the Defense Department, plus the GAO auditors, would have a fix on what information was before the contracting officer when the contract was negotiated. This is the purpose of these amendments.

Representative CURTIS. The original negotiating, then, when you used the phrase, "contracting officer," you meant the original——

Mr. WEITZEL. The procurement contracting officer.

POOR INVENTORY CONTROLS

Chairman PROXMIRE. Now, I would like to ask about what shocked me very much last time, and continues to shock me, and that is the very poor record of the armed services on inventory control. I notice that you have a report here on it, and to refer once again to what Secretary Forrestal said, without the facts, inventory just can't be managed.

We all know that commercial firms that are able to succeed and profit do take inventories and do take them regularly, and consider them necessary and desirable. If you don't know what you have, it is hard to manage your procurement, and you can have enormous waste.

Your record shows that for the overall data period, February 1965 to June 1966, admittedly, this is a little out of date now, it is 18 months old, but I guess it is the best we have, submitted for 20 Army

depots, show that 55 percent took no complete inventories, and 45 percent didn't even take sample inventories.

Now, does this mean that almost half of these firms didn't have any idea of what they had available—half of these depots, I should say—didn't have any idea what their inventory was, except on the basis of——

Mr. BAILEY. Senator Proxmire, they did have ideas as to what was available.

Chairman PROXMIRE. But, no accurate ideas.

LACK OF RECONCILIATION OF RECORDS WITH STOCK

Mr. BAILEY. They had inventory records. But, there was no check to see that these records were accurate, through the medium of taking an inventory of whether the goods on the shelf actually matched what the records showed to be there.

Chairman PROXMIRE. On the basis of your investigations in the past, there are great discrepancies when you don't take physical inventories.

Mr. BAILEY. There are substantial discrepancies, and they did take spot inventories under their procedures where they came across an item that the records reflected as having a balance in the warehouse. If they go to the warehouse and don't find the item on the shelf, then they will take an inventory to see if they can develop where this discrepancy arose, or they will make adjustments in the records, if they fail to find it.

Mr. NEWMAN. But you are right; there are many, many items in the warehouse where inventories haven't been taken for a long period of time.

ADJUSTMENT OF STOCK RECORDS

Chairman PROXMIRE. Not only that, but you say in your letter of November 14 (reading):

> During fiscal years 1965 and 1966 stock records of selected depot inventories averaging in value about $10.4 billion had to be adjusted up or down an average of $2.4 billion annually, in order to bring them into agreement with the physical inventory quantities.

(App. 5, p. 513.)

In other words, they are off 25 percent.

Representative CURTIS. Fantastic.

Chairman PROXMIRE. Which, as Congressman Curtis says accurately, it is fantastic.

Mr. NEWMAN. In many cases, Mr. Chairman, it is just as Mr. Bailey stated, the only adjustments up and down are for items that get requisitions today and their records show they do have it in stock; when they go to get it, it isn't there, so they take an inventory. This may only be 50 percent, I am stretching it—say, 50 percent of the items. The other 50 percent in the warehouse that doesn't move but once a year or so, they do not take inventories on these items.

REASON FOR LACK OF INVENTORIES

Chairman PROXMIRE. Why can't the Army take these inventories? Is this so demanding on their manpower resources that it is wasteful?

Mr. NEWMAN. Basically, that is the last thing they do; take inventories because they haven't got sufficient personnel. At locations where they have personnel, they do work on the physical inventory problem.

Chairman PROXMIRE. It would seem to be a great savings if they could take them just offhand. Isn't that your impression?

Mr. NEWMAN. Yes, sir.

POSSIBILITY OF ANNUAL INVENTORIES

Chairman PROXMIRE. Supposing the depots were all required to have annual inventories; wouldn't this result in an enormous saving to the taxpayer?

Mr. NEWMAN. I believe so.

Chairman PROXMIRE. Have you ever made a study of this situation, so you could make recommendations along this line?

Mr. NEWMAN. On selected items, we have. It has been a few years ago, but we have found particularly in the Air Force, I remember—I think it was generators—they were costing $10,000 each, and the procurement officer was ordering every year 10,000 generators.

Chairman PROXMIRE. That is the point. You have the Army, the Navy, the Air Force. The Air Force seems to do a somewhat better job.

It is hard to tell because you question some of their claims, but they claim that during fiscal years 1965 and 1966 they reported average overall stock accuracy rates ranging from 86 to 99 percent. You questioned very seriously the estimates because you feel that your review indicated the report of high records stock accuracy for certain categories were overstated, or may have been overstated, but then you document that fact that it was overstated. Nevertheless, this is a much better record than the Army has; isn't it?

Mr. NEWMAN. I would say, "Yes."

Chairman PROXMIRE. And the Air Force and Navy seem to have a somewhat better record, although there, again, you feel that they have overstated their accuracy; is this correct?

DOD AGREES WITH GAO DIAGNOSIS

Mr. STAATS. Mr. Chairman, I think that the Defense Department comments in the report that you have before you there indicate that they agree with our diagnosis.

DOD HAS SOLUTIONS IN MOTION

They are not sure they agree with our cure, and they have several other things in motion which they feel are going to solve the problem, and in effect are saying that it is premature to reach the conclusions that we have, without having had an opportunity to evaluate the things that they have in process already.

Chairman PROXMIRE. The last sentence is a pretty startling sentence, too. You say: "During these fiscal years of 1965 and 1966, scheduled inventories were taken on less than 6 percent of the items scheduled for physical inventory."

Less than 6 percent, that means that 94 percent were not inventoried, of the Navy.

Mr. WEITZEL. Mr. Chairman, one of the things that the Defense Department pleaded was the pressures to maintain a continuing flow of high-priority essential military supplies to Vietnam, that that often precluded the orderly process of conversion of their system.

AMC CONDUCTED 900,000 SPECIAL INVENTORIES IN 18 MONTHS

However, we found that sometimes, many times, the lack of regular inventories contributed to a great deal of activity in the special inventory field. For example, the Army Materiel Command furnished data indicating that its depots, responsible for over half a million line items of depot stocks, conducted over 900,000 special inventories between January 1965 and June 1966, and so that it looked to us like they had to count, on an average, each item 1.7 times during the 18-month period.

Some of them were counted many times. One depot conducted, within a 30-day period, five or more special inventories for each of 92 items. Now, that is when they try to find something that is ordered and is urgently needed, and they try to look around and see what they have.

NEED FOR HIGH LEVEL MANAGEMENT

We feel that more high-level management, continuous and recurrent attention to this, would smooth out some of those problems, and avoid, first, having to make all of the inventory adjustments up or down and, second, avoid not filling highly needed military requisitions when they actually have supplies, or going out and buying more than they really need because they don't know they have it.

NEED FOR ACCURATE INVENTORIES

Chairman PROXMIRE. Isn't it true that we would be in a far better position to meet our problems in Vietnam if we had accurate inventory records? We would be able to supply the necessary procurement to Vietnam more promptly, we would know what we have, we would know where it is.

There is not only a matter of reducing cost and the burden on the taxpayer. This is a matter of providing a more effective and efficient military effort.

After all, in modern warfare, certainly, having the equipment, the right kind of equipment, at the right place, at the right time, is overwhelmingly important.

Mr. STAATS. Yes.

Chairman PROXMIRE. And they don't even know what their inventory is in Vietnam, I understand, to some extent. I don't think we can condemn it, though. I think it can be improved very sharply. But, in this country, where nobody is being shot at, and where we have such a tremendous amount of personnel in the Armed Forces, to have this very sloppy, feeble, weak, inadequate kind of inventory control is very bad.

Mr. STAATS. Actually, it is very difficult to divorce the two, because so much is directly supplied to Vietnam out of the continental United States now. It is for this reason that the study which we referred to here—which was made last year by the GAO, in coopera-

tion with the Defense Department, and where we developed some 82 specific recommendations dealing with the whole Far East supply management problem—included the need for improvement of inventory controls.

Now, we had planned to do a followup review about this time, but as a result of the efforts made by the Defense Department, and a trip to the Far East which Mr. Bailey and some of our staff took a few months ago, we decided to defer a further review. But, I would like Mr. Bailey to comment a little bit further on the extent to which these specific recommendations did include improvement in inventory control.

ACCURATE INVENTORY RECORDS ENHANCE EFFICIENCY, ECONOMY, AND EFFECTIVENESS

Chairman PROXMIRE. Before he does that, and my time is up, and I am about to yield, and I am just about through, but I would like to ask you if my conclusion is wrong or right, the conclusion that I suggest it is that accurate inventory records would improve, enhance the efficiency of our military effort in Vietnam, not only save money to the taxpayer, but that this would make it possible for us to provide a more efficient procurement system for Vietnam; is that correct?

Mr. STAATS. This was a part of the objective of the review which we made.

Chairman PROXMIRE. So you agree with that.

Mr. STAATS. I agree with that 100 percent, and I think, as you have indicated, when you are dealing with Vietnam you have other considerations besides the costs which are involved here, and the costs may be relatively unimportant in relationship to getting the supply into the hands of people that need it.

Chairman PROXMIRE. To get it in supply, you have to have records to know what you have.

Mr. STAATS. Exactly.

BIG PROBLEM WITH COMMON ITEMS

Mr. NEWMAN. Mr. Chairman, on big components, high value components, and you mentioned the Air Force, particularly, the Air Force has a good system. They know where every engine for every plane is all over the world, and other items similar to that.

The Army is gradually getting worldwide control, too, on high-value items. But it is in the other inventories, the common supplies and parts where the big problems are.

$3 BILLION ANNUAL COST OF COMPUTERS

Chairman PROXMIRE. My time is up. I yield to Congressman Curtis.

Representative CURTIS. I am glad you added this last remark, because I was getting worried about this. What is it we spend now, about $2 billion a year for computers; or is it above that figure now?

Mr. STAATS. If you include the classified weapons and uses of them, it is around a little over $3 billion, but for direct Government costs it is around $2 billion.

Representative CURTIS. I had been relaxed on that because I felt these computers were necessary in order to have this kind of inventory control and that with them we could have it.

COMMON ITEMS SUBJECT

Now, at least in this one area we do, and that is probably a more important area. And yet, the common use items, is the area where they certainly should have developed the use of inventory controls first.

I might, in regard to Senator Proxmire's interrogation, state this. In your report, B161319, of May 8, 1967, "Examination Into the Transfer of Handtool and Paint Stocks From Department of Defense to GSA," in the introductory letter you make this remark:

$1.1 MILLION ADDITIONAL COSTS DUE TO POOR INVENTORY

"After we brought this situation to the attention of the Department and Administration officials, complete physical inventories were taken at the Department's depot, and about $4 million worth of stocks were found which were not recorded"—I think this was paint—"but which should have been recorded on the Administration's inventory records. During the period when the stocks were 'lost' the Administration purchased about $1.1 million worth of stocks that were identical to the unrecorded stocks."

I just pose this because it illustrates so vividly the waste that is involved in the lack of proper inventory control, as you pointed out here, and there are so many examples, and it just seems continuous.

This committee has been on the subject for years, as an extension in a way of the old Bonner subcommittee of 1951–52. It just seems that we harp on the same things.

SLOW PROGRESS ON OLD PROBLEMS

The Defense Department says, "Yes; we are going to correct," and yet every year we dig into it, we seem to be far away—maybe not as far away, there is some progress—but we certainly seem far away from our ultimate goal.

I am going to make a statement, really for correction, if I am wrong. I think I am right on this.

TAXES ON CONTRACTOR-HELD INVENTORY

Do the contractors, the Government contractors, private contractors, pay local property tax or manufacturers' and merchants' tax on the Government property which they are using, and the material; because the contractor does pay merchants' and manufacturers' local tax on his machinery and his inventory?

Mr. STAATS. You are talking about Government-owned equipment?

Representative CURTIS. Yes.

Mr. STAATS. No.

Representative CURTIS. I don't think they do either.

Mr. BAILEY. They do not pay a tax as such, Mr. Curtis, but in some States there is a use tax levied on the contractor for Government——

Representative CURTIS. Equipment? Well, this is very good. I didn't even know there was that.

Mr. BAILEY. Materials, particularly.

TAXES AND LOCAL BENEFITS

Representative CURTIS. I was thinking of both, of equipment and materials. Now, in most States or most local communities, manufacturers' and license tax do go to leased equipment. It isn't just whether it is ownership. If it is leased it will go to that.

The significance of this, of course, is that the manufacturer gets the benefit of police, fire protection, streets, sewer, all the community facilities which cost, and this is one way of sharing the cost that goes with it.

The police protects that inventory, the fire department protects the inventory, protects the machinery. It all gets this advantage.

LOCAL TAXES AS A FACTOR IN DETERMINING GOVERNMENT IN-HOUSE OPERATIONS

I am very disturbed, I might say, at the Federal Government not paying its fair share for its facilities, and I am now switching fields a bit, to an entirely owned Government facility which gets the same benefits from local services, and yet, here in the A–76 memorandum of the BOB where we are trying to establish the guidelines, the factors in cost accounting, in order to determine whether the Government should be doing something in-house, or whether it should be done in the private sector, there is no recognition of the costs of local taxes, which I would argue again are costs which relate to real services that are rendered. Would you comment on this?

Mr. STAATS. We point this out in our statement here, Congressman Curtis. This is undoubtedly the most difficult and most significant unresolved question in terms of the policies that the budget circular addresses itself to, and I emphasize this because one of the reasons that it is difficult and important is that the size of State and local taxes has obviously gone up very dramatically over the last several years.

Representative CURTIS. Not in relation to wealth, if I may say; not the percentage.

Mr. STAATS. It has gone up almost any way——

Representative CURTIS. Not percentage.

Mr. STAATS. Percentage of what?

Representative CURTIS. Of the tax, the rate of the tax has not gone up. What has happened is that the base, the wealth has gone up, so the total revenue take of local governments has continued to increase, as you said.

But, let me assure you that the ratio of the tax to the wealth, which is the base, is a very healthy one. The tax base of the local communities is in a healthy position, because wealth has been increasing more rapidly than gross national product.

Mr. STAATS. Undoubtedly, but there have also been significant tax rate increases at State and local levels, if you go back over the last 5 years.

Representative CURTIS. I would quarrel with that. You may be right, but the figures I have do not indicate that, not the rate.

Mr. STAATS. Well, perhaps we have a difference in our understanding of the facts, but I think the important thing here also, aside from whether this is a correct statement of the facts or not, is the growth in the grant-in-aid programs, which the Federal Government has made.

It has grown from $15 billion to more than $17 billion, from 1967 to 1968.

NEED TO TAKE TAXES INTO CONSIDERATION

The point here I think, that both you and I are making is that if the Federal Government does not take into account the taxes on its own operations, that the revenue is going to have to come from either grant-in-aid programs or it is going to have to come from local taxes. That is what we are both saying, I think.

IMPACTED SCHOOL AREA BILL

Representative CURTIS. There we are in complete accord. Of course the impacted school area bill was based on this very assumption that the Federal Government comes into a community, acquires the facility, withdraws that land from the local tax base, and so we had in lieu of taxes paid by the Federal Government for schools, sewers and community facilities, a very important item.

Now, getting back to how I brought it in here, if you can find out whether or not this Government-owned property, say $11 billion, is or is not in the local tax base. Now, probably some areas may be, but of the $11 billion, I would be curious to get some idea of how much of that actually does bear its share of local taxes.

Mr. STAATS. I believe we will have to submit something for the record on this.

Representative CURTIS. Yes, I think you probably would. You can see, too, that this is an added advantage to a local contractor in using Government equipment, if my premise is right, that they don't pay a full load of local taxes on that equipment, it would be much preferable to have Government equipment, and so there is a further incentive built in here.

Another reason, another argument I would use for getting this A–76 memorandum corrected so that it does include this very sizable item of local taxes, because whether you and I are right on the rate, the amount of money paid has increased because the amount of equipment used today is so much more valuable.

Mr. STAATS. We would be glad to supply a statement for the record.

Representative CURTIS. Thank you very much.

(The statement subsequently supplied follows:)

Attached is a tabulation, by State, of the federally owned real and personal property covered in our report of November 24, 1967 (appendix III to report. See p. 462.) It does not include military property or materials. The remarks column reflects our opinion whether the property is or is not subject to State taxation. It has not been possible in the limited time available to be sure our research has covered any very recent legislative developments and judicial decisions.

TAXABLE STATUS OF FEDERAL PROPERTY IN HANDS OF CONTRACTORS (app. III to Nov. 24, 1967, report)

State	Remarks	Type	Value of property
Arkansas	Appears subject to taxation	Personal	$3,363,900
California	Taxable under State court decision	do	64,133,700
Connecticut	Appears exempt from taxation	do	9,777,300
Illinois	Exempt under State court decision	do	3,912,200
Kansas	Both types subject to taxation	Personal	254,803,100
		Real	73,416,600
Maryland	Both types exempt from taxation if used in connection with national defense work, taxable otherwise.	Personal	15,256,900
		Real	6,002,000
Massachusetts	Both types appear subject to taxation	Personal	94,697,000
		Real	29,135,600
Michigan	Statute imposing tax voided on technical grounds by 1965 State court ruling.	Personal	5,059,400
Minnesota	Both types exempt if used in connection with production of goods for sale to Federal Government, taxable otherwise.	do	31,500,300
		Real	5,763,800
New Jersey	Both types exempt, except leased real property	Personal	92,511,300
		Real	1,191,800
New York	No personal property tax. Real property exempt by State court decision.	Personal	29,257,000
		Real	117,800
Ohio	Subject to taxation under State board of tax appeals ruling. Possibly exempt as a "public purpose" if used on defense work.	Personal	80,941,700
Pennsylvania	Both types exempt under State court decisions	do	11,546,200
		Real	10,600
Texas	Appears subject to taxation under State court decision	Personal	7,488,300

POSSIBLE LEGISLATION

Chairman PROXMIRE. Thank you. I would like to just suggest now at the end that it would be very helpful to us, I think maybe Congressman Curtis would be interested in this, too, if you could provide two or three alternative legislative proposals to meet the problems that have developed this morning on contractors using Government-owned equipment.

I am thinking in terms of recordkeeping, in terms of rental terms, in terms of purchasing and also in terms of local tax exemptions. Maybe you might recommend against any legislative action. Maybe you feel it can and should be handled by administrative action, but I am inclined to feel on the basis of the experience we have had that it would be best to make it a matter of law.

Furthermore, isn't it true we spent $400 million for a catalog system to number everything that is procured, and we spend something like $3 billion annually for computer equipment, and yet we don't know, we don't seem to be making much progress in providing adequate inventories for the armed services. It is very frustrating.

Mr. STAATS. I feel that while we have identified many weaknesses here we would all have to recognize the magnitude of the problem.

Chairman PROXMIRE. Oh, sure, it is a great problem, but as I say we are spending an enormous amount of money to meet the problem.

Mr. STAATS. That is certainly true.

GAO'S POSITION ON NAVY DAIRY

Chairman PROXMIRE. And then there has been some conflict as to whether you have changed your position on the dairy at Annapolis, the Naval Academy, and it would be very helpful if you could put it on the record here. Have you changed your position, as was reported by one powerful Member of the House, or not? (See also, p. 220.)

Mr. STAATS. No; I was a little surprised to read that in the press, also. We did not revise our opinion.

We understood that the House had taken some action. Defense has apparently withdrawn any plans it had to convert to purchasing its requirements from the commercial market. But, we have no studies which would indicate any alteration in the conclusion which we reached in our report. (See hearings, 1967, pt. 1, p. 32.)

Chairman PROXMIRE. And there are just two other requests here. One, will you provide copies of relevant regulations and so forth on 87–653, and based upon the past year's experience, what are the priority areas that you believe should be worked on in this next year. Either indicate that now or for the record.

Mr. STAATS. I think I would prefer, Mr. Chairman, to do it for the record. We outlined, as I have indicated, a considerable part of our program before the House Armed Services Committee. There have been some revisions in our program since that time.

In fact, we are in the midst of reviewing our program for the next 6 months period and just beyond at the moment so that I believe in another week or 10 days we could supply you a more useful and a more up-to-date picture as to our program and the priority items in the program in the area of procurement and supply management. I assume that those are the two areas that you are particularly interested in.

(Following letter covers work program. See p. 162 for regulations on 87–653, inserted by Sec. Morris.)

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., January 4, 1968.

[SEAL]
B–163175

HON. WILLIAM PROXMIRE,
Chairman, Subcommittee on Economy in Government,
Joint Economic Committee,
Congress of the United States.

DEAR MR. CHAIRMAN: You requested, when we appeared before your Subcommittee on November 27, 1967, that we inform you as to areas we believe should be given priority in planning our work programs for the coming year. The economy and effectiveness with which the military departments procure and control Government-owned facilities, equipment, and materials continue, in our opinion, to warrant close attention by this office and your Subcommittee.

Following is a listing of examinations into subject areas we believe are of prime importance and for that reason are included in our work program for 1968.

SUPPLY MANAGEMENT

1. Continuation of the study of receipt and storage procedures and practices in each of the military services and the Defense Supply Agency for purposes of identifying opportunities for improving the accuracy of inventory records.

2. Inquiry into the effectiveness of Department of Defense procedures for improving interservice utilization of materials either in long supply or excess to a military service's needs.

3. Appraisal of the progress being made by the Department of the Army to improve supply management activities in Vietnam, including correction of inventory records and identification and disposal of excesses.

4. Analysis of the military standard requisitioning and issuing procedures to identify causes for delays in processing requisitions from users.

5. Continuation of a study of the application of the Federal Catalog Program and the Defense Standardization Program in each of the military services and the Defense Supply Agency.

6. Examination into the controls exercised in each of the military services to obtain the maximum return of repairable equipment by using units to depot

maintenance facilities. The examination will also include an appraisal of the propriety of decisions to initiate new procurement in lieu of repairing items already in the supply system.

7. Examination into shipments of materials from Air Force bases to Air Force depots to determine whether items in long supply or excess to the bases' needs are unnecessarily being shipped and increased transportation costs incurred.

8. Inquiry into the General Service Administration's effectiveness in meeting the requirements of priority supply requisitions from overseas customers.

INDUSTRIAL FACILITIES

1. Examination into the bases on which rentals for commercial use of Government-owned facilities are computed, and consideration as to whether contractors who use Government equipment on commercial work have a decided advantage over competitors who use their own equipment on such work.

2. Consideration of the relative economy of the Government or contractors furnishing equipment for use on Government work. The possible need for tighter restrictions on contractors' use of Government equipment for commercial work is being considered also.

3. Review of the management of plant equipment located at Government-owned industrial facilities to determine if equipment, idle for extended periods of time, is being reported as being actively in service, thus preventing the Defense Industrial Plant Equipment Center from redistributing this equipment to meet valid requirements.

4. Review of defense contractors' practices in leasing land and buildings for extended use in the performance of Government contracts, and the relative cost to the Government under this procedure versus purchase of such facilities by contractors.

PROCUREMENT

1. Review the manner in which the Department of Defense is enforcing the new audit and documentation regulations concerning the requirements of Public Law 87–653. We plan to make this review after the Department has had sufficient time to implement the regulations at procurement offices.

2. Examination into the procurement of selected items of aerospace ground equipment for F–4 aircraft to determine whether savings could have been realized had the items been purchased from the equipment manufacturers rather than from the F–4 aircraft manufacturers.

OTHER PROGRAMS

1. Examination into the feasibility and economy of consolidating real property maintenance activities operated by the military services. For example, on the relatively small island of Oahu, Hawaii, the military services maintain eight separate engineer or public works organizations. Similarly in a 45 mile area around Norfolk, Virginia, the military services have 16 engineer or public works organizations.

2. Examination into the management of magnetic tape used in automatic data processing operations. The review will consider the benefits to be derived from greater centralization of control over the acquisition, use, and disposal of magnetic tape.

3. Inquiry into the Navy's management and control of its area coordinating system as it relates to the consolidation of station support service functions.

4. Review of costs and manpower involved in the maintenance of noncombat vehicles in the Army and Air Force.

We would be pleased to discuss any of the foregoing matters with you or members of your staff, should you so desire.

Sincerely yours,

ELMER B. STAATS,
Comptroller General of the United States.

Chairman PROXMIRE. Tomorrow we have Mr. Morris. I understand you will be available for possible rebuttal questioning later.

Mr. STAATS. Yes, we would be very happy to come back and again I would like to refer particularly to the material which we have supplied.

This will bring you up to date on the various matters referred to in your report. What we have attempted to do is to cover all of the items that you requested we address ourselves to in that report.

Chairman PROXMIRE. Thank you very much.

Mr. STAATS. If you would like for us to return after you have had a chance to review this fairly long document, we would be most happy to do so. (See p. 351–395, for later hearings.)

Chairman PROXMIRE. Yes, we are looking forward to it.

The committee will stand in recess.

We will reconvene tomorrow morning at 10 o'clock to hear Secretary Morris.

(Whereupon, at 12:50 p.m. the committee adjourned to reconvene at 10 a.m., Tuesday, Nov. 28, 1967.)

ECONOMY IN GOVERMENT PROCUREMENT AND PROPERTY MANAGEMENT

TUESDAY, NOVEMBER 28, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

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

Present: Senator Proxmire; and Representatives Curtis, Griffiths, and Rumsfeld.

Also present: Ray Ward, economic consultant.

Chairman PROXMIRE. The subcommittee will come to order.

Our witness this morning is the Honorable Thomas D. Morris, Assistant Secretary of Defense—Installations and Logistics.

Mr. Morris is well known to this subcommittee having appeared before it on previous occasions and has always been informed and responsive to our questioning.

My letter of November 8, 1967, to Secretary McNamara to which you responded on November 18, 1967, outlines the subjects upon which we requested testimony and both will be placed in the record at this point together with a short biographical sketch of Secretary Morris. It will be appreciated also, Mr. Secretary, if you will furnish for the record, biographical sketches of your deputies, members of the ASPR committee, and the Director of the Defense Supply Agency.

(The documents referred to follow:)

NOVEMBER 8, 1967.

Hon. ROBERT S. MCNAMARA,
Secretary of Defense,
Washington, D.C.

DEAR MR. SECRETARY: This will confirm conversations with your staff that the Subcommittee on Economy in Government of the Joint Economic Committee will hold follow up hearings on its report of July 1967, from November 27-30, 1967, Room AE-1, The Capitol, Joint Atomic Energy Committee Hearing Room.

We will welcome your appearance or that of staff of your choosing on November 28, 10 a.m. to discuss actions taken and planned on the conclusions and recommendations contained in the July, 1967 report.

We particularly wish a full discussion on developments in implementing the Truth-in-Negotiations Act (P.L. 87-653) and improvements in supply management, including the role of DSA. We are greatly concerned with inventory management pertaining to short shelf-life items and contractor-held equipment and supplies.

In the procurement area cover use of competitive versus negotiated bidding practices, use of Buy American Act differentials and the scope of "breakout of components" in competitive buying.

The status of the development and operation of the National Supply System and relations with GSA are of permanent interest to the Subcommittee.

87-847 O—68——6

Progress in implementing Budget Bureau circulars A–76 and A–2 should be covered in the testimony. Please review steps being taken toward the training and development of a corps of experts in procurement, contract administration, contract audit, and property management generally.

One hundred copies of your prepared text should be forwarded to us at least one day prior to your appearance and you may contact Mr. Ray Ward, Staff Consultant, Code 173, Ext. 8169 for any additional information.

Sincerely yours,

WILLIAM PROXMIRE, *U.S. Senator.*

ASSISTANT SECRETARY OF DEFENSE,
Washington, D.C., November 18, 1967.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR MR. CHAIRMAN: In response to your letter of November 8, 1967, relative to Subcommittee hearings on November 28, Secretary McNamara has requested that I serve as the Defense Department witness. I will be accompanied by my Deputies responsible for the areas of your interest, and by the Director of the Defense Supply Agency.

We are looking forward to meeting with you.

Sincerely,

THOMAS D. MORRIS,
Assistant Secretary of Defense (Installations and Logistics).

THOMAS D. MORRIS, ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS)

Thomas D. Morris was reassigned as Assistant Secretary of Defense (Installations and Logistics) effective September 1, 1967.

A former member of the New York management consultant firm of Cresap, McCormick and Paget, Mr. Morris had been serving as Assistant Secretary of Defense (Manpower) since October 1, 1965. Previously he had served as Assistant Secretary of Defense (Installations and Logistics) from January 29, 1961, to December 11, 1964.

In 1960, Mr. Morris served as Assistant Director for Management and Organization, Bureau of the Budget. In 1956–57, he served in the Office of the Secretary of Defense in several capacities, including the position of Deputy Assistant Secretary for Supply and Logistics.

During World War II, Mr. Morris served in the Navy from 1942 to 1945 as a member of the Navy Management Engineering Staff. Subsequently, as a partner in the consulting firm of Cresap, McCormick and Paget, he participated in the studies of both Hoover Commissions and conducted management surveys for a number of Federal agencies and private organizations.

Mr. Morris was born April 19, 1913, in Knoxville, Tennessee. Following his graduation, in 1934, from the University of Tennessee with a Bachelor of Arts degree, Mr. Morris was employed by the Tennessee Valley Authority as an office systems analyst, and from 1936 to 1939 with the Interchemical Corporation. In 1940–1941, he was on the controller's staff of the U.S. Steel Corporation.

From 1958 to 1960, Mr. Morris was director of management planning and assistant to the president of the Champion Paper and Fibre Company.

Mr. and Mrs. Morris have two children, a son, David, and a daughter, Martha. They reside at 5223 Duval Drive, Washington 16, D.C.

PAUL H. RILEY, DEPUTY ASSISTANT SECRETARY OF DEFENSE, INSTALLATIONS AND LOGISTICS (SUPPLY AND SERVICE)

Paul H. Riley was appointed Deputy Assistant Secretary of Defense on February 13, 1961 by the Assistant Secretary of Defense (Installations and Logistics).

Mr. Riley's primary areas of interest cover: Supply Management, Transportation & Warehousing, Telecommunications, Cost Reduction, Technical Data &

Standardization policies, as well as Food Service Management and Petroleum matters.

Mr. Riley graduated from Bolles Military Academy in Jacksonville, Florida, in 1936. He received a B.S. degree in Business Administration from the University of Indiana in 1942. Immediately upon graduation he was commissioned a second lieutenant in the Army.

During World War II, Mr. Riley served with the Sixth Major Port of Embarkation in Casablanca, Naples, Anzio, and Southern France. Mr. Riley was separated from the Army in February 1946.

From March 1946 to December 1951, Mr. Riley worked with the Production and Marketing Administration of the U.S. Department of Agriculture, where he directed that Administration's classification and wage administration programs.

Mr. Riley was Chief of the Management and Special Analysis Staff in the Military Division of the Bureau of the Budget from December 1951 until March 1958. During this period he conducted programs designed primarily to review and study the supply systems of the Army, Navy, Air Force and Marine Corps.

In February 1958 he became Special Assistant to the Assistant Secretary of Defense for Supply and Logistics. He was appointed to the position of Director of Supply Management Policy in August 1958.

Mr. Riley, his wife, the former Miss Johanna Einikis of Gary, Indiana, and daughters Sharon, Lauren, Christine and Paula reside at 3801 Lake Boulevard, Annandale, Virginia.

JOHN M. MALLOY, DEPUTY ASSISTANT SECRETARY OF DEFENSE (PROCUREMENT)

Mr. Malloy assumed his present position in the Office of the Secretary of Defense in April 1965. He is responsible for determining policy for and ensuring effective implementation of the purchasing program of the Department of Defense.

Mr. Malloy retired from the U.S. Navy in July 1963 with the rank of Captain after 22 years service. During his service in the Navy, Mr. Malloy had a variety of assignments in the procurement field including command of the Navy Purchasing Office in Washington, D.C. and Los Angeles, California. He was Chairman of the Armed Services Procurement Regulations Committee in the Office of the Secretary of Defense from 1958 to 1961.

Prior to being appointed Deputy Assistant Secretary of Defense for Procurement, Mr. Malloy was employed by North American Aviation, Inc., El Segundo, California.

Mr. Malloy graduated from Boston College in 1940 and Harvard Graduate School of Business Administration in 1947.

MAJ. GEN. ALLEN T. STANWIX-HAY, U.S. ARMY

Allen Thomas Stanwix-Hay, USA Signal Corps, was born in New Orleans, Louisiana, February 14, 1911.

Upon graduating from the University of Florida in 1933, he was commissioned a Second Lieutenant as an Artillery officer in the U.S. Army Reserve. As a member of the First Observation Battalion, he specialized in the development of new sound and flash ranging techniques.

While continuing his reserve training, General Stanwix-Hay also operated his own electrical engineering firm, until entering on active duty in March 1942. After a short Stateside assignment with the U.S. Army Air Force, he served in Africa and the European Theater of Operations until late 1945 as Deputy Signal Officer for Operations, Headquarters 9th U.S. Air Force.

From 1946–1948, the General was stationed at the Air University, where one of his major assignments was working on the Joint Brazil-U.S. Military Commission supervising the installation of the Tactical Air Radar System in Brazil. In 1948, he was reassigned to the Signal Corps at Fort Monmouth. After attending the Advance Signal Officers' Course there, he remained until November 1951 for various assignments including that of Chief, Signal Corps Publications Agency.

General Stanwix-Hay began the first of a series of tours in Washington, D.C., in late 1951, where he served with the Office of the Chief Signal Officer and the Deputy Chief of Staff for Logistics. Between 1951 and his present assignment he also held the following positions: Signal Officer, Military Assistance and Advisory

Group, Taiwan; Commanding Officer, USA Signal Support Agency; Commanding General, USA Electronics Materiel Agency; Deputy Chief Signal Officer, U.S. Army; and Test Director for "Project 60" which led to the establishment of Defense Contract Administration Regions in the Continental United States.

The General was appointed Special Assistant to the Assistant Secretary of Defense (Installations and Logistics) on 15 March 1966, with responsibilities for coordination of all Southeast Asia logistic support matters. His broad coordination role was short lived and in April 1966, per Secretary of Defense direction, he established a special Air Munitions Office that applied intensive management to selected air ordnance items critical to Southeast Asia operations. In October 1966 additional offices were established under his direction to extend intensive management to Ground Ammunition, Aircraft and Missiles, and other Major Items critical to Southeast Asia.

General Stanwix-Hay was sworn in as Deputy Assistant Secretary of Defense (Materiel), Office of the Assistant Secretary of Defense (Installations and Logisics) on 19 December 1966. The Deputy Assistant Secretary of Defense (Materiel) mission is to assure the timely availability of materiel in support of (1) force deployments to and military operations in Southeast Asia, and (2) the readiness requirements of the U.S. Approved Force and friendly foreign nations' forces world-wide.

Schools the General has attended during his military career include the British Royal Air Force School, the Armed Forces Staff College, Harvard University Advanced Management and the Industrial College of the Armed Forces.

LT. GEN. EARL C. HEDLUND, USAF DIRECTOR, DEFENSE SUPPLY AGENCY

Earl Clifford Hedlund was born in Valparaiso, Nebraska, on July 16, 1916. He was graduated from Deuel County High School in 1933. He received his Bachelor of Science degree from the University of Nebraska in 1938. He received his Master of Science at the University of Illinois in 1939. He then did two years of graduate work toward his doctorate degree, but this was interrupted by his entry into military service in 1941. He completed his degree requirement with the University of Illinois and received his Ph. D. in 1948.

He was commissioned a second lieutenant in the Reserve in June 1938, through the Reserve Officer Training Corps (ROTC) program at the University of Nebraska, and received his pilot training at Randolph and Foster Fields, Texas, graduating in 1942.

From August 1942 to 1947 he served variously as a fighter pilot, squadron commander, group commander, and deputy wing commander in the Pacific and European theaters. He was credited with the destruction of 15 enemy aircraft, air and ground. Flying duty was interrupted in April 1945, when his P–38 was shot down by ground fire. Although suffering from second degree burns, we was able to parachute from the burning aircraft only to be captured by the Germans. He later escaped and made his way back to the American lines.

During World War II he flew 67 fighter missions in the Aleutian Islands for a total of 180 combat hours, and 103 fighter missions in the European Theater, representing 367 combat hours.

In 1948, General Hedlund was assigned to the Joint Military Transportation Committee of the Joint Chiefs of Staff, where he served until 1951. From 1951 to 1952, he was Chief of the Air Transport Division, Directorate of Transportation, Headquarters United States Air Force (USAF). After attending the Naval War College in 1952–1953, he was assigned as Director of Transportation, Headquarters, Far East Air Forces, in Tokyo, Japan.

In 1956, he became Deputy Director of Transportation, Headquarters USAF, and in August 1959, was appointed Director of Transportation.

On July 20, 1961, General Hedlund became Deputy Commander, Ogden Air Materiel Area, Air Force Logistics Command, with headquarters at Hill Air Force Base, Utah, and in August 1963, began duty as Commander, Warner Robins Air Materiel Area, Air Force Logistics Command, with headquarters at Robins Air Force Base, Georgia.

He became Deputy Director, Defense Supply Agency on August 1, 1966, and Director of the Defense Supply Agency on July 1, 1967.

Among his decorations General Hedlund wears the Distinguished Service Cross; Legion of Merit with one Oak Leaf Cluster; Distinguished Flying

Cross with one Oak Leaf Cluster; Purple Heart; the Air Medal with 19 Oak Leaf Clusters, and several service awards. His foreign decorations include the British Distinguished Flying Cross; the French Croix de Guerre, and the Belgium Fourragere. He is rated a command pilot.

General Hedlund is the son of the late Hulda and Claus Hedlund of Chappell, Nebraska. He married the former Eleanor Neff of Beaman, Iowa, on October 10, 1948, and they have six children.

REAGAN A. SCURLOCK, CHAIRMAN, ARMED SERVICES PROCUREMENT REGULATION COMMITTEE

Colonel Scurlock assumed his present position as Chairman, ASPR Committee, effective May 1, 1965.

Colonel Scurlock has twenty-seven years service in the United States Air Force. He was stationed at Hickam Field, Hawaii, at the time of the attack on Pearl Harbor, and after participating in the battle of Midway, moved with his squadron to the South Pacific. After returning to the United States in 1943, he served as Director of flying training at B–17 Training School. Colonel Scurlock, a command pilot, has been awarded the Silver Star, Legion of Merit, Distinguished Flying Cross and Air Medal.

In 1951, Colonel Scurlock was assigned as a Procurement Officer at Headquarters, Air Materiel Command. Subsequent to that time, with time out for a tour in Korea and at the Armed Forces Staff College, he has served in a series of increasingly responsible assignments in procurement and procurement related fields.

Prior to his present assignment as Chairman of the ASPR Committee, he was Chief, Procurement and Production, Electronics Systems Division, Air Force Systems Command. The ESD is responsible for the design and acquisition of Air Force Command and Control Systems such as SAGE and BEMEWS.

Colonel Scurlock is a graduate of the University of Texas Law School and is a member of the Bar of the State of Texas.

LT. COL. RICHARD P. HERGET, 0324038, ARMY LEGAL MEMBER, ASPR COMMITTEE

Born 16 Dec. 1913, Paragould, Arkansas. Graduated Paragould High School 1929. Graduated New Mexico Military Institute 1931. Graduated (BSME) University of Arkansas 1934. Graduated (LL.B.) Georgetown University College of Law 1941. Member of Bar, State of Arkansas; passed Bar Examination for District of Columbia shortly after graduation from law school. Married in 1938 to Mary E. Barlow; five children. Served as Lt in 29th Infantry Division in Europe in World War II from May 1942 to Sep. 1945. General practice of law, Paragould, Arkansas, 1945 to October 1950. Recalled to active duty 1950 during Korean Conflict; transferred to Judge Advocate General's Corps in May 1953. Action officer, Contract Law Branch, Procurement Law Division, Office of The Judge Advocate General, Army (OTJAG) 1955 to 1959; Staff Judge Advocate, U.S. Army Transportation Terminal Command, Arctic, 1960 to 1961; Chief, Logistics and Contract Law Branch, Procurement Law Division, OTJAG, 1962 to 1965; General Counsel, Hq European Exchange System, 1965 to 1967; Army Legal Member, ASPR Committee, 1967. Member, American Bar Association; Arkansas Bar Association.

GREGORY C. FRESE, JR., COLONEL, USAF

Colonel Frese joined the ASPR Committee as Air Force Policy Member in July 1966. Prior to his assignment on the ASPR Committee he was Chief of the Procurement Office, Air Force Eastern Test Range, Patrick Air Force Base, Florida. Procurement responsibilities at the Air Force Eastern Test Range encompassed base procurement as well as R&D procurement. Procurement was mostly of electronic type equipment necessary to support missile flights. Prior to that assignment, Colonel Frese was Program Manager of a classified program for a period of approximately two years at the Electronic Systems Division, L. G. Hanscom Field, Bedford, Massachusetts. Two years prior to that Colonel Frese worked in the Contract Management Office which was exclusively concerned

with the monitorship and administration of the MITRE Contract. Colonel Frese attended training with industry in Industrial Planning and Procurement for one year at the Large Gas Turbine Division, General Electric Company, Evandale, Ohio.

Upon graduation from Flying School in 1944, Colonel Frese was assigned to the European Theater of Operation and flew 66 combat missions and was awarded the Air Medal with six Oak Leaf Clusters and the Presidential Unit Citation.

Colonel Frese was Assistant Professor of Air Science and Tactics, St. Louis University from 1949–1953. Upon completion of that assignment he was assigned to a flying job in Korea. Upon completion of the Korean tour, he was assigned to the Pentagon from 1955 through 1958.

Colonel Frese has a Bachelor of Science, Social Science from Washington University, St. Louis, Missouri and a Masters Degree in Business Administration (M.B.A.) from St. Louis University, St. Louis, Missouri.

KARL W. KABEISEMAN, DEFENSE SUPPLY AGENCY LEGAL MEMBER, ARMED SERVICES PROCUREMENT REGULATIONS COMMITTEE

Karl Kabeiseman was born in 1927 in South Dakota. After graduation from high school he served in the U.S. Army Infantry. He received his B.A. degree in 1950 and his LLB degree in 1952 from the University of South Dakota, graduating in the upper 15% of his class. While in college he was active in extracurricular activities, was a varsity debater for three years, and served as president of his legal fraternity.

He was admitted to the practice of law in South Dakota in 1952 and subsequently passed the examination for practice before the District Court and the Court of Appeals for the District of Columbia. He has also been admitted to practice before the United States Court of Claims and the Supreme Court of the United States. He is a member of the Federal Bar Association and was elected and served as President of the Pentagon Chapter. He is also a member of the American Bar Association.

In June 1952, he was appointed as an attorney adviser in the Office of the Quartermaster General, Department of the Army, and served as a member of an Operations Advisory Staff providing legal advice on procurement operations. He was progressively appointed to positions of greater responsibility, serving as legal adviser to procurement branch chiefs; as Counsel for General Supplies; as Office Branch Chief in charge of Fraud Investigations; and as Counsel for Anti-trust matters. In these positions he actively participated as a legal adviser in the wide range of Army procurement functions now reflected in Defense Supply Agency procurement operations.

On the basis of those nine years of procurement and procurement-related legal experience, he was detailed to the Defense Supply Agency Planning Staff in October 1961. He was selected as the Assistant Counsel, Fiscal and Manpower, and DSA Legislative Counsel, HQ DSA, in January 1962. In addition to his other duties, he has served from time to time as the HQ DSA legal adviser for contract administration services during the absence of the Assistant Counsel, CAS. He is a GS–15 and was appointed to the ASPR Committee on 20 November 1967.

CHARLES GOODWIN

Charles Goodwin, Navy Legal Member, Armed Services Procurement Committee since Nov., 1965; previously Navy Alternate Legal Member for two years. Born 1908, New York City, N.Y. Educated Brooklyn Boys High School; B.S. *cum laude* 1932, College of the City of New York; LL.B (honors) 1931, Brooklyn Law School. Employed Electrical Testing Laboratories, New York City, 1927–29. Admitted to bar, State of New York, 1932. Private General Practice and Assistant Secretary, Brooklyn Bar Association, 1932–1941. Member and Assistant Head, Research Unit, Lands Division, Department of Justice, 1941–1943. Service, U.S. Navy (Seaman-Lt. Cmdr.) 1943–1946. Assistant Counsel and Counsel, Bureau of Yards and Docks, Navy Department, 1947–1954. Assistant to General Counsel, Navy Department (GS–15), 1954 to date. Currently Professor of Law, Government Procurement Law, Catholic University Law School.

Publications: Government-Furnished Property, Government Contracts Monograph No. 6 (Geo. Wash. Univ. Law School, 1963). Editor, 1965 Supplement to Navy Contract Law (2d Ed. 1958)

Associations: Member, Federal Bar Association; member, Brooklyn Bar Association; Treasurer and Member of Board of Governors, Arts Club of Washington; Formerly Secretary, Lawyers Literary Club, Inc. (book club), now subsidiary of Houghton, Mifflin Co.

EDWARD C. COX

Mr. Edward C. Cox was born in Washington, D.C. on August 24, 1913. He received the degrees of Bachelor of Laws and Bachelor of Commercial Science from Columbus University (now the School of Law of Catholic University) Washington, D.C. in 1937 and 1941 respectively. He was admitted to the Bar in the District of Columbia in 1938. During World War II he served with the Army in the Philadelphia Ordnance District, Price Adjustment Board, as a financial analyst and legal advisor in matters under the Renegotiation Act.

After eight years in commercial banking Mr. Cox began his career in Government Service in 1941 with the Investigations Division of the General Accounting Office. His experience in the procurement field includes service with the Office of the Chief Signal Officer, the Atomic Energy Commission, and the Office of the Deputy Chief of Staff for Logistics. In this latter assignment, he served as Chief of the Contract Awards Section. Mr. Cox is presently employed in the Office of the Assistant Secretary of the Army (Installations and Logistics) as Chief, Procurement Policy Division and the Army Policy Member on the Armed Services Procurement Regulation Committee.

LEROY J. HAUGH

LeRoy J. Haugh, the Navy's Policy Member on the ASPR Committee, was born in Minnesota in 1925. He entered Navy civilian employment in the Bureau of Ships through the Junior Management Intern Program in June 1954. He remained with the Bureau of Ships five years as a Contract Specialist. In January 1960 he became a Staff Assistant for Procurement to the Assistant Secretary of the Navy (Material). On 1 August 1961 he was appointed to the ASPR Committee, and has served in that capacity to date with the exception of the year from August 1965 to August 1966 when he attended the resident course at the Industrial College of the Armed Forces.

Mr. Haugh has served two tours of active duty as a line officer in the U.S. Naval Reserve, 1944–46 and 1951–54, and joined the ranks of retired reservists in July 1966 after completing 22 years of service. He holds a B.A. degree in Political Science from College of St. Thomas, St. Paul, Minnesota; an LL.B. from Georgetown University Law School, Washington, D.C., and an MSBA from George Washington University, Washington, D.C. He is a member of the Bar in the District of Columbia and Virginia.

JOHN LANE, JR., AIR FORCE LEGAL MEMBER, ASPR COMMITTEE

John Lane, Jr., was born in New York City on September 8, 1940, and lived in Yonkers, New York from about 1943 until he came to Washington in 1965. He attended the College of the Holy Cross in Worcester, Massachusetts, with a mathematics major and a philosophy minor, graduating with a Bachelor of Arts degree in 1961. He then attended Fordham Law School in New York City. He received his LL.B. in 1964, and was admitted to the New York State Bar in December 1964 and the District of Columbia Bar in November 1967.

After law school he was associated with Sullivan & Cromwell, New York City, for seven months. Then in March 1965, he became associated with the Air Force General Counsel's Office, where he has specialized in Government contracts work; he is presently Air Force Legal Member of the DOD Armed Services Procurement Regulation Committee.

ROBERT LINTNER, DSA POLICY MEMBER, ARMED SERVICES PROCUREMENT REGULATION COMMITTEE

Robert Lintner, the Defense Supply Agency Policy Member on the ASPR Committee, was born in New Jersey in 1910. He attended Rutgers University during 1927 and 1928. In March of 1943 he accepted a position with the Food Distribution Organization of the United States Department of Agriculture.

In July of 1944 he was assigned to the United Nations Relief and Rehabilitation Administration where he participated in the management of agricultural rehabilitation programs, continuing with that agency until July of 1947. Mr. Lintner returned to private industry for the period from August 1947 until September 1948 at which time he accepted employment with the Office of the Quartermaster General, Department of the Army, as a procurement officer.

He remained with the Office of the Quartermaster General until January of 1962, progressing through various procurement assignments to the position of Assistant Chief of the Procurement Policy Branch. In November 1961 he was loaned by the Office of the Quartermaster General to the Defense Supply Planning Group for the purpose of developing a Defense Supply Agency procurement regulation. On 8 January 1962 he was appointed to the ASPR Committee and has served in that capacity to date.

Chairman PROXMIRE. Yesterday's testimony by the Comptroller General of the United States and his staff focused attention on the Truth in Negotiation Act, Public Law 87-653, and upon inventory management including Government-owned property in contractor's plants, as well as several other issues.

We have received copies of your statement and you may proceed with it as you choose after first identifying your associates for the record.

STATEMENT OF HON. THOMAS D. MORRIS, ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS); ACCOMPANIED BY PAUL H. RILEY, DEPUTY ASSISTANT SECRETARY (SUPPLY AND SERVICES); JOHN M. MALLOY, DEPUTY ASSISTANT SECRETARY (PROCUREMENT); GEN. A. T. STANWIX-HAY, DEPUTY ASSISTANT SECRETARY (MATERIEL); LT. GEN. EARL G. HEDLUND, DIRECTOR, DEFENSE SUPPLY AGENCY; G. G. MULLINS, DIRECTOR, CONTRACT SUPPORT SERVICES; DR. R. A. BROOKS, ASA (INSTALLATIONS AND LOGISTICS); ALSO PRESENT: ALBERT F. SANDERSON, DEPUTY CHIEF, MATERIALS POLICY DIVISION, NATIONAL RESOURCE ANALYSIS CENTER OEP; WILLIAM B. PETTY, DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

Mr. MORRIS. Thank you, Mr. Chairman.

Mr. Chairman, I am accompanied this morning on my right by Mr. Malloy, our Deputy Assistant Secretary for Procurement Policy. On my left, by the Honorable Robert Brooks, the Assistant Secretary of Army for Installations and Logistics. I have other associates who are with us this morning, and who may have occasion to comment.

Mr. Chairman and members of the committee, we welcome this opportunity to report to you on the progress which has been made, and that which we plan to accomplish during coming months, in the management of Defense procurement and supply programs. This statement will cover the specific subjects identified in your letter of November 8, 1967, in the following three areas:

A. Procurement management policies;

B. Supply management policies;

C. Contractor versus in-house methods of acquiring goods and services.

We are pleased to report that a number of important actions have been taken since our appearance before you last May, and that we have consulted frequently with Comptroller General Staats and his staff in developing these revised policies. While there are several matters on which final decisions have not been reached, all are being intensively examined and we will be pleased to keep you fully informed of our conclusions.

A. Procurement Policies

During the past 6½ years Defense procurement practices have undergone significant changes. In terms of volume alone we have experienced a 100-percent increase in number of actions (from 7.5 to 15.1 million since 1961), and an increase of 74 percent in dollar volume (from $25.6 to $44.6 billion). During this time frame there have been continuous efforts to introduce far stronger management controls and substantially greater incentives—with the goal of buying required equipment and supplies at the lowest sound price. We are dedicated to acting promptly and vigorously to eliminate inefficient procurement practices, and we thus welcome the spotlighting of such opportunities by congressional committees, the General Accounting Office, and our own internal audit and review staffs. As you so well appreciate, almost every purchase action represents a potential opportunity for either waste or improved buying, depending upon the soundness of our policies and the skill of our procurement personnel.

In your hearings earlier this year, you stressed particularly, the need for more precise rules governing competitive procurement, and for greater attention to the implementation of Public Law 87–653 (Truth in Negotiations Act). In addition, we believe you will be interested in our plans to improve small purchase procedures and in our progress with respect to more economical procurement of replenishment spare parts. I would like to comment briefly on each of these subjects.

1. PRICE COMPETITION

At the time of your hearings last May, GAO challenged three aspects of the longstanding definition of price competition. As a result, revised regulations were issued on August 18, 1967. These appear below as attachment A to this statement.

(The attachment follows:)

ATTACHMENT A

Memorandum for:

The Assistant Secretary of the Army (I. & L.).
The Assistant Secretary of the Navy (I. & L.).
The Assistant Secretary of the Air Force (I. & L.).
The Director, Defense Supply Agency.
The Director, Defense Communications Agency.
The Director, Defense Atomic Support Agency.

Subject: Reporting of procurement statistics on price competition.

We have reviewed the current rules for reporting competitive procurements following the recent GAO report and Congressional hearings which dealt with this subject. While the attention focused on our reporting of competition was primarily in the spare parts area, our review has encompassed the full spectrum of procurement.

The objective was to assure that our reporting rules accurately reflect the competition actually achieved.

We do not interpret either the GAO or Joint Economic Committee position as suggesting any change in our current reporting rules for formal advertising. With respect to negotiated procurements however, I have determined that statistical accuracy will be best attained by adoption of rules substantially as follows:

1. A contract shall be reported as price competitive if offers were solicited and received from at least two responsible offerors capable of satisfying the government's requirements wholly or partially and the award or awards were made to the offeror or offerors submitting the lowest evaluated prices. However, price competition may exist even though only one offer is received when the offers are solicited from at least two responsible offerors who normally contend for contracts for the same or similar items.

2. Procurements shall not be reported as competitive where only one responsive offer was received and the solicitation was restricted to a prime contractor and his vendor for that item.

3. Multiple awards in such areas as subsistence, clothing and equipage, and other commodities where several awards normally result from one solicitation may be recorded as competitive, even though the total quantity of the solicitation is not awarded, if in the judgment of the contracting officer there are sufficient facts to support a valid finding of price competition.

4. Transactions shall not be recorded as price competitive solely on the basis of the number of solicitations made. Contracting officers shall consider the content of the responses to solicitations, the procurement history of the items procured, and other relevant information and shall exercise sound judgment in the recording of transactions as competitive.

5. Purchase orders in amounts less than $250 shall be reported as noncompetitive. With regard to orders of $250 or over, but not exceeding $2,500, contracting officers shall determine on an individual transaction basis which actions should be recorded as competitive and which noncompetitive. However, where it is not economically feasible to do this, these actions will be recorded as noncompetitive.

These instructions shall become effective upon publication in a DPC, in approximately two weeks.

(Signed) PAUL R. IGNATIUS,
Assistant Secretary of Defense
(Installations and Logistics).

The questions raised by GAO were as follows:

(*a*) Is it proper to automatically classify "open market purchases of $2,500 or less within the United States" as price competitive? GAO found that there is no assurance in these very numerous transactions (approximately 8 million annually) that purchasing personnel are, in fact, obtaining two or more quotations. We agree with GAO and have issued regulations under which purchase orders in amounts less than $250 shall not be reported as competitive due to the costly paperwork involved in keeping track of each such transaction. With respect to orders of $250 or over, an individual determination will be made as to those transactions which are competitive and those which are not. Our statistics in the future will be based directly on these individual determinations. GAO has endorsed these revised reporting rules.

Chairman PROXMIRE. Why did you pick the $250 break-off point?

Mr. MORRIS. Due to the numerous actions, sir, of very small character falling under that amount—it did not seem worthy to try to keep account of these. And, of course, these purchases are frequently made in the customary fashion of taking oral quotations.

Chairman PROXMIRE. You say, in this statement, "We agree with GAO—in amounts less than $250 shall not be reported as competitive."

Mr. MORRIS. Yes, sir.

Chairman PROXMIRE. Will they be reported in the statistics at all?

Mr. MORRIS. They will be reported, sir, as noncompetitive.

Chairman PROXMIRE. What does that amount to in terms of dollars—proportionate procurement?

Mr. MORRIS. It is a relatively small amount, sir.

Chairman PROXMIRE. Two, three, four, five percent—that area?

Mr. MORRIS. No, sir. The total of all procurements $2,500 and under is 4 percent of our procurement dollars.

Chairman PROXMIRE. $250 would be maybe 1 percent?

Mr. MORRIS. It could be, sir, in that range.

Chairman PROXMIRE. I see. Very good.

Mr. MORRIS. Secondly, sir, is it proper to classify a transaction as competitive when only one responsive offer is received on solicitations restricted to the prime contractor and his vendor for that item? We agree with GAO and have revised our rules to provide that such procurement shall not be reported as price competitive in the future.

(*c*) Are there instances where valid price competition exists, even though only one offer is received? We have revised this rule to state that the vast majority of competitive procurements require the receipt of at least two responsive offers, but that valid competitive pressures may exist where offers are solicited from at least two responsible offers, who normally contend for contracts for the same or similar items. Each such instance must be fully documented if it is classified as competitive. GAO has also endorsed this revision.

During the May hearings a question was raised as to whether our former rules overstated the degree of improvement in price competition. I frankly do not believe this is the case. We began our major emphasis on improving price competition in the spring of calendar year 1961. The following table shows the progress which has been reported since that time:

[In percent]

Type of construction	Fiscal year 1961	Fiscal year 1967
Formally advertised	11.9	13.4
Small business and labor surplus area set-asides	3.9	4.5
Negotiated price competition	13.4	20.8
Open market purchases ($2,500 or less)	3.7	4.2
Total	32.9	42.9

In fiscal year 1961, $8.1 billion of contracts were awarded in the above categories. In fiscal year 1967, the total was $18.6 billion. If our fiscal year 1967 procurement volume of $43.4 billion—excluding intragovernmental—had been only 32.9 percent competitive (the fiscal year 1961 rate), the volume of purchases placed competitively would have been $14.3 billion, or $4.3 billion less than reported in fiscal year 1967.

We believe that if the new rules were in effect in 1961, both the fiscal year 1961 statistics *and* the fiscal year 1967 statistics would have been reduced by two or three percentage points. Thus, the same rate of improvement would result. In other words, the difference between 30 and 40 percent of awards placed under price competition would still generate about $4 billion more awards under price competitive meth-

ods during the period. We have consistently found in our studies that when price competition is introduced for the first time, a price reduction on the order of 25 percent results. Thus, we feel confident in concluding that the Government has saved substantial sums during this period because of the intensive efforts made at the urging of this committee, other Members of Congress and the GAO to obtain maximum price competition. I hope that you will continue to support our efforts and to find gratification in the results which have been achieved thus far.

2. PUBLIC LAW 87–653—TRUTH IN NEGOTIATIONS ACT

During our appearance on May 9, questions were raised regarding the GAO's January 1967 report which indicated that there had been inadequate documentation by Defense buyers and prime contractors of the cost or pricing data submitted in connection with negotiated contracts. We immediately began an intensive analysis of this matter and found that our field personnel had not, in fact, been documenting their actions to the degree of completeness required by the ASPR; and that considerable improvement in our training was essential. To overcome these problems, we have taken two steps:

(*a*) *Training.*—A comprehensive training film and seminar were developed to inform our personnel more fully. To date over 3,000 field procurement officials have attended the seminar. In addition, we developed, with the assistance of the GAO, a self-help kit containing a complete case example, with questions and answers. This has been distributed to 54,000 individuals, including 8,000 contractor personnel. We are laying major stress on the importance of full compliance with Public Law 87–653 in speeches of top-level DOD officials and through the activities of the Defense Contract Audit Agency and our procurement review teams. We would be pleased, Mr. Chairman, to furnish to the committee copies of the various training materials and the training film which are being employed.

Chairman PROXMIRE. Yes, we would like to have those—a transcript of the film and copies of the material.

Mr. MORSE. Fine, sir.

Department of Defense

Training Seminar

on

CERTIFIED COST OR PRICING DATA

and

PUBLIC LAW 87-653

SEPTEMBER 1967

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE

(INSTALLATIONS AND LOGISTICS)

SEMINAR ON COST OR PRICING DATA
AND PUBLIC LAW 87-653

9:00 - 9:05	Administrative Details - Host
9:05 - 9:15	Welcome - Host Director
9:15 - 9:30	Course Introduction - Instructor
9:30 - 10:00	Film - John M. Malloy, Deputy Assistant Secretary of Defense (Procurement)
10:00 - 10:15	Break
10:15 - 10:45	Inventory Examination
10:45 - 11:45	Lecture: Public Law 87-653 and Its ASPR Implementatior
11:45 - 12:15	Lecture: Contract Pricing Proposal - DD Form 633
12:15 - 1:15	Lunch
1:15 - 1:30	Read: Excerpt from GAO Report to Congress
1:30 - 2:00	Read and Discuss - Defense Procurement Circular #55
2:00 - 4:00	Case Discussion
4:00 - 4:30	Review and Discuss Inventory Examination

Public Law 87-653
87th Congress, H. R. 5532
September 10, 1962

An Act

76 STAT. 528.

To amend chapter 137, of title 10, United States Code, relating to procurement.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That title 10 of the United States Code is hereby amended as follows:

Armed Forces Procurement Act of 1947, amendment.
70A Stat. 128.

(a) Subsection 2304(a) is amended to read as follows:

"(a) Purchases of and contracts for property or services covered by this chapter shall be made by formal advertising in all cases in which the use of such method is feasible and practicable under the existing conditions and circumstances. If use of such method is not feasible and practicable, the head of an agency, subject to the requirements for determinations and findings in section 2310, may negotiate such a purchase or contract, if—".

(b) Subsection 2304(a)(14) is amended to read as follows:

"(14) the purchase or contract is for technical or special property that he determines to require a substantial initial investment or an extended period of preparation for manufacture, and for which he determines that formal advertising would be likely to result in additional cost to the Government by reason of duplication of investment or would result in duplication of necessary preparation which would unduly delay the procurement of the property;".

(c) Section 2304 is amended by adding a new subsection as follows:

"(g) In all negotiated procurements in excess of $2,500 in which rates or prices are not fixed by law or regulation and in which time of delivery will permit, proposals shall be solicited from the maximum number of qualified sources consistent with the nature and requirements of the supplies or services to be procured, and written or oral discussions shall be conducted with all responsible offerors who submit proposals within a competitive range, price, and other factors considered: *Provided, however*, That the requirements of this subsection with respect to written or oral discussions need not be applied to procurements in implementation of authorized set-aside programs or to procurements where it can be clearly demonstrated from the existence of adequate competition or accurate prior cost experience with the product, that acceptance of an initial proposal without discussion would result in fair and reasonable prices and where the request for proposals notifies all offerors of the possibility that award may be made without discussion."

(d) The second sentence of subsection 2306(a) is amended by substituting "(f)" for "(e)".

(e) Section 2306 is amended by adding a new subsection as follows:

"(f) A prime contractor or any subcontractor shall be required to submit cost or pricing data under the circumstances listed below, and shall be required to certify that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete and current—

"(1) Prior to the award of any negotiated prime contract under this title where the price is expected to exceed $100,000;

"(2) Prior to the pricing of any contract change or modification for which the price adjustment is expected to exceed $100,000, or such lesser amount as may be prescribed by the head of the agency;

"(3) Prior to the award of a subcontract at any tier, where the prime contractor and each higher tier subcontractor have been required to furnish such a certificate, if the price of such subcontract is expected to exceed $100,000; or

"(4) Prior to the pricing of any contract change or modification to a subcontract covered by (3) above, for which the price adjustment is expected to exceed $100,000, or such lesser amount as may be prescribed by the head of the agency.

"Any prime contract or change or modification thereto under which such certificate is required shall contain a provision that the price to the Government, including profit or fee, shall be adjusted to exclude any significant sums by which it may be determined by the head of the agency that such price was increased because the contractor or any subcontractor required to furnish such a certificate, furnished cost or pricing data which, as of a date agreed upon between the parties (which date shall be as close to the date of agreement on the negotiated price as is practicable), was inaccurate, incomplete, or noncurrent: *Provided*, That the requirements of this subsection need not be applied to contracts or subcontracts where the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, prices set by law or regulation or, in exceptional cases where the head of the agency determines that the requirements of this subsection may be waived and states in writing his reasons for such determination."

70A Stat. 132. (f) The first sentence of subsection 2310(b) is amended to read as follows:

"Each determination or decision under clauses (11)-(16) of section 72 Stat. 967. 2304(a), section 2306(c), or section 2307(c) of this title and a decision to negotiate contracts under clauses (2), (7), (8), (10), (12), or for property or supplies under clause (11) of section 2304(a), shall be based on a written finding by the person making the determination or decision, which finding shall set out facts and circumstances that (1) are clearly illustrative of the conditions described in clauses (11)-(16) of section 2304(a), (2) clearly indicate why the type of contract selected under section 2306(c) is likely to be less costly than any other type or that it is impracticable to obtain property or services of the kind or quality required except under such a contract, (3) clearly indicate why advance payments under section 2307(c) would be in the public interest, or (4) clearly and convincingly establish with respect to the use of clauses (2), (7), (8), (10), (12), and for property or supplies under clause (11) of section 2304(a), that formal advertising would not have been feasible and practicable."

70A Stat. 132. (g) Section 2311 is amended to read as follows:

"§ 2311. Delegation

"The head of an agency may delegate, subject to his direction, to any other officer or official of that agency, any power under this chapter except the power to make determinations and decisions under clauses (11)-(16) of section 2304(a) of this title. However, the power to make a determination or decision under section 2304(a)(11) of this title may be delegated to any other officer or official of that agency who is responsible for procurement, and only for contracts requiring the expenditure of not more than $100,000."

(h) The amendments made by this Act shall take effect on the first day of the third calendar month which begins after the date of enactment of this Act. Effective date.

Approved September 10, 1962.

"Certified Cost or Pricing Data and P. L. 87-653"

Mr. John M. Malloy
OSD- I&L
1 September 1967

Public Law 87-653 and the submission and certification of cost or pricing data for non-competitive price proposals is important to all of us involved in procurement.

First, I doubt that there are many other areas in procurement that have commanded our attention more than negotiating on the basis of cost or pricing data. This is an area where we have received public criticism of our implementation - or alleged lack of implementation - of Public Law 87-653, the so-called "Truth in Negotiations" Act. Here are a few examples from the Congress and the press. I quote from the Congressional Record.

". . .The Pentagon's lax administration of the Truth in Negotiations Act. . .is costing the taxpayers billions of dollars in overcharges on Defense Contracts."

"Public Law 87-653. . .is the taxpayer's only defense against the establishment of unreasonably high cost levels in negotiated contracts."

". . .A failure to enforce the 1962 Truth-in-Negotiations Act. . . resulting in taxpayers being overcharged millions and millions of dollars. The exact amount has not. . .and no doubt cannot. . .be measured."

"The Comptroller General has reported. . .there has been overpricing of more than $130 million during a 10-year period."

Now from the press:

"Defense Officials disagree with GAO regarding DOD implementation of Public Law 87-653."

"DOD to issue ASPR Revision clarifying requirements for submission and certification of cost or pricing data."

The $130 million reported by GAO is a substantial sum of money and we must - and we are - taking every action possible to eliminate any opportunity for defective pricing. I want to dispel any misunderstanding between our

primary objective of establishing fair and reasonable prices and the obligation of the contracting officer to require contractors to submit the cost or pricing data necessary to comply with Public Law 87-653.

Each year we obligate a tremendous sum of money on non-competitive buys - where cost or pricing data forms the basis for negotiating the price. During FY 1967 alone we obligated $22.8 billion without the benefit of competition. We have a compelling need, then, for cost or pricing data to accomplish our pricing responsibilities. We are also required to comply with Public Law 87-653.

The basic objective of all Government contracting is to obtain necessary supplies and services at fair and reasonable prices - calculated to result in the lowest overall cost to the Government. We meet this objective in two environments - price competitive buys and procurements where price competition is not possible.

Where competition is possible, we are concerned mainly with price. We rely on competition to establish the reasonableness of price and then make award to the lowest responsible bidder. Unfortunately, the majority of our requirements from the standpoint of dollars expended are of the types that cannot be competed. Therefore, we must use the various negotiation policies which apply and we are forced to evaluate price reasonableness by means of techniques we refer to as price analysis and cost analysis. Where competitive market forces are lacking or are inadequate to insure a reasonable pricing result, price analysis usually is not enough and we must have cost analysis.

What is cost analysis? It's the evaluation of factual cost or pricing data and those judgmental factors used to project price from this data. We conduct this evaluation to determine, as best we can, the probable costs of contract performance assuming reasonable economy and efficiency. To accomplish this evaluation we ask the contractor to submit a breakdown of his projected costs based on factual information, price trends, and other intelligence he used in the preparation of his proposed price.

Thus, cost analysis is based largely on evaluation of the contractor's own cost or pricing data - information produced by his own accounting and estimating systems. Obviously any price evaluated and negotiated on this basis can only be as good as the factual information furnished by the contractor.

In non-competitive situations we must have cost or pricing data from the contractor. The degree to which we analyze the information varies with our knowledge of the product we're buying and the contractor that we are considering. In many cases our knowledge of a contractor - through our auditors, engineers, administrative contracting officers - is such that we are almost as familiar with his operations as are his own people. In such a situation it is not necessary for our own negotiating team to completely review, each time, every element of that contractor's proposal.

This principle is expressed in the Armed Services Procurement Regulation which states in part, "Some form of price or cost analysis is required in connection with every negotiated procurement action. The method and degree of analysis, however, is dependent on the facts surrounding the particular procurement and pricing situation. Cost analysis shall be performed ... when cost or pricing data is required to be submitted under the conditions described in ASPR 3-807.3; however, the extent of the cost analysis should be that necessary to assure reasonableness of the pricing result, taking into consideration the amount of the proposed contract ..."

The requirement for the submission of cost or pricing data is as old as non-competitive negotiated procurement itself. For our purposes, we can start with the requirement in the first edition of ASPR issued in 1948 ... "Whenever supplies or services are to be procured by negotiation, price quotations, supported by statements and analyses of estimated costs or other evidence of reasonable prices and other vital matters deemed necessary by the contracting officer shall be solicited ..."

As the need for cost or pricing data continued, the ASPR in 1959 was revised to require all Departments to obtain a certificate of current pricing data for negotiated procurements in excess of $100,000. The certificate related to the fact that all available actual or estimated cost or pricing data had been considered in preparing the cost estimate and was made known to the contracting officer.

The next important event occured in 1961 when ASPR was amended to provide for the inclusion of a defective pricing data clause. The Government now had a contractual right to reduce the contract price in the event that it was later determined that the price was overstated because of defective cost or pricing data.

Despite the requirements of ASPR, there were adequate indications through reports of the Comptroller General that unreliable cost or pricing

data was being used in price negotiations. Due to Congressional concern, in 1962 Public Law 87-653 known as the "Truth in Negotiations Act" was enacted. ASPR was revised to include a new certificate and defective pricing data clause. In addition, for the first time a clause was provided to obtain an audit to determine the accuracy, currentness and completeness of the cost or pricing data which formed the basis of the contractor's proposal.

We have added, then, to our requirement for the submission of necessary cost or pricing data on non-competitive negotiated procurements, the requirement for "Certification," defective price recovery and audit rights to the proposal data.

Let's examine the law and our ASPR coverage on the subject to see what is now required.

The cost or pricing data requirements of the law are stated briefly and can be divided into five provisions:

The Law states that prime and subcontractors shall be required to submit cost or pricing data.

The Law further states that prime and subcontractors shall be required to certify that the cost or pricing data submitted are accurate, complete, and current.

The requirements for prime and subcontractor submission and certification of cost or pricing data is made applicable to awards or transactions expected to exceed $100,000.

Where certification is obtained, the law states that a provision for price reduction shall be contractually incorporated permitting adjustment of the established contract price to exclude any significant amounts by which the price was overstated because defective cost or pricing data were submitted.

Lastly, the law states that the requirements for submission and certification of cost or pricing data need not apply in cases where the price negotiated is based on adequate price competition established catalog or market prices of commercial items sold in substantial quantities to the general public, prices set by law or regulation, or in those special situations where a Secretarial waiver is obtained.

This is what the statute requires. Let's now review the more significant questions of implementation of Public Law 87-653 and attempt to summarize how ASPR accommodates them for us.

First, what is cost or pricing data and what is meant by the term "Accurate, complete and current"? To begin with, ASPR tells us that cost or pricing data is factual ... the kinds of information that can be verified for accuracy. While this includes the information upon which pricing judgments are based, the ASPR makes clear that it does not include the judgments themselves. This distinction between a judgment and a fact helps to clarify what is meant by "Accuracy." But what about the words "Complete" and "Current"? In this regard, ASPR states that the contractor's submission is complete if it includes all factual information that significantly affects price negotiations. Putting this another way, it means contractor submission of all facts that could contribute to sound estimates of future costs. ASPR further tells us that "Current" means all such facts as are reasonably available to the contractor up to the time of agreement on price.

In my opinion, the difference between getting data for good pricing and data to comply with this law has created a misunderstanding which I feel requires clarification.

In the past when we said all data, we meant all the data needed for arriving at a fair and reasonable price. Today, under Public Law 87-653, when we say all data, we mean the contractor will submit and will certify to all factual data which could have a significant effect on price negotiations.

Today there isn't any difference between securing cost or pricing data from the contractor for good pricing and full technical compliance with the "Truth in Negotiations Act." Under the requirements of this Law, the contractor must actually submit or specifically identify all significant factual data. From the data thus disclosed the negotiator, auditor and price analyst evaluate the data necessary to arrive at a fair price.

I believe that our negotiators, generally, seek to secure data as required. However, our documentation of this data apparently needs some improvement. The contractors submission should specifically identify his data, so that later there can be no question as to what data he submitted and certified. The negotiator should indicate clearly what data, if any, furnished by the contractor was not relied upon, and set forth what other data was relied upon in reaching agreement on price. This will permit a later judgment as to whether action should be initiated against the contractor under his certificate and the defective pricing clause. To do this, every procurement contracting officer must insist that the contractor:

1st. Actually submits or specifically identifies in writing factual data and estimated prices separately - this means completing the DD Form 633 correctly and submitting necessary supporting schedules.

2nd. Certifies the data are accurate, complete and current as of the date of agreement on price.

3rd. Accepts defective pricing, audit and subcontractor certification clauses in his contract.

Additionally the contracting officer must:

1st. Analyze the data which is needed to negotiate a fair and reasonable price.

2nd. After negotation require the contractor to certify that he has either actually submitted - or identified in writing - all significant factual data and that such data are accurate, complete and current as of the date of agreement on price.

3rd, Assure the appropriate clauses are included in the contract.

Last, Document the files to assure "trackability" - that is - that the data the contractor submitted and certified was or was not the data on which the conttacting officer relied in negotiation.

I've been discussing the cost or pricing data requirements of Public Law 87-653 and its ASPR implementation. Before closing, I want to emphasize the individual responsibility of the contracting officer for complying with these requirements.

It may seem obvious, but the first step is a complete understanding of what's expected. When you have the responsibility for contract price negotiations, then it's imperative that you be thoroughly conversant with the ASPR coverage in this area, including a detailed study of the DD Form 633. This form is an integral part of the coverage and makes clear that you are required to secure the cost or pricing data required by Public Law 87-653. Otherwise you must secure a Secretarial Waiver.

The contracting officer should make sure that the contractors he's dealing with appreciate and understand exactly what is required in terms of written submission or identification of supporting cost or pricing data. This should be done by personal contact and specific instructions in the RFQ. If you have any reason to anticipate a potential problem with a particular contractor, then the time to resolve it is now. This will avoid the delay which will occur in the event the contractor submits inadequate supporting data with his proposal. If you cannot communicate with the contractor at

your level, promptly refer it through your appropriate channels so that necessary action can be taken. In this regard, remember that you're dealing with statutory requirements. You either get the data or you get a Secretarial Waiver or neither you nor the contractor are complying with Public Law 87-653 and the ASPR.

Contract files must contain sufficient documentation to reflect clearly what cost or pricing data was submitted by the contractor throughout the negotiation process, including any revision or up-dating, and the extent to which you relied on other than contractor data. Of course, documentation was important before the passage of Public Law 87-653. Adequate supporting data always has been essential, and documenting our files to indicate exactly what we looked at and how we evaluated it is necessary to explain why we believe the price negotiated is a realistic one. However, the ASPR provisions implementing this law, including the new DD Form 633, recognized that documentation now has another important purpose - it facilitates our ability to adjust prices based on defective data.

Remember, it is the contractor who is required to submit or identify the required data. We expect you, the PCO, to assure that he has complied with the law.

The degree to which you assist the contractor in complying with these requirements has a natural and direct impact on the effectiveness of contractor certification and on the Government's rights under the defective pricing clause. The most obvious result of strict compliance with ASPR and Public Law 87-653 is good pricing, not a paperwork burden added at the end of a normal negotiating process. If the contractors cooperate by supplying the requisite DD Form 633 and supporting exhibits and identificatior - and I'm convinced that with your assistance they will - your evaluation of their proposals will be greatly facilitated.

If we do this, we will have all the data needed to negotiate good prices and we will comply fully with Public Law 87-653.

EXCERPT FROM
GAO REPORT TO
THE CONGRESS OF THE UNITED STATES

Need for Improving Administration of the Cost or Pricing Data
Requirements of Public Law 87-653
In the Award of Prime Contracts and Subcontracts
Department of Defense

* * * * * * * * * * * * * * * * * * *

Conclusions

The Department of Defense has recognized the desirability of obtaining certified cost or pricing data for negotiating fair and reasonable prices and for effecting price adjustment under the defective-pricing-data provisions of the contracts. Nevertheless, our review showed that agency procurement officials and prime contractors, in awarding a substantial number of prime contracts and subcontracts, did not obtain factual or verifiable cost or pricing data in support of cost estimates although required to do so by the procurement regulations implementing Public Law 87-653.

Although contracting officers and prime contractors generally obtained cost breakdowns and certificates of current cost or pricing data and included defective-pricing-data clauses in the contracts and subcontracts, the offerors were not required to submit a written identification of the source documents or other bases for significant cost elements included in their estimates. In some cases auditors and price analysts were able to seek out the supporting information during their prenegotiation reviews of the offerors' records; however, there was generally no authoritative record by the offerors of the data used by them to prepare and submit their estimates to contracting officials. Consequently, we could not determine to what data the contractors and subcontractors were certifying.

The law, in providing that prime contractors and subcontractors be required to submit certified cost or pricing data, in our opinion, did not intend that this requirement would be accomplished by having agency auditors and other representatives of the contracting officer seek out supporting cost or pricing data, while contractors submit and certify, in writing, only the estimated cost. Therefore, we believe it

desirable that ASPR be amended to provide that, where a prime contractor or any subcontractor is required to submit or identify, in writing, the cost or pricing data used by him in establishing the estimates, an authoritative record by the offeror be retained in the buyer's record of the negotiations.

Furthermore, many of the subcontracts that were awarded without submission of adequate cost or pricing data either were reviewed and approved by the administrative contracting officer prior to the award or were not required to be reviewed and approved since they were awarded by a contractor whose purchasing system had been previously approved by the contracting officer. We believe that this illustrates a need for a more extensive review by administrative contracting officers in order to ascertain whether the prime contractor is complying with the cost or pricing data requirements of ASPR.

We believe that a major step toward compliance with these cost or pricing data requirements could be achieved if the use of the new DD Form 633, Contract Pricing Proposal, and compliance with the instructions thereon by prime contractors and subcontractors were strictly enforced.

In addition, our review showed that the ASPR did not provide for contracting officer review and approval of subcontracts awarded under firm fixed-price prime contracts or second-tier subcontracts. We believe that, since the law requires that certified cost or pricing data be obtained from these subcontractors, some review of these awards should be made to determine whether prime contractors and subcontractors are complying with these requirements, and if not, what steps should be taken to obtain such compliance.

Also, our review showed that agency contracting officers and prime contractors did not sufficiently document their records to clearly explain why cost or pricing data were not obtained and explain the basis for determining that the negotiated prime contract or subcontract price resulted from or was based on adequate price competition or on established catalog or market prices of commercial items sold in substantial quantities to the general public. We believe that the requirement for documentation should be strictly enforced so that the record will clearly show the basis for the determination that cost or pricing data are not required and that such basis is consistent with prescribed Department of Defense policy.

DEPARTMENT OF DEFENSE
CONTRACT PRICING PROPOSAL

Form Approved
Budget Bureau No. 22-R100

This form is for use when submission of cost or pricing data *(see ASPR 3-807.3)* is required

PAGE NO. | NO. OF PAGES

NAME OF OFFEROR

HOME OFFICE ADDRESS

DIVISION(S) AND LOCATION(S) WHERE WORK IS TO BE PERFORMED

SUPPLIES AND/OR SERVICES TO BE FURNISHED

QUANTITY

TOTAL AMOUNT OF PROPOSAL
$

GOVT SOLICITATION NO.

COST ELEMENTS	PROPOSED CONTRACT ESTIMATE: TOTAL COST[1]	UNIT COST[2]	REFERENCE[3]
1. DIRECT MATERIAL[4] a. PURCHASED PARTS[5]			
1. DIRECT MATERIAL[4] b. SUBCONTRACTED ITEMS[6]			
1. DIRECT MATERIAL[4] c. OTHER MATERIAL (1) RAW MATERIAL[7]			
1. DIRECT MATERIAL[4] c. OTHER MATERIAL (2) STANDARD COMMERCIAL ITEMS[8]			
1. DIRECT MATERIAL[4] c. OTHER MATERIAL (3) INTERDIVISIONAL TRANSFERS (at other than cost)[9]			
2. MATERIAL OVERHEAD[10]			
3. INTERDIVISIONAL TRANSFERS AT COST[11]			
4. DIRECT ENGINEERING LABOR[12]			
5. ENGINEERING OVERHEAD[10]			
6. DIRECT MANUFACTURING LABOR[12]			
7. MANUFACTURING OVERHEAD[10]			
8. OTHER COSTS[13]			
9. *SUBTOTALS*			
10. GENERAL AND ADMINISTRATIVE EXPENSES[10]			
11. ROYALTIES[14]			
12. FEDERAL EXCISE TAX[15]			
13. *SUBTOTALS*			
14. PROFIT OR FEE			
15. TOTAL PRICE *(Amount)*			

1. HAVE THE DEPARTMENT OF DEFENSE, NATIONAL AERONAUTICS AND SPACE ADMINISTRATION, OR THE ATOMIC ENERGY COMMISSION PERFORMED ANY REVIEW OF YOUR ACCOUNTS OR RECORDS IN CONNECTION WITH ANY OTHER GOVERNMENT PRIME CONTRACT OR SUBCONTRACT WITHIN THE PAST TWELVE MONTHS?

☐ YES ☐ NO *IF YES, IDENTIFY.*

NAME AND ADDRESS OF REVIEWING OFFICE | TELEPHONE NUMBER

2. WILL YOU REQUIRE THE USE OF ANY GOVERNMENT PROPERTY IN THE PERFORMANCE OF THIS PROPOSED CONTRACT?

☐ YES ☐ NO *IF YES, IDENTIFY ON A SEPARATE PAGE.*

3. DO YOU REQUIRE GOVERNMENT CONTRACT FINANCING TO PERFORM THIS PROPOSED CONTRACT?

☐ YES ☐ NO *IF YES, IDENTIFY.* ☐ ADVANCE PAYMENTS ☐ PROGRESS PAYMENTS OR ☐ GUARANTEED LOANS

4. HAVE YOU BEEN AWARDED ANY CONTRACTS OR SUBCONTRACTS FOR SIMILAR ITEMS WITHIN THE PAST THREE YEARS?

☐ YES ☐ NO *IF YES, SHOW CUSTOMER(S) AND CONTRACT NUMBERS BELOW OR ON A SEPARATE PAGE.*

5. DOES THIS COST SUMMARY CONFORM WITH THE COST PRINCIPLES SET FORTH IN ASPR, SECTION XV *(see 3-807.3(c)(2))*?

☐ YES ☐ NO *IF NO, EXPLAIN ON A SEPARATE PAGE.*

This proposal is submitted for use in connection with and in response to _____

_____ * and reflects our best estimates as of this date, in accordance with the Instructions to Offerors and the Footnotes which follow.

**DESCRIBE RFP, ETC.*

TYPED NAME AND TITLE | SIGNATURE

NAME OF FIRM | DATE OF SUBMISSION

DD FORM 1 DEC 64 633 PREVIOUS EDITIONS ARE OBSOLETE

INSTRUCTIONS TO OFFERORS

1. The purpose of this form is to provide a standard format by which the offeror submits to the Government a summary of incurred and estimated costs *(and attached supporting information)* suitable for detailed review and analysis. Prior to the award of a contract resulting from this proposal the offeror shall, under the conditions stated in ASPR 3-807.3, be required to submit a Certificate of Current Cost or Pricing Data *(see ASPR 3-807.3(e) and 3-807.4)*.

2. As part of the specific information required by this form, the offeror must submit with this form, and clearly identify as such, cost or pricing data (that is, data which is verifiable and factual and as defined in ASPR 3-807.3(e). In addition, he must submit with this form any supporting schedules or substantiation which are reasonably required to explain this offeror's estimating process and to clearly identify:

a. The judgmental factors applied in projecting from known data to the estimate, and

b. The contingencies used by the offeror in his proposed price.

3. When attachment of supporting cost or pricing data to this form is impracticable, the data will be specifically identified and described (with schedules as appropriate), and made available to the contracting officer or his representative upon request.

4. The format and the prescribed cost breakdown are not intended as rigid requirements. With the approval of the contracting officer the data may be presented in another form if required for a more effective and efficient presentation of cost or pricing data.

5. By submission of this proposal the offeror if selected for negotiation grants to the Contracting Officer, or his authorized representative, the right to examine, for the purpose of verifying the cost or pricing data submitted, those books, records, documents and other supporting data which will permit adequate evaluation of such cost or pricing data, along with the computations and projections used therein. This right may be exercised in connection with any negotiations prior to contract award.

NOTE 1. Enter in this column those necessary and reasonable costs which in the judgment of the offeror will properly be incurred in the efficient performance of the contract. When any of the costs in this column have already been incurred *(e. g., on a letter contract or change order)*, describe them on an attached supporting schedule. When "pre-production" or "startup" costs are significant or when specifically requested in detail by the contracting officer, provide a full identification and explanation of same. Identify all sales and transfers between your plants, divisions, or organizations under a common control, which are included at other than the lower of cost to the original transferror or current market price.

NOTE 2. The use of this column is optional for multiple line item proposals, except where the contracting officer determines that a separate DD Form 633 is required for selected line items.

NOTE 3. Attach separate pages as necessary and identify in this column the attachment in which the information supporting the specific cost element may be found. No standard format is prescribed; however, the cost or pricing data must be accurate, complete and current, and the judgment factors used in projecting from the data to the estimates must be stated in sufficient detail to enable the Contracting Officer to evaluate the proposal. For example, provide the basis used for pricing the bill of materials such as by vendor quotations, shop estimates, or invoice prices; the reason for use of overhead rates which depart significantly from experienced rates *(reduced volume, a planned major rearrangement, etc.)*; or justification for an increase in labor rates *(anticipated wage and salary increases, etc.)* Identify and explain any contingencies which are included in the proposed price, such as anticipated costs of rejects and defective work, anticipated costs of engineering redesign and retesting, or anticipated technical difficulties in designing high-risk components.

NOTE 4. Provide a list of principal items within each category of material indicating known or anticipated source, quantity, unit price, competition obtained, and basis of establishing source and reasonableness of cost.

NOTE 5. Include material for the proposed contract other than material described in the other footnotes under the cost element entitled "Direct Material."

NOTE 6. Include parts, components, assemblies, and services to be produced or performed by other than you in accordance with your designs, specifications, or directions and applicable only to the prime contract.

NOTE 7. Include raw and processed material for the proposed contract in a form or state which requires further processing.

NOTE 8. Include standard commercial items normally fabricated in whole or in part by you which are generally stocked in inventory. Provide explanation for inclusion at other than the lower of cost or current market price.

NOTE 9. Include all materials sold or transferred between your plants, divisions or organizations under a common control at other than cost to the original transferror and provide explanation of pricing method used.

NOTE 10. Provide the method of computation and application of your overhead expense, including cost breakdown, and showing trends and budgetary data as necessary to provide a basis for evaluation of the reasonableness of proposed rates.

NOTE 11. Include separate breakdown of costs.

NOTE 12. Provide a separate breakdown of labor by job category and furnish basis for cost estimates.

NOTE 13. Include all other estimated costs *(e.g., special tooling, facilities, special test equipment, special plant rearrangement, preservation packaging and packing, spoilage and rework, and warranty)* which are not otherwise included. Identify separately each category of cost and provide supporting details. If the proposal is based on a F.O.B. destination price, indicate separately all outbound transportation costs included in total amount.

NOTE 14. If the total cost entered here is in excess of $250, provide on a separate page *(or on DD Form 783, Royalty Report)* the following information on each separate item of royalty or license fee: name and address of licensor; date of license agreement; patent numbers, patent application serial numbers, or other basis on which the royalty is payable; brief description, including any part or model numbers of each contract item or component on which the royalty is payable; percentage or dollar rate of royalty per unit; unit price of contract item; number of units; and total dollar amount of royalties. In addition, if specifically requested by the contracting officer, a copy of the current license agreement and identification of applicable claims of specific patents shall be provided.

NOTE 15. Selling price must include any applicable Federal excise tax on finished articles.

3-807.2 Requirement for Price or Cost Analysis

(a) General. Some form of price or cost analysis is required in connection with every negotiated procurement action. The method and degree of analysis, however, is dependent on the facts surrounding the particular procurement and pricing situation. Cost analysis shall be performed in accordance with (c) below when cost or pricing data is required to be submitted under the conditions described in 3-807.3; however, the extent of the cost analysis should be that necessary to assure reasonableness of the pricing result, taking into consideration the amount of the proposed contract and the cost and time needed to accumulate the necessary data for analysis. Price analysis shall be used in all other instances to determine the reasonableness of the proposed contract price. Price analysis may also be useful in corroborating the overall reasonableness of a proposed price where the determination of reasonableness was developed through cost analysis.

* *

(c) Cost Analysis

(1) Cost analysis is the review and evaluation of a contractor's cost or pricing data (see 3-807.3) and of the judgmental factors applied in projecting from the data to the estimated costs, in order to form an opinion on the degree to which the contractor's proposed costs represent what performance of the contract should cost, assuming reasonable economy and efficiency. It includes the appropriate verification of cost data, the evaluation of specific elements of costs (see 16-206), and the projection of these data to determine the effect on prices of such factors as:

(i) the necessity for certain costs,
(ii) the reasonableness of amounts estimated for the necessary costs,
(iii) allowances for contingencies,
(iv) the basis used for allocation of overhead costs; and
(v) the appropriateness of allocations of particular overhead costs to the proposed contract.

NOTE: ASPR 3-807.3 requires the contractor to submit cost or pricing data in compliance with P. L. 87-653.

PROPOSED ASPR REVISION

3-807.3 Cost or Pricing Data

(a) The contracting officer shall require the contractor to submit, either actually or by specific identification in writing, cost or pricing data in accordance with 16-206 and to certify, by use of the certificate set forth in 3-807.4, that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete, and current prior to:

(i) the award of any negotiated contract expected to exceed $100,000 in amount;

(ii) any contract modification expected to exceed $100,000 in amount to any formally advertised or negotiated contract whether or not cost or pricing data was required in connection with the initial pricing of the contract;

(iii) the award of any negotiated contract not expected to exceed $100,000 in amount or any contract modification not expected to exceed $100,000 in amount to any formally advertised or negotiated contract whether or not cost or pricing data was required in connection with the initial pricing of the contract, provided the contracting officer considers that the circumstances warrant such action in accordance with (d) below;

unless the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. The requirements under (i) and (ii) above may be waived in exceptional cases where the Secretary (or, in the case of a contract with a foreign government or agency thereof, the Head of a Procuring Activity) authorizes such waiver and states in writing his reasons for such determination. Whenever a Certificate of Current Cost or Pricing Data is required, the applicable clause in 7-104.29 shall be included in the contract, and the appropriate clauses in 7-104.41 and 7-104.42 shall be used if required in accordance with these paragraphs.

(b) Any contractor who has been required to submit and certify cost or pricing data in accordance with (a) above shall also be required to obtain cost or pricing data from his subcontractors under the circumstances set forth in the appropriate clause in 7-104.42.

(c) When there is adequate price competition, cost or pricing data shall not be requested regardless of the dollar amount involved. As a general rule, cost or pricing data should not be requested when it has been determined that proposed prices are, or are based on, established catalog or market prices of commercial items sold in substantial quantities to the general public. Where, however, despite the willingness of a number of commercial purchasers to buy an item at such a catalog or market price, the purchaser (*e.g.*, the contracting officer) finds that that price is not reasonable and supports such finding by an enumeration of the facts upon which it is based, cost or pricing data may be requested if necessary to establish a reasonable price; *provided*, that such find-

ing is approved at a level above the contracting officer. In addition, cost or pricing data may be requested, if necessary, where there is such a disparity between the quantity being procured and the quantity for which there is such a catalog or market price that pricing cannot reasonably be accomplished by comparing the two. Where an item is substantially similar to a commercial item for which there is an established catalog or market price at which substantial quantities are sold to the general public, but the offered price of the former is *not* considered to be "based on" the price of the latter in accordance with 3-807.1(b)(2), any requirement for cost or pricing data should be limited to that pertaining to the differences between the items if this limitation is consistent with assuring reasonableness of pricing result.

(d) Certified cost or pricing data shall not be requested prior to the award of any contract anticipated to be for $10,000 or less and generally should not be requested for modifications in those amounts. There should be relatively few instances where certified cost or pricing data and the inclusion of defective pricing clauses would be justified in awards between $10,000 and $100,000. In most such awards, the administrative costs will outweigh the benefits which might otherwise accrue from receipt of certified cost or pricing data; hence all other means of determining reasonableness of price should be utilized. When less than complete cost analysis (e.g. analysis of only specific factors) will provide a reasonable pricing result (see 3-807.2(a)) on awards under $100,000 without the submission of complete cost or pricing data, the contracting officer shall request, without certification, only that data which he considers adequate to support the limited extent of the cost analysis required.

(e) "Cost or pricing data" as used in this Part consists of all facts existing up to the time of agreement on price which might affect the price negotiations. The definition of cost or pricing data embraces more than historical accounting data; it also includes, where applicable, such factors as vendor quotations, nonrecurring costs, changes in production methods and production or procurement volume, unit cost trends such as those associated with labor efficiency, and make-or-buy decisions or any other management decisions which could reasonably be expected to have a significant bearing on costs under the proposed contracts. In short, cost or pricing data consists of all facts which can reasonably be expected to contribute to sound estimates of future costs as well as to the validity of costs already incurred. Cost or pricing data, being factual, is that type of information which can be verified. Because the contractor's certificate pertains to "cost or pricing data," it does not make representations as to the accuracy of the contractor's judgment on the estimated portion of future costs or projections. It does, however, apply to the data upon which the contractor's judgment is based. This distinction between fact and judgment should be clearly understood.

(f) The requirement for submission of cost or pricing data is met when all accurate cost or pricing data reasonably available to the contractor at the time of agreement on price is submitted, either actually or by specific

identification, in writing to the contracting officer or his representative. The distinction between the "submission" of cost or pricing data and the "making available" of records should be clearly understood. The mere availability of books, records and other documents for verification purposes does not constitute submission of cost or pricing data.

3-807.4 Certificate of Current Cost or Pricing Data. When certification of cost or pricing data is required in accordance with 3-807.3, a certificate in the form set forth below shall be included in the contract file along with the memorandum of the negotiation. The contractor shall be required to submit only one certificate which shall be submitted as soon as practicable after agreement is reached on the contract price.

CERTIFICATE OF CURRENT COST OR PRICING DATA (OCT. 1964)

This is to certify that, to the best of my knowledge and belief, cost or pricing data as defined in ASPR 3-807.3(e) submitted, either actually or by specific identification in writing (see ASPR 3-807.3(f)), to the Contracting Officer or his representative in support of _____ * are accurate, complete, and current as of the data of execution of this certificate.

Firm _____
Name _____
Title _____

_____ **
Date of Execution

* Describe the proposal, quotation, request for price adjustment or other submission involved, giving appropriate identifying number (e.g., RFP No. _____).

** As a general rule, this date should be the date when the price negotiations were concluded and the contract price was agreed to. The responsibility of the contractor is not limited by the personal knowledge of the contractor's negotiator if the contractor had reasonably available (see ASPR 3-807.5(a)) at the time of the agreement information showing that the negotiated price is not based on accurate, complete, and current data.

3-807.4 Defective Cost or Pricing Data.

(a) Where any price to the Government must be negotiated largely on the basis of cost or pricing data submitted by the contractor, it is essential that the data be accurate, complete and current and in appropriate cases so certified by the contractor (see 3-807.3 and 3-807.4). If an agreed price includes amounts which can only be attributed to erroneous or incomplete cost or pricing data, it is not a fair price and the resultant profits are not earned profits. Where negotiations are to be conducted on the basis of full disclosure, failure of one party to proceed on that basis undercuts full mutual assent to the price negotiated so that, in this sense, the price is not fully agreed to, and fairness warrants its adjustment. If such certified cost or pricing data is subsequently found to be inaccurate, incomplete or non-current, the Government is entitled to an adjustment of the negotiated price, including profit or fee, to exclude any significant sum by which the price was increased because of the defective data. The clauses set forth in 7-104.29 are designed to give the Government in such a case an enforceable contract right to a price adjustment, that is, to a reduction in the price to what it would have been if the contractor had submitted accurate, complete and current data. In arriving at a price adjustment under a clause, the contracting officer should, after review of the record of the contract negotiation (see 3-811), consider the following:

(1) The time when cost or pricing data was reasonably available to the contractor. Certain data such as overhead expenses and production records may not be reasonably available except on normal periodic closing dates. Also, the data on numerous minor material items may be reasonably available only as of a cut-off date prior to agreement on price because the volume of transactions would make the use of any later date impracticable. Furthermore, except where a single item is used in substantial quantity, the net effect of any changes to the prices of such minor items would likely be insignificant. Notwithstanding the foregoing, significant matters, such as changes in the labor base or in the prices of major material items, are important to contractor management and to the Government, and the related data would be expected to be current on the date of agreement on price and therefore will be treated as reasonably available as of that date.

(2) In establishing that the defective data caused an increase in the contract price, the contracting officer is not expected to reconstruct the negotiation or to speculate on what would have been the mental attitudes of the negotiating parties if the correct data had been submitted at the time of agreement on price. The natural and probable consequence of defective data is an increase in the contract price in the amount of the defect plus related burden and profit or fee; therefore, unless there is a clear indication that the defective data was not used, or was not relied upon, the contract price should be reduced in that amount.

(3) As a general rule, understated cost or pricing data shall not be "set off" against overstated cost or pricing data in arriving at a price adjustment. However, an exception to the general rule may be warranted where the overstated data is so inextricably interconnected with understated data that it would be impractical to consider the one without considering the other. For example, if an overhead account had been overstated by reason of a failure to use the most recent available quarterly figures, the consequent downward price adjustment should be based on the net change in the total overhead account, including both the "minus" and "plus" elements. However, the contract price shall be adjusted only if the net adjustment is downward.

(b) If at any time prior to agreement on price the contracting officer learns through audit or otherwise that any cost or pricing data submitted is inaccurate, incomplete or non-current, he shall immediately call it to the attention of the contractor. Thereafter, the contracting officer shall negotiate on the basis of any new data submitted, or on a basis which in his opinion makes satisfactory allowance for the incorrect data as he considers appropriate and shall reflect these facts in his record of negotiation.

(c) If after award the contracting officer obtains information which leads him to believe that the data furnished may not have been accurate, complete, or current, he should request an audit.

16-206.2 DD Form 633 (Contract Pricing Proposal) or one of the special forms authorized in 16-206.3 shall be used whenever contractor or subcontractor cost or pricing data (see 3-807.3(e)) is required; provided, however, that the "Cost Elements" and the "Proposed Contract Estimate" may be presented in a different format, acceptable to the contracting officer, where the contractor's accounting system makes the use of the prescribed format impracticable or when required for a more effective and efficient presentation of cost or pricing information, and provided further that in such cases a signed DD Form 633 or one of the special forms is required to be submitted and fully accomplished as to all items except that the "Cost Elements" and the "Proposed Contract Estimate" may be accomplished by making reference to the contractor's format.

DD Form 633

Question 3: Delete.

Question 6: Delete.

Instruction 2: Change to read as follows:

As part of the specific information required by this form, the offeror must submit with this form, and clearly identify as such, cost or pricing data (that is, data which is verifiable and factual and otherwise as defined in ASPR 3-807.3(e)). In addition, he must submit with this form any supporting schedules or substantiation which are reasonably required to explain this offeror's estimating process and to clearly identify:

a. the judgmental factors applied in projecting from known data to the estimate, and

b. the contingencies used by the offeror in his proposed price.

Instruction 3: Change to read as follows:

When attachment of supporting cost or pricing data to this form is impracticable, the data will be specifically identified and described (with schedules as appropriate), and made available to the Contracting Officer or his representative upon request.

Instruction 4: Change to read as follows:

The formats for the "Cost Elements" and the "Proposed Contract Estimate" are not intended as rigid requirements. With the approval of the Contracting Officer, these may be presented in different format if required for more effective and efficient presentation. In all other respects this form will be completed and submitted without change.

Instruction 5: In the first sentence, after the word "offeror," add the following: ", if selected for negotiation,".

3–810 Exchange of Information. In appropriate cases it is desirable to exchange and coordinate specialized information regarding a contractor between Military Departments, bureaus, technical services, and other procuring activities since it will provide uniformity of treatment of major issues and it may aid in the resolution of particularly difficult or controversial issues.

3–811 Record of Price Negotiation.

(a) At the conclusion of each negotiation of an initial or a revised price, the contracting officer shall promptly prepare or cause to be prepared, a memorandum, setting forth the principal elements of the price negotiation, for inclusion in the contract file and for the use of any reviewing authorities. The memorandum shall be in sufficient detail to reflect the most significant considerations controlling the establishment of the initial or revised price. The memorandum should include an explanation of why cost or pricing data was, or was not, required (see 3–807) and, if it was not required in the case of any price negotiation in excess of $100,000, a statement of the basis for determining that the price resulted from or was based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. If cost or pricing data was submitted and a certificate of cost or pricing data was required (3–807.4), the memorandum shall reflect the reliance placed upon the factual cost or pricing data submitted and the use of this data by the contracting officer in determining his total price objective. Where the total price negotiated differs significantly from the total price objective, the memorandum shall explain this difference. The memorandum shall also reflect the extent to which the Contracting Officer recognized in the negotiation that any cost or pricing data submitted by the contractor was inaccurate, incomplete, or non-current; the action taken by the Contracting Officer and the contractor as a result; and the effect, if any, of such defective data on the total price negotiated. Whenever cost or pricing data are used in connection with a price negotiation in excess of $100,000, the contracting officer shall forward one copy of the memorandum to the cognizant Defense Contract Audit Agency officer—for use by the auditor to improve the usefulness of his audit work and related reports to negotiation officials. Where appropriate, the memorandum should include or be supplemented by information on how the auditor's advisory services can be made more effetcive in future negotiations with the contractor. In those cases where a copy is forwarded to the auditor, a copy will also be furnished to the ACO.

(b) As part of the requirement in (a) above, determination of the profit or fee objective, in accordance with 3–808, shall be fully documented. Since the profit objective is the contracting officer's pre-negotiation evaluation of the total estimated profit under the proposed contract, the amounts set forth for each category of cost will probably change in the course of negotiation. Furthermore, the negotiated profit will probably vary from the profit objective, and from a detailed application of the weighted guidelines method to each element of the Contractor's Input to Total Performance as anticipated prior to negotiation. Since the profit objective is viewed as a whole rather than as its component parts, insignificant variations from the pre-negotiation profit objective, as a result of changes of the Contractor's Input to Total Performance need not be documented in detail. Conversely, significant deviations from the profit objective necessary to reach a final agreement on profit or fee shall be explained. The profit earned as a result of contract performance will generally vary from that anticipated at the time of the negotiation.

ITEM I -- CONTRACTOR SUBMISSIONS OF COST OR PRICING DATA

The following series of questions and answers were developed for use in DoD procurement training courses. They deal with the proper use of the DD Form 633 in the preparation of pricing proposals and particularly with submission and identification of the contractor's cost or pricing data. The material is reproduced here for the information and guidance of all procurement personnel involved in price negotiations.

QUESTION. Why is so much attention placed on the use of the current DD Form 633? The form is basically a price breakdown, which does not appear to be any different from the old pricing form which we used for many years or for that matter, from proposals received on contractors' own forms.

ANSWER. The DD Form 633 was revised in December 1964 as a part of a general revision of the ASPR implementation of P. L. 87-653, the "Truth in Negotiations" Act. The form is a pricing form, i. e., it covers more than the bare P. L. 87-653 requirements. It contains instructions and guidance which are essential to sound pricing and which are not contained elsewhere in the ASPR. We placed this information on the form itself because it relates specifically to the contractor's cost breakdown and submission. Consequently, it is essential that the approved DD Form 633 (or one of the related dash models) be used. A reproduction of the front side only or a contractor form which does not contain the instructions, footnotes and other data are not acceptable.

QUESTION. What significance attaches to the Instructions and Footnotes on the reverse of the DD Form 633? My contractor reproduces the form and omits this portion.

ANSWER. The Instructions and Footnotes to the DD Form 633 are the most important part of the form. They were designed specifically for good price and cost analysis, to enable you to do a better pricing job, and to be responsive to the requirements of P. L. 87-653. The quality of the contractor's submission and hence your price will depend on both of you understanding clearly the requirements of the Instructions and Footnotes. If you haven't read them lately, do so now.

QUESTION. Are contractors required to use DD Form 633 in view of the exception mentioned in Instruction 4 to that form?

ANSWER. Instruction 4 was intended to permit the use of the contractor's own format for listing his estimated costs and proposed price, because we recognized that no standard format would fit every accounting and estimating system. We did not intend this to mean that the balance of the DD Form 633 should be ignored. We propose to make this clear by changing ASPR to require a signed DD Form 633 in all instances, even though the contractor's format is substituted for the cost elements and proposed contract estimate portion of the standard form.

QUESTION. What is the significance of the "Reference" column on the DD Form 633?

ANSWER. This column was included to provide you with a "road map," i.e., with the specific identification of the detail supporting the estimated cost element. This detail must be presented in such a manner that the factual data can be identified apart from the judgmental factors and estimates.

QUESTION. Should a contractor furnish a "reference column" when using his own format?

ANSWER. Yes, but the reference column is merely the tool which enables you to find what you are looking for. The important thing is that the contractor make it clear what factual basis, i.e., cost or pricing data, his estimates rest on. In addition, he must show the factors which will tie his estimated costs to the factual base.

QUESTION. Why the emphasis on contractor identification of historical data? I have always relied on the audit report for support in this area.

ANSWER. You will still rely on the audit report but in two ways: first, as a tool to verify contractor furnished data, rather than the principal means of obtaining that data; and second, for commenting where appropriate on data not provided as a part of the contractor's submission. You must remember that it is the contractor, not the auditor, who will certify to the data. You must, therefore, have a clear picture of what the contractor is furnishing and certifying to.

QUESTION. My contractor says that compliance with DD Form 633 will require a "truckload" of data to be submitted with each proposal. What is your reaction to this?

ANSWER. This is nonsense. We are receiving many proposals which are adequate in every respect and these are not voluminous. Strict compliance with the DD Form 633 places an exacting requirement on the contractor. If he does an adequate job of identifying the factual data used to support his estimate, the evaluation job of our technical and audit people will be effective despite the volume of records from which the basic source data was drawn.

QUESTION. Won't this emphasis on specific identification of data delay procurement actions?

ANSWER. This is a possibility if you are forced to return unsatisfactory proposals for reprocessing. If a proposal is properly prepared, it should speed up your procurements. Every one -- auditors, price analysts, technical specialists and you yourself -- will be able to make more effective use of the data because of the better visibility.

QUESTION. What if my contractor refuses to submit in accordance with the ASPR as reflected by this model?

ANSWER. Most, if not all, contractors want to submit their proposals correctly. They look for you to inform them of any deficiencies. If you have a contractor who appears to be wilfully submitting inadequate data or failing to give you the identification you need to trace the data to his estimate, you should return his proposal for reprocessing. Obviously, this will require good judgment as you do not want to delay any critical procurements. If in doubt, discuss with your supervisor.

QUESTION. What is all this emphasis on precise cost data identification doing to pricing? Are we now expected to agree on elements of cost?

ANSWER. No! The purpose of P. L. 87-653, the ASPR implementation and DD Form 633 is to improve pricing, not degrade it. You are already reviewing cost analyses and audits which deal with elements of cost. The contractor's proposal is made up of estimates by cost elements. What we are trying to do is improve your understanding of those estimates. After you understand the cost base, you are expected to negotiate as you have in the past, i. e., price, not costs. For refreshing your memory on total price negotiation see OASD (I&L) letter of 17 December 1964, which was published in DPC 22. The policy

stated in this letter is still in effect and will not be affected by any of the requirements of the DD Form 633 as reflected here.

QUESTION. Have you any examples of good submissions that we can use for training our people and for the education of our contractors?

ANSWER. Yes. We are attaching an actual submission with only the contractor's name and other identifying characteristics disguised, e. g., the item, unit costs and total amounts. It is, of course, a simple proposal, but it illustrates the method very well. Each submission may require more or less detail dependent upon the procurement situation. We consider this a good proposal that substantially meets the requirements of P. L. 87-653. However, there are three areas where even this proposal could be improved; e. g., (1) Schedule A - Raw Material Costs - should identify base for raw material requirements, i. e., production experience under present contracts, etc.; (2) contractors' reference to pro-rata share of indirect selling expense in item 10 could be improved by explanation of how he actually pro-rates the expense, and (3) references to "past experience" (items 6B, 8C, D and G) should be explained by dates and type of experience and its relation to current procurement.

DEPARTMENT OF DEFENSE
CONTRACT PRICING PROPOSAL

Form Approved
Budget Bureau No. 22-R100

This form is for use when submission of cost or pricing data *(see ASPR 3-807.3)* is required

PAGE NO. 1 | NO. OF PAGES 8

NAME OF OFFEROR: Doe Corporation	SUPPLIES AND/OR SERVICES TO BE FURNISHED: Product X
HOME OFFICE ADDRESS: Washington, D. C.	QUANTITY: 2,000,000 lbs. / TOTAL AMOUNT OF PROPOSAL: $704,500
DIVISION(S) AND LOCATION(S) WHERE WORK IS TO BE PERFORMED: New York Division	GOVT SOLICITATION NO.: RFP XYZ-1

COST ELEMENTS	PROPOSED CONTRACT ESTIMATE — TOTAL COST[1]	UNIT COST[2] (per 100 lb.)	REFERENCE[3]
1. DIRECT MATERIAL[4] — a. PURCHASED PARTS[5]			
1. DIRECT MATERIAL[4] — b. SUBCONTRACTED ITEMS[6]			
1. DIRECT MATERIAL[4] — c. OTHER MATERIAL — (1) RAW MATERIAL[7]	260,000	13.00	Schedule A Schedule A1
1. DIRECT MATERIAL[4] — c. OTHER MATERIAL — (2) STANDARD COMMERCIAL ITEMS[8]	25,000	1.25	Schedule A Schedule A1
1. DIRECT MATERIAL[4] — c. OTHER MATERIAL — (3) INTERDIVISIONAL TRANSFERS (at other than cost)[9]			
2. MATERIAL OVERHEAD[10]			
3. INTERDIVISIONAL TRANSFERS AT COST[11]			
4. DIRECT ENGINEERING LABOR[12]			
5. ENGINEERING OVERHEAD[10]			
6. DIRECT MANUFACTURING LABOR[12]	48,580	2.43	Schedule B
7. MANUFACTURING OVERHEAD[10]	55,400	2.77	Schedule B
8. OTHER COSTS[13]	126,215	6.31	Schedule B
9. SUBTOTALS	515,195	25.76	
10. GENERAL AND ADMINISTRATIVE EXPENSES[10]	80,600	4.03	Schedule B
11. ROYALTIES[14] Process Improvement & Research	5,000	.25	Schedule B
12. FEDERAL EXCISE TAX[15]			
13. SUBTOTALS	600,795	30.04	
14. PROFIT OR FEE	103,705	5.18	
15. TOTAL PRICE (Amount)	704,500	35.22	Schedule B

1. HAVE THE DEPARTMENT OF DEFENSE, NATIONAL AERONAUTICS AND SPACE ADMINISTRATION, OR THE ATOMIC ENERGY COMMISSION PERFORMED ANY REVIEW OF YOUR ACCOUNTS OR RECORDS IN CONNECTION WITH ANY OTHER GOVERNMENT PRIME CONTRACT OR SUBCONTRACT WITHIN THE PAST TWELVE MONTHS?
☒ YES ☐ NO *IF YES, IDENTIFY.* AF 00(000)-7890

NAME AND ADDRESS OF REVIEWING OFFICE: Defense Contract Admin. Service Region, N.Y., N.Y.
TELEPHONE NUMBER: SP 7-4200

2. WILL YOU REQUIRE THE USE OF ANY GOVERNMENT PROPERTY IN THE PERFORMANCE OF THIS PROPOSED CONTRACT?
☐ YES ☒ NO *IF YES, IDENTIFY ON A SEPARATE PAGE.*

3. DO THE AMOUNTS SHOWN ON THIS FORM INCLUDE *(i)* ANY CHARGE FOR PROPERTY WHICH DUPLICATES ANY CHARGE AGAINST ANY OTHER PRIOR OR CURRENT GOVERNMENT CONTRACT OR SUBCONTRACT OR *(ii)* ANY RENTAL OR USE CHARGE ON GOVERNMENT PROPERTY?
☐ YES ☒ NO *IF YES, JUSTIFY ON SEPARATE PAGE.*

4. DO YOU REQUIRE GOVERNMENT CONTRACT FINANCING TO PERFORM THIS PROPOSED CONTRACT?
☐ YES ☒ NO *IF YES, IDENTIFY.* ☐ ADVANCE PAYMENTS ☐ PROGRESS PAYMENTS *OR* ☐ GUARANTEED LOANS

5. HAVE YOU BEEN AWARDED ANY CONTRACTS OR SUBCONTRACTS FOR SIMILAR ITEMS WITHIN THE PAST THREE YEARS?
☒ YES ☐ NO *IF YES, SHOW CUSTOMER(S) AND CONTRACT NUMBERS BELOW OR ON A SEPARATE PAGE.*
Schedule C

6. DO THE AMOUNTS SHOWN ON THIS FORM INCLUDE ANY CHARGE FOR OVERTIME PREMIUMS OTHER THAN OVERTIME OF THE TYPES DESCRIBED IN ASPR 12-102.5?
☐ YES ☒ NO *IF YES, EXPLAIN ON A SEPARATE PAGE.*

7. DOES THIS COST SUMMARY CONFORM WITH THE COST PRINCIPLES SET FORTH IN ASPR, SECTION XV *(see 3-807.2(c)(3))*?
☒ YES ☐ NO *IF NO, EXPLAIN ON A SEPARATE PAGE.*

This proposal is submitted for use in connection with and in response to RFP XYZ-1

* and reflects our best estimates as of this date, in accordance with the Instructions to Offerors and the Footnotes which follow.

*DESCRIBE RFP, ETC.

TYPED NAME AND TITLE: John Doe, President	SIGNATURE: John Doe
NAME OF FIRM: Doe Corporation, N. Y. Division	DATE OF SUBMISSION: June 10, 1967

DD, FORM DEC 64 633 — PREVIOUS EDITIONS ARE OBSOLETE

INSTRUCTIONS TO OFFERORS

1. The purpose of this form is to provide a standard format by which the offeror submits to the Government a summary of incurred and estimated costs *(and attached supporting information)* suitable for detailed review and analysis. Prior to the award of a contract resulting from this proposal the offeror shall, under the conditions stated in ASPR 3-807.3, be required to submit a Certificate of Current Cost or Pricing Data *(see ASPR 3-807.3(e) and 3-807.4)*.

2. In addition to the specific information required by this form, the offeror is expected, in good faith, to incorporate in and submit with this form any additional data, supporting schedules, or substantiation which are reasonably required for the conduct of an appropriate review and analysis in the light of the specific facts of this procurement. For effective negotiations, it is essential that there be a clear understanding of -

   a. The existing, verifiable data

   b. The judgmental factors applied in projecting from known data to the estimate, and

   c. The contingencies used by the offeror in his proposed price.

In short, the offeror's estimating process itself needs to be disclosed.

3. When attachment of supporting cost or pricing data to this form is impracticable, the data will be described *(with schedules as appropriate)*, and made available to the contracting officer or his representative upon request.

4. The format and the prescribed cost breakdown are not intended as rigid requirements. With the approval of the contracting officer the data may be presented in another form if required for a more effective and efficient presentation of cost or pricing data.

5. By submission of this proposal the offeror grants to the Contracting Officer, or his authorized representative, the right to examine, for the purpose of verifying the cost or pricing data submitted, those books, records, documents and other supporting data which will permit adequate evaluation of such cost or pricing data, along with the computations and projections used therein. This right may be exercised in connection with any negotiations prior to contract award.

NOTE 1. Enter in this column those necessary and reasonable costs which in the judgment of the offeror will properly be incurred in the efficient performance of the contract. When any of the costs in this column have already been incurred *(e. g., on a letter contract or change order)*, describe them on an attached supporting schedule. When "pre-production" or "startup" costs are significant or when specifically requested in detail by the contracting officer, provide a full identification and explanation of same. Identify all sales and transfers between your plants, divisions, or organizations under a common control, which are included at other than the lower of cost to the original transferror or current market price.

NOTE 2. The use of this column is optional for multiple line item proposals, except where the contracting officer determines that a separate DD Form 633 is required for selected line items.

NOTE 3. Attach separate pages as necessary and identify in this column the attachment in which the information supporting the specific cost element may be found. No standard format is prescribed; however, the cost or pricing data must be accurate, complete and current, and the judgment factors used in projecting from the data to the estimates must be stated in sufficient detail to enable the Contracting Officer to evaluate the proposal. For example, provide the basis used for pricing the bill of materials such as by vendor quotations, shop estimates, or invoice prices; the reason for use of overhead rates which depart significantly from experienced rates *(reduced volume, a planned major rearrangement, etc.)*; or justification for an increase in labor rates *(anticipated wage and salary increases, etc.)* Identify and explain any contingencies which are included in the proposed price, such as anticipated costs of rejects and defective work, anticipated costs of engineering redesign and retesting, or anticipated technical difficulties in designing high-risk components.

NOTE 4. Provide a list of principal items within each category of material indicating known or anticipated source, quantity, unit price, competition obtained, and basis of establishing source and reasonableness of cost.

NOTE 5. Include material for the proposed contract other than material described in the other footnotes under the cost element entitled "Direct Material."

NOTE 6. Include parts, components, assemblies, and services to be produced or performed by other than you in accordance with your designs, specifications, or directions and applicable only to the prime contract.

NOTE 7. Include raw and processed material for the proposed contract in a form or state which requires further processing.

NOTE 8. Include standard commercial items normally fabricated in whole or in part by you which are generally stocked in inventory. Provide explanation for inclusion at other than the lower of cost or current market price.

NOTE 9. Include all materials sold or transferred between your plants, divisions or organizations under a common control at other than cost to the original transferror and provide explanation of pricing method used.

NOTE 10. Provide the method of computation and application of your overhead expense, including cost breakdown, and showing trends and budgetary data as necessary to provide a basis for evaluation of the reasonableness of proposed rates.

NOTE 11. Include separate breakdown of costs.

NOTE 12. Provide a separate breakdown of labor by job category and furnish basis for cost estimates.

NOTE 13. Include all other estimated costs *(e.g., special tooling, facilities, special test equipment, special plant rearrangement, preservation packaging and packing, spoilage and rework, and warranty)* which are not otherwise included. Identify separately each category of cost and provide supporting details. If the proposal is based on a F.O.B. destination price, indicate separately all outbound transportation costs included in total amount.

NOTE 14. If the total cost entered here is in excess of $250, provide on a separate page *(or on DD Form 783, Royalty Report)* the following information on each separate item of royalty or license fee: name and address of licensor; date of license agreement; patent numbers, patent application serial numbers, or other basis on which the royalty is payable; brief description, including any part or model numbers of each contract item or component on which the royalty is payable; percentage or dollar rate of royalty per unit; unit price of contract item; number of units; and total dollar amount of royalties. In addition, if specifically requested by the contracting officer, a copy of the current license agreement and identification of applicable claims of specific patents shall be provided.

NOTE 15. Selling price must include any applicable Federal excise tax on finished articles.

Defense Procurement Circular #55

Page 2

Schedule A

PRODUCT X
Raw Material Costs
Items 1(1) and 1(2)

Raw Materials	Yield Usage Unit	Quantity (lbs.)	Price	Amount
Material A	.70	1,000,000	.10	100,000
Material B	.60	800,000	.09	72,000
Material C	.45	600,000	.08	48,000
Material D	.50	400,000	.07	28,000
Material E.	.50	200,000	.06	12,000
Total				260,000
Cost per lb. of Product X (260,000 ÷ 2,000,000 lbs.)				13.00 C lb.
Standard Commercial Items				
Material F	.50	500,000	.05	25,000
Cost per lb. of Product X (25,000 ÷ 2,000,000 lbs.)				1.25 C lb.

Yield Usage Unit Factors based on actual experience (average last six months) on first two contracts listed on Schedule C.

Schedule A1

Item 1(1) and 1(2)

Explanation of Raw Material Prices

1. Material A is purchased under contract from M Co. and N Co. at $.10/pound delivered to New York. This procurement was competitively bid with 4 suppliers, and contracts at this price are effective January 1, 1966, and have been renegotiated at the same price for 1967.

2. Material B is purchased under an escalation contract from J Co. The proposal requires a monthly consumption rate of 60-70,000 lbs. at a cost of $.09/lb. Competitive bids were obtained prior to contract award. The contract runs from 2/64 to 6/68.

3. Material C is purchased from K Co. and P Co. at $.08/lb. delivered to New York.

4. Material D is purchased from L Co. at $.067/lb. Freight from _____ is $.003/lb. for a total delivered price of $.07/lb.

5. Material E is purchased under an escalation contract from H Co. The proposal requires a monthly consumption rate of 15-20,000 lbs. at a cost of $.06/lb.

6. Material F was derived from the July 4 issue of Oil, Paint and Drug Reporter. This was $.048/lb. Freight, with _____ as the equalizing point, is $.002/lb. This is to be supplied by Doe. Doe will purchase quantities in excess of those quantities required under this contract for use or sale in its overall operations.

GENERAL COST INFORMATION

Production costs for the Proposed Contract were assembled on the basis of producing at a rate of 3,000,000 lbs. of Product X for the 12-month period from October 1, 1966 to September 30, 1967, at an average monthly rate of 250,000 lbs. Unit costs developed at a production rate of 3,000,000 lbs. per year were then applied to the quantity in the Proposed Contract (2,000,000 lbs.) to determine the dollar of costs in this bid. The Contractor uses a standard cost system of accounting.

Item 6. Direct Manufacturing Labor

A. Operating Labor.

Seven first-class operators at 40 hours per week plus 7% overtime allowance, based on standard plant operating practices.

October 1, 1966 to May 31, 1967	-	$3.00 per hour
June 1, 1967 to September 30, 1967	-	$3.10 per hour
Average (incl. overtime and shift)	-	$3.03 per hour

These rates are based on current union contract and include shift differentials. 2080 X 7 = 15,579 X $3.03 = $47,204 - $3,115 (leave = $44,089 X 2/3 = $29,390. (Leave including holiday, sick, etc. based on actual 6/1/66-5/31/67 @ 147 hours per man.)

B. Maintenance and Yard Labor.

These costs were based on estimated hours of services required at the 1966 standard rate developed for these services. Hours of service required are based on past experience for the time period and production volume involved, overtime and shift included.

Maintenance - $5.00 per hour - 5,000 hrs. = 25,000 - 115 (leave) X 2/3 = $16,590.
Yard - 4.00 per hour - 1,000 " = 4,000 - 100 (leave) X 2/3 = $ 2,600.
(Leave represents estimated casual leave for contract period.)

Direct manufacturing labor for the production contract is as follows:

Operating Labor	$29,390	
Maintenance	16,590	
Yard	2,600	
Total	$48,580	(2,000,000 lb.)
Unit Cost	2.43	- C lb.

Item 7. Manufacturing Overhead

Manufacturing overhead is apportioned to all products produced at the New York plant, using total cost of production (not including other costs) of all products as the basis, and total Plant Overhead as the pool to be distributed. The 1965 actual overhead rate of 16.6% was used in this proposal.

The manufacturing overhead for this production contract amounts to $55,400, at a unit cost of 2.77 - C lb.

Item 8. Other Costs

A. Payroll Added Costs
These costs are based on a standard rate of 24% for hourly operating labor and 16% for salaried supervisory labor to cover the costs of FICA, Unemployment Taxes, Pension and Retirement Plans, Hospitalization, Workmen's Compensation, Insurance, Vacations, Holidays, variance, etc.

B. Supervisory Labor
Includes one supervisor at an annual salary of $11,000.

C. Lab Service
These costs were based on estimated hours of service required at the 1966 standard rate developed for these services. Hours of service required are based on past experience for the time period and production volume involved. The standard rate is $8.00 - 1,000 hours.

D. Maintenance and Operating Supplies
Estimated usage of these supplies is based on past experience. They are charged to production, as used, at our actual purchase price for each individual item. Costs also include outside contract maintenance for painting and other preventative and maintenance work.

E. Equipment Rental
Includes rental of a control panel at an annual rental of $2,544.

F. Taxes, Insurance and Depreciation
Taxes and Insurance are charged to product costs on the basis of asset values. Since the Product X plant is fully depreciated, the only depreciation charge to Product X is a proportionate share of the depreciation for utility and general service facilities as shown in the depreciation ledger used for income tax purposes.

G. Power, Water, Steam and Air

Usage of these utilities is based on past experience for the time period and production volume involved. They are charged to all product costs, as used, at the standard cost rate (1966 standard was used for this estimate) or at our actual purchase price as follows:

Power	-	$.01 per KWH - .8 KWH per lb. Product X
Water	-	.10 per 1000 gal. - 30 gal. per lb. Product X
Steam and Air	-	.80 per 1000 lbs. - 20 lbs. per lb. Product X

H. Drumming

Drum cost is $.0245 per lb. Product X
Drumming labor is $.0033 per lb. Product X
Total Cost is $.0278 per lb. Product X
Proposed Contract includes 120,000 lbs. Product X in drums

The summary of Other Costs is as follows:

		REFERENCE
Payroll Added Costs	$8,240	A
Supervisory Labor	7,395	B
Lab Service	5,400	C
Travel Expense	200	(Estimated)
Maintenance Supplies	23,190	D
Operating Supplies	5,400	D
Medical Expense	130	(Estimated)
Equipment Rental	1,800	E
Taxes, Insurance & Depreciation	14,390	F
Power	15,990	G
Water	6,595	G
Steam and Air	33,385	G
Shipping	800	(Estimated)
Drumming	3,300	H
Total	$126,215	
Unit Cost	6.15 - C lb.	(1,850,000 lb.)
Unit Cost	8.35 - C lb.	(150,000 lb.)
Average	6.31 - C lb.	(2,000,000 lb.)

Item 10. General and Administrative Expense

A. Contract Administrative and Technical Service

Based on time and effort devoted to the Product X government contract business, contract administrative and technical service consists of a pro

rate share of these direct costs. It also includes technical assistance to manufacturing operations performed by Contractor's Research and Technical Center. Also included is a pro rata share of the New York Division's indirect selling expense which is developed by using a formula that has been audited by the government and included in all previous Product X bids. 2/3 of the estimated amount of $58,050 has been included in this proposal.

B. General and Administrative Expense

This expense is determined by using a formula that has been audited by the government and included in all previous Product X bids. Essentially, the formula spreads G&A expense pools on a Cost of Sales basis to all segments of the New York Division and Chicago Division operations. Unaudited 1965 actual G&A rate of 8.13% was used in this proposal.

G&A expense is included as follows:

Contract Administration & Technical Service		$38,700
General Administrative		41,900
	Total	$80,600
	Unit Cost	4.03 - C lb.

Item 11. Process Improvement and Research

This consists of process improvements and characterizations (measurement of physical and chemical properties) of Product X to be performed by Contractor's Research Center. Annual expenditures for this item have ranged from $50,000 to %5,000 over the past several years. This Proposal includes $5,000 at a unit cost of .25.

Item 15. Total Price

The contract proposal price is calculated as follows:

1,850,000 lbs.	Bulk at $.35/lb.	$647,500
150,000 lbs.	Drummed at $.38/lb.	57,000
	Total	$704,500
	Average Unit Price	35.22 - C lb.

Attachment to DD Form 633 dated 15 July 1966

Contract No.	Procuring Agency
AF 00(000) - 0123	Middletown Air Materiel Area, AFIC
AF 00(000) - 0456	Same
AF 00(000) - 0789	Same

9 August 1967

MEMORANDUM

SUBJECT: ASBCA Decisions on Defective Cost or Pricing Data

AMERICAN BOSCH ARMA CORPORATION

65-2 BCA paragraph 5280; December 17, 1965

This case arose under ASPR provisions antedating P. L. 87-653. The Board held:

(1) Having disclosed pricing data on purchased parts pursuant to RFP with knowledge that data would be used by Government in negotiating price, and having entered into negotiations with knowledge that it would be required to certify that it had disclosed complete, accurate and current pricing data, the company was under a duty to assure that the data furnished or disclosed to the Government was reasonably current at the time the contract price was negotiated.

(2) Pricing data from vendor quotations dated subsequent to one month prior to negotiations were not reasonably available for the negotiations.

(3) Anything that could be found from examination of records which were made available to Air Force auditors who examined them during audit and reported the results of their examination to the negotiating team was disclosed to the Government.

(4) Pricing data is "significant" if it would have any significant effect for its intended purpose, which was as an aid in negotiating a fair and reasonable price. Significance cannot be determined as a percentage of the total price.

(5) The absence of understanding or agreement on the amount of materials costs in negotiation of a total price does not operate to defeat the effectiveness of the Price Reduction clause.

(6) The Government has the burden of proof and the effect of nondisclosure of pricing data cannot be determined on the basis of speculation.

(7) In the absence of any more specific evidence tending to show what effect the nondisclosure of pricing data had on the negotiated price, we should adopt the natural and probable consequence of the nondisclosure as representing its effect. The record shows the Government relied on and utilized the pricing data submitted by the company.

FMC CORPORATION

66-1 BCA paragraph 5483; March 31, 1966

The Board held:

(1) The method of negotiation--agreement on total price or agreement on subsidiary cost--is immaterial.

(2) The method of negotiation may become significant in determining whether the Government did in fact rely upon the data furnished or would have relied upon absent data in reaching agreement on price.

(3) Continuation of previously unsuccessful experimentation on manufacturing methods does not constitute cost and pricing data which should have been disclosed in negotiations. Such experimentation should particularly not be included when negotiations look to a firm fixed price contract.

(4) Significance of data is equivalent to its capability of being used for its intended purpose.

(5) Data not disclosed was not significant because it would not have any practicable effect on negotiation of either the price or contract type.

DEFENSE ELECTRONICS, INC.

66-1 BCA paragraph 5604, May 24, 1966

The Board held:

(1) For the Government to have any valid claims, it must be established (i) that the contractor furnished inaccurate, incomplete or non-current pricing data, (ii) that the inaccurate, incomplete

or non-current pricing data caused the price to be increased, and (iii) the dollar amount by which the price was increased as a result thereof. The Government has the burden of proving every element in the chain of proof necessary to substantiate its claim.

(2) When the contractor made data available to the auditor for his use in auditing the proposal, that was sufficient furnishing of data, and the contractor was under no obligation to furnish to the contracting officer personally data not requested by him which had already been made available to the auditor and which had been used and referred to in the audit report.

(3) A clear distinction is drawn beteen "fact" and "judgement."

(4) While the company failed to disclose significant pricing data, the Government has not sustained the burden of proving that the non-disclosure caused any increase in price.

LOCKHEED AIRCRAFT CORPORATION

67-1 BCA paragraph 6356; May 18, 1967

The Board held:

(1) The subcontractor should have disclosed that in excess of 90 percent of the materials needed had already been purchased and significant reductions in material costs were experienced. The gesture allegedly made that all records were available was practically meaningless absent any inkling that such specific significant data was in reality present and available. In American Bosch Arma there was actual disclosure as the auditor in fact physically examined the records and reported the results of the examination. In this appeal the Government auditors did not physically examine the purchase orders and the pricing data made available was not complete or current.

(2) The Government is bound by its examination of the limited records because there was disclosure to that extent.

(3) With only 3 percent of labor cost incurred, the historical or factual data regarding the labor rate is too minimal as a basis for a violation of the clause. The rate advanced by the subcontractor was projective and was not nor intended to be factual in nature.

(4) "Offsetting" cost items were only remotely related to the material costs in issue. The equitable reduction permitted under the clause is intended to cover solely the cost items concerning which the pricing data was defective. To permit unrelated offsets would be tantamount to repricing the entire contract.

CUTLER-HAMMER, INC.

ASBCA No. 10900; June 28, 1967

The Board held:

(1) Offsetting omissions in material pricing, in no instances due to the improper extrapolation of quantities to Bill of Materials which was responsible for the overstatement of quantities, are not available for offset. P. L. 87-653 was intended solely as a vehicle for recoupment by the Government of over-pricing.

(2) A significantly lower bid from an unproven vendor, not disclosed to the Government was far from being data upon which a firm price reduction would have been reached; but this information was significant from the standpoint of over-all contract negotiation.

(3) The burden on the Government of proving the causal relationship between significant, nondisclosed, pricing data and the resulting price reduction is not intended to be an unreasonably heavy one.

TRUTH IN NEGOTIATION

CASE EXAMPLES

Background

On January 3, 1965, the Albert Scurloc Corporation quoted a price of $1,000,000 to the Government for 100 navigation radars. This included quotations for proposed subcontracts with Tyler-Bachman, Inc. (for antennas at a price of $150,000) and with Sigmund Gerber Company (for scopes at a price of $65,000).

On February 15, 1965, a firm fixed price of $955,000 was agreed on and a Certificate of Current Cost or Pricing Data furnished.

On March 15, 1965, Scurloc Corporation signed the contract which was executed by the Government on March 20, 1965.

Exercise 1

On April 15, 1965, Scurloc Corporation negotiated a firm fixed price subcontract with Tyler-Bachman, Inc., for $135,000 based on certified cost and pricing data. The subcontract contained the Price Reduction for Defective Cost and Pricing Data and Audit and Records clauses.

Upon later audit, the data Tyler-Bachman, Inc., submitted was found to contain an error of $10,000 due to the use of incorrect forecast rates resulting in a price reduction of $11,000 in the price of that subcontract.

> Discuss Scurloc Corporation obligations under its prime contract and the effect on its profits of the reductions of $15,000 due to subcontract negotiation and $11,000 due to adjustment of the subcontract for defective data.

Exercise 2

On February 25th, Scurloc Corporation negotiated a firm fixed price subcontract with Sigmund Gerber Company for $60,000.

> Discuss Scurloc Corporation obligations and the effect on its profits of the reduction of $5,000 due to negotiation of the price of this subcontract.

On November 1, 1965, Albert Scurloc Corporation quoted a price to the Government of $1,800,000 for 100 Navigation Radars. On November 15, 1965 Albert Scurloc Corporation completed a V.E. study applicable to commercial and military work. The V.E. study resulted in a patentable manufacturing process. If applied to the contract under negotiation it would reduce costs by $350,000, but a change in contract specifications would be required.

On January 4, 1966 agreement was reached on a fixed price incentive contract as follows:

Target Cost:	$1,550,000
Profit	155,000
Total	$1,705,000
Maximum Price:	$1,850,000
Incentive Sharing:	80/20 Ratio

Albert Scurloc Corporation signed the contract March 10 and the Government executed it March 15th.

Exercise 1

Upon completion of the contract, the audit report stated that defective pricing was indicated; Albert Scurloc had completed the V.E. study before the prices were negotiated. Projected savings of $350,000 might have accrued to the Government if the Contracting Officer had been informed. Accordingly, the target cost should be reduced to $1,200,000 and the target profit correspondingly reduced.

Please discuss.

Exercise 2

Assume the same facts as above in all respects except that the new process developed under the V.E. study did not require a change in contract specifications. After receipt of the contract, Albert Scurloc Corporation decided to use the new process during performance, reduce the cost by the estimated amount, and claimed $70,000 additional

incentive profit. The auditor on the other hand claimed that there was defective pricing; hence the target cost should be reduced by $350,000 and the target profit reduced by $35,000.

Please discuss.

Exercise 3

Would your answer be any different if the V.E. study were completed on January 5, 1966, instead of November 15, 1965?

Please discuss.

WHIZ COMPANY

FACTS

On May 20, 1966, the Whiz Company received a request for a rush proposal for 60 widgets. The proposal was submitted on May 31. In response to the RFP an exhibit was attached to the proposal setting forth in detail the prices and sources for all major material items--a total of 75 items comprising 72 percent of the total Bill of Materials containing some 2000 items. Negotiations were conducted September 7 - 10. The Certificate of Current Cost or Pricing Data was signed on September 10, and a FPI contract in the total amount of $2,100,000.00 was awarded on September 25.

The audit review of the proposal was conducted on June 10 - 17. In support of the material estimate the company gave the auditor the complete purchase files on the 2000 items. The Auditor refused the file and asked that a file pertaining only to the 75 major items be prepared, stating that he was limiting his review to the 75 major items in the exhibit in order to expedite submission of the report. In his review, the auditor found that there were many lower quotations received by the company following submission of the proposal to the Government. His audit report documented recommended adjustments amounting to a total of $250,000.

The negotiations were conducted on a total price basis. Although there was no understanding or agreement on the amount of materials cost being reached between the Government and Whiz, the negotiation report prepared by the Government buyer stated that a reduction of $250,000 had been negotiated in material costs.

In an audit following completion of the contract, the auditor examined the material costs in detail and he found several items of interest which had not previously been made known to the Government:

(a) There was one revised quotation which had been in the file he had examined in the initial pricing audit, but which he had somehow overlooked. This quotation showed that the recommended reduction in the material price for the 75 major items should have been $285,000 and not $250,000.

(b) There were many quotations received by Whiz prior to the negotiations, all offering lower prices on the balance of the material items which he had not examined in the initial pricing review. The total reduction reflected in these quotations was $15,000.

(c) There were three quotations offering further reductions in three of the 75 major material items he had examined. These had been received after the initial pricing audit and two days before the negotiations. The total of these adjustments was $18,500.

(d) There was one quotation offering a reduction in price on another of the 75 major material items he had examined. This had been received on the day following execution of the Certificate. The total reduction in this quotation was $12,000.

(e) There was another quotation offering a reduction in price on the most costly of the 75 major material items he had examined. This had been received on the day following award of the contract. The total of this adjustment was $27,000.

When the results of this audit were discussed with Whiz management, the President pointed out that all of the records had

been available to the auditor throughout the period and that the price negotiations had resulted in a final price some $500,000 less than its proposal.

PROBLEM

Is defective pricing indicated by this review, and to what extent?

MARBLE INC.

FACTS

In his audit of costs incurred on a $4,000,000 FPI contract for 233 gidgets, the auditor drew the Contracting Officer's attention to four items which he thought might require action under the contract clause Price Reduction For Defective Cost or Pricing Data.

The first item arose out of the fact that the cost data submitted by the company for use in negotiating prices had inadvertently overstated the average unit costs of production under an existing contract for the gidgets. In determining the average unit costs incurred on the earlier contract, the proposal manager for Marble had accidently divided the production costs for units shipped, on hand and in production only by the number of units shipped, thereby overstating the unit costs. The units omitted represented all undelivered gidgets on hand or in production. As a result of the faulty method of computing unit costs, prices on the contract were excessive by about $500,000.

The second item was that the actual factory labor rate on the contract was $2.97, and not $3.20 per hour as projected in the company's proposal. The auditor reminded the contracting officer that in his report on the initial pricing audit he had recommended that a rate no higher than $2.95 per hour was indicated. Further, he had pointed out that Marble consistently over-priced its labor rates. Lastly, he reminded the Contracting Officer that the memorandum of negotiations clearly stated the CO's continuing disagreement with the proposed rate of $3.20, but that the company was adament in its refusal to agree that any lower rate was proper. The indicated overpricing on this item was $50,470 (219,437 actual hours x $0.23/hour).

The third item involved an entry on the bill of materials of a major part which had been replaced and which should have been deleted from the bill. Even the company had not been aware that this part was not needed; the part had been ordered and received, had no scrap value and could not be returned. While the company had not earned any "excessive profits" as a consequence of this error, the facts were that the error had cost the Government $116,500 plus G&A and profit--a total of $137,000.

The fourth item was a clerical error in transcribing the cost of packaging materials. This error was only $6,250 in total amount and represented less than 2/10th of 1 percent of the total contract price. The auditor suggested that this amount could hardly be called a "significant sum," but that it might warrant consideration in view of all the other items he had uncovered.

PROBLEM

Is defective pricing indicated?

RP INDUSTRIES

The pricing data utilized in negotiating the price of a firm fixed-price contract awarded to RP Industries included the following:

	Total Cost Including G&A
Part No. 12-524 Buy	$600,000
Part No. 20-300 Make	300,000

After award of the contract it was ascertained that RP management did not buy Part No. 12-524, but decided to make it in-house, thereby resulting in savings of $150,000 below the best available buy cost. RP also found that the facilities required for manufacture of Part No. 20-300 were the same as required for Part No. 12-524, and it had no choice but to buy Part No. 20-300 at a total price of $375,000 (compared to make-costs of $300,000). Total net savings to RP were $75,000.

The auditor found that RP's plans to make Part No. 12-524 were in preparation prior to negotiation of the contract. There was no pre-contract "buy" data on Part No. 20-300 and it does not appear that RP recognized the facilities problem at that time since there was no mention of it in the Part No. 12-524 back-up papers.

PROBLEMS

1. Do these facts support a case for apparent defective pricing?

2. Is the prime contract price defective to the extent of $150,000 or $75,000?

HI-MISSILE CORPORATION

FACTS

Schnozzles Co. (subcontractor), submitted its price proposal for 1300 specialized nozzles to Hi-Missile Corporation (CPIF prime contractor) on August 8, 1962. Prior thereto, the subcontractor had produced 74 of these nozzles, under a cost reimbursable subcontract. These nozzles were essentially preproduction developmental units and were manufactured by slow and laborious manual methods. At that time, certain production equipment necessary for quantity production had not been acquired by Schnozzles and development of an important equipment item had not been completed (i.e. an automated drilling machine for boring about 11,000 small holes in each exit cone). Schnozzles was developing the drilling machine at Government expense under a purchase order awarded by Hi-Missile in November 1961, in conjunction with the planned mass production of the nozzles. The drilling machine was completed in December 1962, and was first used in January 1963.

Hi-Missile did not agree with Schnozzles' estimating approach, primarily because it included inaccurate learning curve data. Hi-Missile developed its own estimates, and as a result Schnozzles reduced the labor cost estimate included in its August 8, 1962, price proposal by $35 a unit, apparently in consideration of Hi-Missile's revised learning curve application. Although Hi-Missile was aware that a new drilling machine was being developed by Schnozzles for use in production of nozzles, there is no evidence that it considered the impact of the new machinery on labor hours and on the production-line methods which were essential to meet the delivery schedule. A firm fixed-price subcontract was signed on October 10, 1962, and a certificate of current cost and pricing data was executed on the same date.

Schnozzles experienced a cost underrun of about $681,250 in relation to the cost estimates for direct labor and the related manufacturing overhead included in the purchase order price, or a profit equivalent to 60% of cost. This underrun resulted primarily because of reduced labor costs obtained by using mass production methods, and more than $400,000 of special equipment financed by the Air Force under Hi-Missile's prime contract. In October 1962, at the time of negotiation for the 1300 nozzles it was not precisely known when this special equipment would become available and operative. However, it was generally understood by Hi-Missiles, Schnozzles, and the Government, that the special equipment would be used in producing the nozzles.

PROBLEM

In a review of the prime contract awarded to Hi-Missile Corporation, should this case be considered as an apparent defective pricing situation?

THE MOXIE COMPANY

BACKGROUND

A firm fixed-price contract awarded to the Moxie Company on July 2, 1966, was for the manufacture of gadgets which Moxie developed under prior AF contracts. Moxie is the only established source for gadgets and this was the fourth procurement of gadgets from Moxie.

The price was established through negotiations between Moxie officials and procurement personnel on the basis of estimated production costs as submitted by Moxie, and comparison by the negotiation team of this estimate with Moxie's prior experienced costs. There was no audit evaluation of this proposal.

FACTS

The price negotiated included an estimated cost of $900 a unit for a major component, designated as LSD-2. Under prior production contracts, Moxie had purchased LSD-2 from XYZ Company for $500 a unit, but on March 1, 1966, the XYZ Company discontinued part of its operation and advised that it would no longer be a source for LSD-2. In anticipation of future orders for gadgets, in March 1966, Moxie began to explore other sources for LSD-2.

In response to a request from the Government on May 20, 1966, Moxie submitted a price proposal for gadgets. As indicated, their proposal included an estimate of $900 for LSD-2. Moxie indicated that a new supplier had not been selected at the date of its proposal and it was, therefore, necessary to include an allowance in its estimate for the cost of resolving

87-847 O - 68 - 10

technical problems anticipated in establishing a new supplier. A certificate of current cost or pricing data was signed by Moxie on June 2, 1966.

The contract price negotiations were held on June 11 and 12, 1966, at which time the Government negotiators questioned the $400 increase in unit cost for LSD-2. The negotiation memorandum shows that Moxie provided the negotiators with information that Inflato Corporation had submitted the best competitive bids for LSD-2, at $900 a unit, and that this amount was finally accepted by the negotiator.

During the estimating system survey, the auditor was evaluating the contractor's use of current vendor quotations and noted that Moxie had received a quotation, dated May 24, 1966, from Undercut Company showing a price of $550 a unit for LSD-2. He also found that engineers from Moxie had visited both the Inflato Corporation and Undercut Company in June. They had advised the proposal manager that there was no question about Inflator Corporation being able to supply the LSD-2 component, but that additional technical discussions would be required before the same might be said of Undercut Company.

About two months after the award of the prime contract, Moxie awarded a subcontract to Honestjohn for LSD-2 at the quoted amount of $550 a unit.

PROBLEMS

1. Is this a case of possible defective pricing?

(*b*) *Improved Regulations.*—As a corollary to our training efforts, we are sharpening the guidance contained in the ASPR and have made a very significant addition covering the Government's right of access to performance records of contractors holding noncompetitive firm-fixed-price contracts, as recommended by GAO, and in fact in accordance with the bill which you yourself submitted, Mr. Chairman. Deputy Secretary Nitze's directive which enunciated this decision, appears as attachment B to this statement, below. This directive is being widely publicized in a Defense procurement circular dated November 30, and will be effective upon receipt, which is an abnormal procedure. We usually allow 90 days. In this case it is effective upon receipt. The Defense Comptroller has already issued guidance to the Defense Contract Audit Agency.

ATTACHMENT B

THE SECRETARY OF DEFENSE,
Washington, September 29, 1967.

Memorandum For:
Secretaries of the Military Departments.
Assistant Secretary of Defense (Comptroller).
Assistant Secretary of Defense (I.&L.).
Directors of Defense Agencies.

Subject: Access to cost performance records on noncompetitive firm fixed price contracts.

I have given careful consideration to the arguments for and against access to contractor post-award cost performance records on noncompetitive firm fixed price contracts, for the purpose of determining the degree of contractor compliance with PL 87-653. Clearly, it has been and remains our policy that in firm fixed price contracts the cost and profit consequences are the full responsibility of the contractor since he assumes all the risk of performing in accordance with the contract. Likewise, it is our policy that such contracts be used only where there exists a reliable basis for judging reasonableness of contractor cost estimates. Where such a basis does not exist, other contract forms should be used.

The Department of Defense is required to conduct a program of review and audit sufficient to ascertain that the cost or pricing data submitted by contractors in connection with the negotiation of noncompetitive firm fixed price contracts were current, accurate and complete as required by PL 87-653. It is our policy to make such audits, as fully as possible, prior to completing the negotiation of the contract. However, when it is necessary to provide assurance that defective cost or pricing data were not submitted, audits should also be conducted of actual costs incurred after contracts are consummated. To assure that such post-award audits may be conducted when deemed appropriate, action shall be taken to include in all noncompetitive firm fixed price contracts involving certified costs or pricing data, a contractual right to have access to the contractor's actual performance records.

Circumstances which may dictate the use of a post-award cost performance audit include such cases as those where: (1) factors of urgency in placing the initial procurement were clearly present; (2) material costs are a significant portion of the contractor's total cost estimate; (3) a substantial portion of the contract is proposed for subcontracting; or (4) there was a substantial interval between completion of the pre-contract cost evaluation and agreement on price.

In directing this action, I wish to make it clear that the purpose of any post-award cost performance audit, as provided herein, is limited to the single purpose of determining whether or not defective cost or pricing data were submitted. Access to a contractor's records shall not be for the purpose of evaluating profit-cost relationships, nor shall any repricing of such contracts be made because the realized profit was greater than was forecast, or because some contingency cited by the contractor in his submission failed to materialize—unless the audit reveals that the cost and pricing data certified by the contractor were, in fact, defective.

I desire that the Assistant Secretary of Defense (Installations and Logistics) and the Assistant Secretary of Defense (Comptroller) issue implementing instructions to place the above policies into effect.

PAUL H. NITZE.

In summary, Mr. Chairman, I believe that actions have been taken on a broad front to improve the effectiveness of our regulations and their implementation, and we can assure you that full implementation of Public Law 87–653 will have continuing emphasis. We recently completed a 4-day conference on contract pricing—attended by 280 top procurement officials, the material secretaries, the Director, DSA, and the Assistant Comptroller General. Particular stress was given to the importance of Public Law 87–653 during this conference.

3. SPARE PARTS BREAKOUT PROGRAM

In fiscal year 1961, GAO reported that the noncompetitive procurement of aeronautical replenishment spare parts was depriving the Defense Department of significant price savings. We immediately launched a major effort to obtain sufficient technical information regarding spares and repair parts to obtain competition.

Since fiscal year 1962, we have maintained records which reveal the percent of such procurements placed after obtaining price competition. This percent rose from 28 percent in fiscal year 1962 to 45.5 percent in fiscal year 1967—60 percent improvement—despite the greatly increased volume of urgent procurements during fiscal year 1967.

In addition to obtaining competition whenever possible, cost reductions are being achieved on an additional 20 percent of these purchases by buying direct from the manufacturer of such items rather than from the prime contractor. By this action we are able to avoid paying the overhead and handling costs of the prime contractor.

The results stated above have been achieved through the "high dollar" approach to spare parts breakout, the formula for which requires that each military department endeavor to obtain competition or direct procurement on that segment of its replenishment spares which account for 80 percent of its annual procurement. This approach has been used for two reasons:

First, it assures us of concentrating on those items which will be repetitively bought and which represent annual purchases of significant size (generally $2,500 and up) and on which vigorous competition is therefore possible. Between 300,000 and 400,000 items currently fall in this category.

Second, it avoids dissipating our actions over an additional million or more items on which purchases are highly erratic and typically of small size.

Now that we have achieved major improvement in the procurement of the "high dollar" segment, we are turning our attention to the small purchase area. I would like to comment further on this particular area of opportunity.

4. SMALL PURCHASES

We initiated an appraisal by each military department and DSA last August on the adequacy of our performance in the small pur-

chase area. The need for this appraisal had been highlighted by investigations of individual instances of unreasonable pricing, disclosed by Congressman Pike, covering 18 specific instances. Although the majority of the cases cited involved only one supplier, our investigation revealed that we have a general problem throughout the military departments and the Defense Supply Agency in assuring the most economic purchase of these items. The heart of this problem lies in the fact that small purchases represent a massive workload—68 percent of purchase actions—but only 4 percent of the dollar awarded. The average value per order is $231. Such purchases typically represent small quantities of components, spare parts or common items needed for immediate use at post, camp, or station level; and they have highly erratic usage rates.

New hardware entering the Defense inventory each year contains an estimated 4 million parts which are potentially new items to the supply system. But, experience shows that only about 15 percent of these parts break or wear out and require replacement. Obviously, we cannot afford to stock quantities of all of these parts and, hence, on a judgment basis, we must decide which of them should be cataloged and placed under full supply control. For the remainder, we follow the customary business practice of ordering on an "as needed basis," using vendor catalogs and parts manuals furnished by the prime contractor. Often, therefore, we have no other known source for the item than the prime contractor, or the source he identifies in the manual which accompanies the equipment.

The challenge we face is the degree to which we can justify adding personnel to our procurement organizations in order to conduct the additional research needed to determine the original source of such items, and to develop reliable specifications on the basis of which to obtain competition.

As mentioned above, in connection with replenishment spare parts procurements, we have concentrated, during the past several years, on the "high dollar" formula approach. In so doing, we have knowingly given lower priority to the large universe of small purchase parts and supplies.

Our recent studies have revealed that we can and must do a more skillful job of procurement in this area, despite its small size and unpredictable nature. We estimate that by (1) improved training of our small purchase buyers, (2) increased supervision, and (3) more extensive utilization of vendor catalogs, we can, with our present purchasing force, obtain better pricing which may yield savings of $10 to $25 million annually in small purchase procurement. We have launched a comprehensive program, built around 16 specific improvement actions, to obtain these results.

5. OTHER PROCUREMENT MANAGEMENT IMPROVEMENTS

Finally, Mr. Chairman, we would like to comment briefly on two remaining procurement matters in which we believe you may be interested:

First: Improved procurement techniques. We are continuing efforts to maximize the use of formal advertising as the preferred method of procurement. We will continue to emphasize the use of two-step formal

advertising to obtain the benefits of formal advertising where inadequate specifications preclude the use of conventional formal advertising. Another source of significant savings is being obtained by awarding contracts on a multiyear basis, where our requirements are sufficiently predictable, so as to obtain the benefits of lower unit prices on larger quantities. Savings of over $50 million were obtained last year through the use of this technique. In the area of new weapons systems development and production, we are continuing to make progress through the application of advanced procurement planning, and the use of "total package procurement," where a single contract is awarded to cover the full cycle from design through development and production.

Second: In the field of training and career development, perhaps the single most important factor in effective procurement is the skill of the individual negotiator and buyer. We have now established 43 DOD-wide procurement training courses (that is, one school offers training available to all Defense personnel). During fiscal year 1967 over 8,300 students completed one or more of these courses. We are now concentrating on providing increased promotional opportunities for personnel specializing in the procurement field. Beginning last March, we instituted a system of selecting personnel for promotion to key jobs under which the best candidates in all Departments and DSA are assured of consideration as job openings occur.

B. Supply Management Policies

We would now like to comment, Mr. Chairman, on several aspects of our inventory management programs, including particularly—

1. Southeast Asia supply support;
2. Improvements in integrated management of common supplies;
3. Other improvements in inventory management;
4. The special problem of short shelf life items; and
5. Control of contractor-held equipment and supplies.

In each of these important areas we believe that our actions have been responsive to the recommendations of GAO and this committee.

In respect to Southeast Asia supply support, our major attention in supply management during the past 2 years has, of course, been concerned with timely support of the forces in Vietnam. In order to accomplish the logistic buildup to support these forces, we have transported approximately 8 million short tons of equipment and supplies and 1 million men to Vietnam. During the buildup phase—due to the absence of usage data tailored to the climate, terrain and missions—we chose the conservative course of providing complete "supply packages" to move with units as they deployed. These packages contained all of the items which it was anticipated each unit might need.

This first phase has been highly successful. General Westmoreland has stated:

> Never before in the history of warfare have men created such a responsive logistical system . . . not once have the fighting troops been restricted in their operations against the enemy for want of essential supplies.

In fact, the out-of-service rates on major equipment items, due to lack of spare parts, is far below the standard norms established by military commanders.

As the buildup began to reach completion, General Westmoreland directed that logistical management be intensified. In March of this year, 500 supply specialists were sent to Vietnam to assist in the task of inventory adjustment. The initial project, which has recently been completed, screened out unnecessary items, in the hands of some 1,900 units. As a result, the U.S. Army Vietnam has, during this calendar year, eliminated over 78,000 items from stockage lists, canceled $100 million in outstanding requisitions, and marked for redistribution $117 million of its stocks.

A second trained team is now in Vietnam and will shortly be followed by a third. Their program will concentrate on refining inventory management at the depot level by establishing accurate and complete inventory records; and identifying for redistribution all quantities not required under revised stock levels established on the basis of actual demand.

Last week at General Westmoreland's request, Assistant Secretary Brooks of the Army and I visited the Army logistic commanders in Vietnam and reviewed their supply management procedures. We were highly impressed by their competent and vigorous management under very austere conditions. To further assist them, the Secretary of Defense directed, on November 24, the formation of a special organization—to be known as the "Pacific Utilization and Redistribution Agency"—whose mission will be to assume accountability for and supervision over the redistribution of all materials currently excess to Vietnam requirements.

(A copy of the directive, attachment C, follows:)

ATTACHMENT C

THE SECRETARY OF DEFENSE,
Washington, November 24, 1967.

Memorandum For:
Secretaries of the Military Departments.
Chairman, Joint Chiefs of Staff.
Assistant Secretaries of Defense.
Directors of Defense Agencies.

Subject: Utilization and redistribution of excess materiel in the Pacific area.

General Westmoreland has reported that the logistic buildup in Southeast Asia has now been virtually completed, and that never before in our history have military forces been so effectively supported. The Military Departments, the Defense Agencies, and all commands concerned are deserving of the highest commendation for this superb achievement. This buildup has required since 1965:

The transportation to Vietnam—a distance of 10,000 miles—of over 1 million men and almost 8 million short tons of ammunition, supplies and equipment.

The construction in Vietnam of a complete logistical base which includes personnel facilities for a force of 525,000 men, 6 new deep draft ports, 88 airfields, and over 12 million square feet of covered storage space, in which are stored about 300,000 different items of supply.

General Westmoreland has placed increasing emphasis during the past year on the importance of prudent and economical management of these resources. He wants to maintain not only the most responsive logistic support base in our history, but also the best managed.

I fully endorse this objective. The aftermath of past conflicts has been the accumulation of huge surpluses, which because of deterioration and obsolescence

have had little salvage value. Following Korea, for example, we were left with $12 billion of such excesses. I am determined that this will not happen in Vietnam.

The speed and magnitude of the Vietnam build up has unavoidably resulted in the accumulation of some imbalances and excesses in inventories. We will begin immediately to redistribute these excesses so as to assure their application against approved military requirements elsewhere in the military supply system. By doing so we can avoid the inefficiencies and waste experienced in the past. To this end the following steps will be taken, effective at once:

First, the Secretary of Army is designated Executive Agent for the Department of Defense to assure that SEA excess materiel of all Services is promptly identified and made available for redistribution. A General Officer will be designated the Project Coordinator.

Second, the Commander-in-Chief, Pacific, will establish a special agency to (1) maintain an inventory of excess materiel identified in the Pacific area, (2) supervise redistribution or disposal of such materiel within his area, and (3) report the availability of materiel which cannot be utilized in the Pacific area to other Defense activities, in accordance with procedures developed by the Project Coordinator. This Agency will be known as the "Pacific Utilization and Redistribution Agency."

By February 1, 1968, I desire to receive the Secretary of Army's plan for the implementation of the Project, and CINCPAC's plan for the organization and operation of the Pacific Utilization and Redistribution Agency. Each month thereafter, I would like to receive a report on the excess materiel identified and on the reutilization accomplished.

ROBERT S. MCNAMARA.

As a consequence of this timely action, we are convinced that we will be able to avoid the generation of excesses such as has occurred in past conflicts. Following Korea, for example, we were left with $12 billion of excess stocks.

We have invited GAO to assess these actions during their current on-site review in Vietnam.

Second, improvements in the integrated management of common supplies:

From the viewpoint of long-term economy, the most noteworthy supply management accomplishment during the past 6 years has been the progress made in placing common items under integrated management.

Prior to the formation of the Defense Supply Agency in January 1962, only 41,000 out of the 4 million items in the Defense supply system were under integrated management. Today, this number stands at 1.8 million (1.7 million of which are managed by DSA). An additional 500,000 items have now been identified for integrated management.

The crucial test of the value of this approach to more economical supply management has occurred during the Vietnam buildup. Prior to the buildup, DSA had achieved substantial economies as measured by a 21-percent reduction in value of inventories, and a 13-percent reduction in personnel and operating costs.

With this more efficient organization, DSA was well prepared to cope with the rapid growth required to support the buildup. In fiscal year 1967, it handled a procurement volume almost 2½ times greater than in 1963 (up from $2.6 to $6.2 billion), with very sizable increases in tonnages handled and requisitions processed. While stock availability dipped slightly during the first months of the buildup (due to the rapid drawdown on clothing, subsistence, and general supply stocks), DSA is currently maintaining a stock availability rate of 91

percent—a rate significantly higher than that experienced in the Defense supply system as a whole.

We are equally dedicated to working with GSA in achieving the maximum benefit of integrated management for the Government as a whole. Plans have now been established which provide for the following:

GSA will support DOD on 65 Federal supply classes. These include paint and handtools, office equipment, furniture and supplies, cleaning materials, and paper products. To date, 51,000 items have been transferred to GSA, and 15,000 additional items are scheduled to be transferred by June 30, 1968.

DOD has plans in process, by agreement with GSA, to provide direct support of civil agencies in certain classes where the Defense supply expertise is predominant. These include fuel, electronic items, medical and subsistence items. It is estimated that these arrangements will save the Government well in excess of $3 million annually. A supplementary statement on the status of these arrangements appears below as attachment D to this statement.

(The statement follows:)

ATTACHMENT D

NATIONAL SUPPLY SYSTEM

We are working very closely with the General Services Administration to coordinate the development of our respective supply systems so as to insure the most effective and economical supply support for all Departments and Agencies of the Federal Government. To date we have reached agreement with GSA for the transfer to GSA of the primary management of 65 Federal Supply Classes. Approximately 51,000 items have been transferred to GSA to date and 15,000 additional items are scheduled to be transferred through June 30, 1968, for a total of 66,000 items. Ninety-nine Federal Supply Classes have now been designated as "Primary Defense Supply Agency" classes. For the 65 "Primary FSS" classes all functions such as mobilization reserve management, procurement and supply will be transferred to GSA and we are now working with GSA on arrangements for the assumption of these functions.

Under the other major aspect of the DoD/GSA agreement, DSA is considering support to all Government agencies for electronics, medical, fuel, clothing and textiles, and subsistence supplies wherever there would be no adverse effect on support of the military services. Progress is being made in the various commodity areas as follows:

1. Fuel

Planning actions have already begun for DSA assumption of fuel support. A time-phased schedule for implementation of DSA fuel support of civil agencies, based on a DSA mission assignment date of 1 July 1968, has been developed and staffed with GSA. Target dates for completion of the phase-in are January 1969 for packaged fuel items and November 1969 for bulk fuel/coal items.

2. Electronics

DSA is reviewing its capability to implement civil agency support of electronics without risking impairment of military support requirements. Based on findings, a time-phased plan will be developed and implementation action directed accordingly. Indications at this time are that a 12-month, phased implementation will begin in July 1968.

3. Medical and Nonperishable Subsistence

The Defense Personnel Support Center has been directed to undertake a technical review of these commodities for the purpose of identifying areas in which there exists a potential for increased commonality in DSA and civil agency items sufficient to warrant reconsideration of present limited DSA mission support.

A schedule for accomplishing the review has been developed and is presently being reviewed by GSA and the affected civil agencies.

a. As to the medical review, we plan to proceed first with a select group of medical supplies (FSC 6515, surgical instruments), working into the full category of medical material including drugs. This will require a comprehensive review with the combined technical/professional talents of all the affected civil agencies.

b. As to the nonperishable subsistence item commonality review, no significant problems are envisioned and recommendations should be completed by the end of 1968.

4. Perishable Subsistence

a. Substantial progress continues in cross-servicing support of Veterans Administration and HEW Public Health Service hospitals from the DSA regional subsistence offices. From the initiation of this program in April 1966 through August 1967, sales have totaled $1,884,000 under 48 support agreements. Three additional support agreements have been signed, two effective in September 1967 and the latest which became effective in October 1967.

b. Standardization of Hospital Feeding Items. During the course of developing cross-servicing agreements with VA and PHS in perishable subsistence, it was agreed that we needed a joint review of item specifications used in hospital feeding programs. Joint DSA/VA/GSA/PHS review of hospital feeding items was completed in May 1967. Of 687 items reviewed, 462 items (67%) were acceptable for both military and civilian hospital feeding programs; of remaining items, 27% were retained by agencies to meet unique dietetic requirements of their programs and 6% were deleted as no longer required for hospital feeding.

DSA/GSA/VA/PHS will maintain continuous review of the perishable subsistence program with a view toward increasing the number of standard items and specifications. A charter is being staffed with the civil agencies for an Interagency Council to be established for this purpose.

Since May 1967 the DoD has completed the following new interagency supply support agreements:

(*a*) In conjunction with the Department of Interior, agreement has been reached for DSA to provide perishable subsistence support to four Bureau of Indian Affairs schools. It is expected that the annual demands from these schools will be approximately $350,000.

(*b*) An agreement to support the Post Office Department for selected classes of electronics, general and industrial supplies has been consummated. Initially, annual sales of these commodities to the Post Office Department will approximate $250,000.

There is, of course, much more to relate about the total story of DSA's performance. In addition to supply management, it is handling the administration of contracts with a value of $21.8 billion; and is administering the DOD inventory of industrial plant equipment which now consists of 400,000 items valued at $4 billion. Through the Defense Logistics Service Center in Battle Creek, Mich., DSA last year managed the redistribution of defense stocks, effecting a reutilization within DOD of $1.5 billion.

Third: Other improvements in inventory management.

While Southeast Asia supply support and the integrated management of common use items have received our major attention, I would like to mention briefly our recent progress in three other aspects of supply management:

(*a*) *Purification of back orders.*—Annually, some 80 million requisitions are placed on the Defense supply system by requisitioning activities. One of our longstanding problems has been the tendency of requisitioners to submit duplicate requisitions when deliveries are delayed due to the need for procurement action. Requirements may also change during such periods. Unnecessary requisitions result in excess issues and inflated stock levels. During fiscal year 1967, a new system was instituted at the 22 inventory control points which requires

revalidation and requisitions outstanding for 90 days or more in the case of domestic users, and 120 days or more for oversea users.

The first application of this new procedure in fiscal year 1967 resulted in canceling unnecessary requests having a dollar value of $191 million. During fiscal year 1968 to date, 105,000 requisitions have been canceled, with a value of $266 million. We consider this program to represent a breakthrough, which has been made possible by the proper application of continuous computerized analysis of outstanding requisition.

(*b*) *Purging of inventory lists.*—A second longstanding problem results from the fact that as old equipments are phased out, supporting parts become inactive but continue to remain on our shelves, needlessly consuming warehouse space and the time of inventory managers. DSA has developed a system of systematically screening inactive items for elimination and as a result dropped from inventory 16 percent of the items which were transferred to its management by the military departments. The residual stocks are substituted wherever possible for other active item requirements, or made available for prompt disposal.

Based on this successful experience, we have inaugurated a DOD-wide inactive item review program which, during the past 2 years, has resulted in screening out over 690,000 items from DOD inventories.

We have concluded that this must be a continuing program and plan to give it increased emphasis during the coming year.

(*c*) *Intensive management of selected items.*—Early in the Vietnam buildup we established the objective of assuring that our commanders were fully supported with equipment and supplies they needed; but that at the same time we take special action to minimize the generation of excesses. The initial program of intensive management was applied to ammunition requirements by the institution of frequent reports to the Joint Chiefs of Staff and the Secretary of Defense, revealing by item:

(1) Actual consumption.
(2) Inventories onhand and intransit.
(3) Planned production schedules.

As a result, we have been successful in maintaining an optimum balance between production, inventories and consumption. The Army in Vietnam has, for example, recently been able to reduce its fiscal year 1968 ammunition requirements by more than $50 million. This intensive management technique has now been extended to 284 ammunition, aircraft and equipment items, representing 60 percent of our major equipment procurement program; and it is currently being extended to secondary items having an annual procurement value of $1 million or more (representing 40–50 percent of annual procurement programs). Worldwide accountability is being installed on these items at the central inventory control points.

A companion step in this program is intensive management of pipeline intransit time (the time required to order, pack, ship and receive). In the Pacific area a reduction of pipeline time of 27 percent (40 days) has been made, permitting a one-time inventory reduction of $170 million in fiscal year 1968. Further reductions in overseas pipelines will permit budget reductions of over $65 million in fiscal year 1969.

Fourth: The problem of short shelf life items.

Since the committee's review last May, intensive work has been carried on in this area, in accordance with DOD instruction 4140.27.

Our principal progress in the past 6 months has been applied to tighter control over the procurement of 40,900 items of this type. Our policy prescribes that procurement must not exceed the quantity firmly projected for use during the shelf life of the item (each item has been coded to reflect its shelf life expectancy). We have recently completed a special sampling of shelf life items in each service and DSA and find that procurement order quantities are being accurately computed in line with this policy, and that losses due to perishability are minimal.

We are now preparing, for implementation by January 1, 1968, special procedures to expedite the screening of any excess quantities identified in the future, in order to insure rapid redistribution to eligible users while remaining shelf life is available. We are likewise requiring the submission of special reports on results obtained under these improved systems so that performance can be carefully monitored.

Fifth: Control of Government-owned property in the possession of Defense contractors.

Your committee recommended that the General Accounting Office cooperate with the Department of Defense in the development of an adequate contractor inventory accounting system, and that a thorough review be made of our controls over Government-owned property in the hands of contractors. As a consequence of your recommendation, the GAO conducted a review of the property control systems in effect for Government-owned property. They made onsite examinations into the manner of use of Government property at a number of contractor locations. Where weaknesses were identified, the Comptroller General recommended procedural changes. Through the cooperative efforts of the GAO representatives, various improvements in property control systems discussed in the report were promptly brought to the attention of both local and departmental officials.

It is our basic policy to have industry finance its own capital equipment where practicable. There have been problems in this regard, and we are taking steps to further reinforce this policy.

In its draft report, the GAO made 14 specific recommendations. I would now like to highlight our actions in respect to them:

(*a*) *Improved utilization.*—One of the most significant recommendations was that provision be made in the armed services procurement regulation to provide for improved recordkeeping on utilization of Government-owned property by contractors. This recommendation also suggested better analysis of the records to show the extent and manner of use by the contractor of Government-owned industrial plant equipment.

First, we are taking action now to establish the Defense Industrial Plant Equipment Center (DIPEC) as a center management point with enhanced authorities.

Second, as a result of a specific GAO recommendation, ASPR is being revised to prescribe that contractors will be required (contractually) to establish and maintain a written system for controlling the utilization of Government industrial plant equipment.

Third, the proposed regulations will provide for appropriate detection and reporting of Government-owned plant equipment which is

not being effectively and economically used by Defense contractors, so that these items will be declared idle and available for use elsewhere within the Defense complex.

Fourth, DIPEC is being directed to develop, in conjunction with the military departments, tailored usage standards by types of machines. These standards will be utilized as a yardstick to measure the adequacy of machine use, and reports will be prepared for the property administrator, with copies provided to DIPEC. Substandard usage would be cause for enforcing better utilization or for reassignment. Also, these records will furnish the property administrators with data to determine whether such machines should be authorized for use on non-Government work.

(*b*) *Rental rates for commercial use.*—The Department of Defense is currently reevaluating rental rates with the Office of Emergency Planning to determine an appropriate charge so as to be consistent with commercial lease rates. This action will deter the use of Government tools on commercial work and reinforce the policy that contractors should provide the capital investment required to perform all work.

(*c*) *Replacement and modernization.*—In conformance with the basic policy of having industry provide its own capital equipment, we plan to install a procedure whereby, before the Department of Defense procures replacement IPE for use in a contractor's plant, the contractor will be required to state in writing his unwillingness to finance such replacement and his financial incapability to do so. When it does become necessary for Department of Defense procurement of replacement machines, every replacement of IPE funded by DOD is subjected to an individual analysis of proposed use of both the existing machines and their replacement. Replacements are authorized only when such use is required for execution of Government contracts, and then only when the savings resulting from increased productivity will result in payback of the investment within 3 years or less. Usually one new machine replaces an average of three old machines, with their attendant operators.

(*d*) *Management improvements.*—The GAO in its report also recommended that the DOD—

(1) Place continuing emphasis on efforts to upgrade and improve the quality of property administrators and thus the effectiveness of their control of Government-owned property in the possession of contractors, and

(2) Initiate an effective program of internal audit of property administration.

The DOD has underway a joint study to evaluate the current position classification standards for property administrators. We are working with the Civil Service Commission on this project.

We concur with the GAO that there should be additional emphasis on the DOD audit of control over the utilization of Government-owned property in the possession of contractors. The Assistant Secretary of Defense (Comptroller), in a memorandum of December 27, 1966, to the military departments and others, established areas of audit responsibility for both contract and internal auditors in Government property audits. This policy guidance, together with the internal audits scheduled by the military departments and DSA, should achieve the audit coverage contemplated by the GAO recommendations.

The DOD comments on each of the 14 recommendations will be included in the final GAO report presented to this committee for consideration. Improving the accounting and control of Government-owned property in the possession of defense contractors is receiving our close attention. (See pp. 52, 153, 455.)

C. Progress Under Budget Bureau Circular No. A–76

Finally, we wish to report progress, Mr. Chairman, on our actions to implement Budget Circular A–76—"Acquiring Commercial or Industrial Products and Services for Government Use"—issued in March 1966.

Our original instructions were issued in March 1963, and we have reported to you on results of our earlier review in past hearings. In 1965 we launched a comprehensive survey of our base support services. In this review we conducted more than 40 detailed cost comparison studies covering 22 major classes of base support services.

As a result of this survey we discovered opportunities for savings not only by placing greater reliance upon commercial sources but also by discontinuing certain types of contractual arrangements which were more costly than in-house alternatives. Generally, these latter cases involved contracts for technical support services in which contractors assumed little if any risks and the Government necessarily retained primary management responsibility.

When Bureau of the Budget Circular A–76 was issued in March 1966, we adapted our existing procedures to include the new features in the circular. Implementing instructions were issued and each of the military departments and agencies assigned staffs to assure that the policies were being implemented. A small organization was also set up in my office.

The latest inventory indicates a total of 5,605 commercial or industrial activities in all of the services. We have classified these activities into 58 categories and have assigned priorities for completion of reviews for each of these categories. Reviews of 1,292 activities have been completed and are in process of final evaluation. Our goal is to complete the remaining reviews in all categories as rapidly as possible.

We have also implemented provisions of the circular which established additional controls of new starts. Our procedures provide that all proposed new starts shall be reviewed and approved in my office. Less than a dozen such proposals have been submitted to my office and we have approved about half of these. This is not a true measure of the value of this procedure, however, because it has caused reviews of proposals to be conducted in the offices of the military departments and agencies. The result of these departmental reviews is that some of the proposals are disapproved before they reach my office.

Attachment E to this statement, which follows, cites 10 recent examples of the application of the above policies.

Attachment E

Recent Illustrations of the Application of Policies Prescribed by Budget Bureau Circular A–76

1. At Fort Huachuca, Arizona, several activities such as photographic and film processing services, building maintenance and repair, laundry and dry cleaning installations, bus services and other similar activities previously op-

erated by the base have been discontinued and the functions transferred to Headquarters, U.S. Army Strategic Communications Command, recently relocated to Fort Huachuca. This consolidation resulted in the elimination of 14 commercial or industrial activities and saved 636 personnel which were either transferred to other work or separated from the payrolls.

2. The curtailment of "in-house" manufacturing activities at Springfield Armory has permitted a reduction in the personnel strength of 636 persons.

3. The janitorial services at Dugway Proving Ground were transferred from "in-house" to contract.

4. The Defense Supply Agency has further curtailed the "in-house" production of packing boxes and crates during 1967. Initial increments were previously reported. Now 73 percent of such work ($5.9 million) is obtained from commercial sources. In 1966 commercial sources provided 67 percent of these requirements.

5. At the Defense Personnel Support Center at Philadelphia, Pennsylvania, the "in-house" janitorial force has been curtailed through greater use of contractor effort.

6. Expansion of a large Government-owned telephone system at McClellan Air Force Base, California was requested by the Air Force but was not approved. The system has been turned over to a common carrier. A similar decision has been made with respect to a very large telephone system at Redstone Arsenal.

7. The Defense Supply Agency requested approval of plans to expand the clothing manufacturing activity at the Defense Personnel Support Center, Philadelphia, Pennsylvania so as to be able to meet the need for odd sizes and small lots of military clothing. This request was approved.

8. The Air Force proposes to use civil service personnel to accomplish janitorial work now contracted at Keesler Air Force Base, Mississippi. This case is still under consideration and has not been approved.

9. The Army requested approval for activation of two troop laundries, one at Fort Rucker, Alabama and one at McClellan, Alabama. They have not been approved. The Army was asked to explore further the possibility of relying upon commercial laundries.

10. Air Force requested approval for the conversion of the telephone exchange at Los Angeles Air Force Station from contractor to operation by Airmen in order to maintain proficiency of the Airmen while serving in the States between overseas assignments. This request was approved.

We have also been engaged in a program to convert certain contract positions for technical personnel to Federal employment and we consider this effort to be related to our implementation of circular No. A–76. We had used technical contract personnel in an irregular manner with respect to the civil service regulations and laws. In addition to the legal questions posed by the Civil Service Commission and the Comptroller General, we discovered that these practices resulted in higher costs in some instances than would be incurred under an in-house arrangement. We initiated a program for conversion of 10,471 of these positions into the civil service. The Army and the Air Force have completed their portions of this task. We estimate that the Navy will complete its portion by about March 31, 1968.

Mr. Chairman, this concludes our progress report to you. We will now be pleased to answer your questions.

Chairman PROXMIRE. Thank you, Secretary Morris. You have done a very persuasive and comprehensive job. My questions, I anticipate, will be critical in view of what happened yesterday, but I am sure you will be expecting that. It does not mean we do not understand the difficulties under which you operate, and the enormous problem you have in this very, very massive procurement responsibility that you have.

TRUTH IN NEGOTIATIONS ACT

I would like to ask you first about the Truth in Negotiations Act. Following the testimony last May about the lack of documentation

in contract negotiation files, the Defense Department, in June, proposed new regulations in accord with GAO recommendations. I am not talking about the Nitze statement about postaudit.

Industry was given an opportunity to comment. We understand that the new regulations are about to be promulgated in their final form, and I would like to know when this will be.

NEW REGULATIONS READY FOR RELEASE

Mr. MORRIS. Sir, we have them with us this morning. They are just off the printing press. They are dated the 30th of November. They will be effective upon receipt by the action authorities.

Chairman PROXMIRE. When you say upon receipt, what does that mean?

Mr. MORRIS. As soon as received through the mail, sir.

Chairman PROXMIRE. Give me an estimate of that.

Mr. MORRIS. I would think within a week of release.

Chairman PROXMIRE. Have they been released?

Mr. MORRIS. The release will start within a day or two. They were dated for release on the 30th of November, sir.

Chairman PROXMIRE. In early December they will be effective?

Mr. MORRIS. Yes, sir.

Chairman PROXMIRE. Now, what this means is there must be complete documentation in compliance with the Truth in Negotiations Act, which means that the contractors have to keep records showing their costs as current, comprehensive, and accurate; is that correct?

INTERPRETATION OF NEW REGULATIONS

Mr. MORRIS. It means, sir, as required by the law and our regulations, that they must submit and fully identify and disclose to us, and then certify as to the accuracy of those submissions and disclosures. They certify to the data upon which their cost and price estimates were developed in connection with the procurement.

Chairman PROXMIRE. And how comprehensive is this? What does this apply to?

Mr. MORRIS. I would like to ask Mr. Malloy, who is our expert in this field, to discuss this with you, Mr. Chairman.

APPLY TO NEGOTIATED CONTRACTS OVER $100,000

Mr. MALLOY. Mr. Chairman, these regulations have the same impact as the provisions in the law, and they apply to all negotiated contracts over $100,000.

Chairman PROXMIRE. By negotiated contracts, are you talking about competitive negotiated contracts, too?

NOT APPLICABLE TO COMPETITIVE NEGOTIATED CONTRACTS

Mr. MALLOY. The law has an exemption for competitive negotiated contracts with respect to the application of Public Law 87–653. In other words, in a competitive contract, where there was adequate price competition, Public Law 87–653 does not apply.

Chairman PROXMIRE. This gives me a chance to ask about this so-called competitive negotiated contract.

The Comptroller General, and I thought rightly, presented the competitive and noncompetitive in terms of advertised competitive bidding as his definition of a competitive procurement. And the non-advertised competitive bidding as not competitive.

Now, you have a further refinement, in which you say competitive negotiation. Can you give me an example of that? Obviously, it is not advertised. But, you must have more than one source which is competing at some stage in the procurement process.

ADEQUATE PRICE COMPETITION

Mr. MALLOY. That is right. We have a definition of adequate price competition for purposes of Public Law 87-653. It requires that at least two bidders contend for the contract, and truly contend for it in a competitive atmosphere. If that does not hold true, then it cannot be classified as a competitive transaction.

Chairman PROXMIRE. You don't advertise this for all comers. You simply pick two or more potential suppliers, and ask them to provide bids. Then on the basis of that, you negotiate with one of them?

NORMAL NEGOTIATION PROCEDURE

Mr. MALLOY. The normal procedure, Mr. Chairman, would be for us to solicit all of the suppliers that we know about—all that we have on our mailing list notwithstanding the fact that it is a negotiated transaction. Thereafter, depending on the bidding, there may be enough competition so that the contract could be awarded to the low responsive bidder in much the same way as formal advertising.

Chairman PROXMIRE. And, what is the difference between that and advertised competitive bidding?

Mr. MALLOY. Well, under the law, to be formally advertised, a transaction goes through a very formal procedure. Formal bid procedures require specifications that are firm and equally applicable to all bidders. There must be time available to go through this procedure. Thereafter the contract is awarded to the low responsive and responsible bidder.

Chairman PROXMIRE. Isn't it true you would, for example, in procuring a plane or procuring a submarine, or something of that kind—that you might have competition in the design phase, and then having made your commitment, then the production, and so forth, would not be competitive, but the whole procurement be classified as negotiated—competitive negotiations?

Mr. MALLOY. Yes. Many of our procurements would fall into that category.

Chairman PROXMIRE. And, you would classify that as competitive negotiation?

Mr. MALLOY. That is correct.

Mr. MORRIS. Except that the follow-on production, sir, if it continued only with the one source, it would not be competitive.

We have a separate classification.

Chairman PROXMIRE. What do you call that?

Mr. MORRIS. Follow-on, after price or design competition. That would be noncompetitive.

Chairman PROXMIRE. Classified as noncompetitive.

Mr. MORRIS. Right. About 18 to 20 percent of our procurements each year are in that classification.

42.9 PERCENT PRICE COMPETITIVE BUYING

Chairman PROXMIRE. All right. Now, in the area—more than 50 percent of your procurement is now so-called competitive negotiated or advertised competition—something like 58 percent now, or 56 percent.

Mr. MORRIS. As indicated in our statement, sir, under the rules that we use for reporting true price competition, 42.9 percent of our procurement last year were price competitive.

Chairman PROXMIRE. So, 57.1 is not price competitive, even on the basis of so-called negotiations.

Mr. MORRIS. That is correct.

NEED FOR RELIANCE ON COST RECORDS

Chairman PROXMIRE. Here, of course, there is enormous reliance on the cost records of the contractor. This is essential to determine the fair price.

Mr. MORRIS. That is correct.

Chairman PROXMIRE. And, under these circumstances, as you say, you will have to comply with—the contractor will have to comply with the Truth in Negotiations Act, and have to provide full, complete, comprehensive records, beginning 10 days or so from now.

Mr. MORRIS. That is correct, sir.

NITZE ORDER TO BE INCORPORATED INTO ASPR

Chairman PROXMIRE. Now, in addition to that, Deputy Secretary Nitze issued a memorandum in September, ordering a program of post-award audits, on noncompetitive, firm, fixed price contracts.

We understand this is about to be formally incorporated into the armed services procurement regulations. And you, as I understand in your statement that this would be effective upon receipt. Does that mean that this is going to go into effect at about the same time?

Mr. MORRIS. Concurrently, sir. This one document contains all provisions. (See p. 162.)

Chairman PROXMIRE. This means, then, that the Comptroller General, as well as the auditing staff of the—of your office, will have access to these records?

Mr. MORRIS. The Comptroller General always has had, sir, by law. We have not by regulation. We now, by Mr. Nitze's decision, will have the access as a matter of contract right. That is, we will negotiate this right in each contract.

ORDER APPLIES TO SUBCONTRACTS

Chairman PROXMIRE. Does this extend to subcontracts, or—this Nitze order—or is it only confined to prime contracts?

Mr. MALLOY. Mr. Chairman, there is a flow down from the prime contract to the subcontract. In other words, this audit right follows the same line as the law itself. Wherever the law is applicable, and it is applicable at the subcontract level under certain conditions——

NOT APPLICABLE IN CERTAIN CASES

Chairman PROXMIRE. Where is it not applicable?

Mr. MALLOY. Well, it is not applicable under the same conditions that it would not be applicable in a prime contract; namely, if there is adequate price competition, or if the purchase is for catalog items, or for items the price of which is set by law or regulation.

Chairman PROXMIRE. So, it would be applicable to subcontracts, unless there is price competition?

Mr. MALLOY. Any time the Public Law 87–653 is applicable, this audit right is applicable.

WHAT ASSURANCE OF ENFORCEMENT

Chairman PROXMIRE. Well, this kind of thing has been done before, as you know—this kind of tightening up at the insistence of the GAO. Yet, it has not been followed up with enforcement in the eyes of the GAO, or in our eyes. And, in view of the past criticisms by the GAO of the Defense Department's failure to enforce many of its own regulations, what steps is the Department now taking to insure enforcement of the new regulations we just referred to?

ENFORCEMENT STEPS BEING TAKEN BY DOD

Mr. MORRIS. Sir, I think it is important in respect to this audit question to point out that we are addressing one specific area that has not formerly been covered; namely, the firm fixed price contract awarded noncompetitively. As to cost contracts, we have, in fact, had this audit right and exercised it. The steps that are being taken are those that are outlined in our statement. We started, in fact, some weeks ago with an 8-hour training seminar which has been given now to 3,000 of our principal negotiators. This includes the film which I believe——

Chairman PROXMIRE. Eight-hour seminar. These men come in what—for 2 days?

Mr. MORRIS. For 1 full day of training discussions.

Chairman PROXMIRE. This includes the film, it includes lectures, being given material to read. Are they tested at all, to see if they have assimilated it?

Mr. MORRIS. Yes, they are, sir.

Chairman PROXMIRE. Now——

Mr. MORRIS. In addition to this, we have put out, quite apart——

TRAINING AND TESTING PROGRAM

Chairman PROXMIRE. They are all tested—each procurement official is tested?

Mr. MORRIS. Those who are attending the seminar. In addition, we run procurement review teams—each department, and our office, makes

periodic surveys of our principal buying offices. During such surveys, the teams frequently give spot tests to the personnel on this and on other of our regulations.

Chairman PROXMIRE. Are these spot tests, or all 3,000 of the officials have been tested?

Mr. MORRIS. We are talking about two different things. The particular training seminar I referred to, Mr. Malloy tells me, involves a testing at the end of the course.

Chairman PROXMIRE. For all members?

Mr. MORRIS. Those who attend; yes, sir. In addition, we have published——

Chairman PROXMIRE. I hate to keep interrupting you—but this 3,000—out of how many procurement officials?

Mr. MORRIS. We have a total professional force of around 25,000, of whom I would guess about 5,000 are small purchase personnel, and they have a separate training course of their own.

Chairman PROXMIRE. That would leave about 20,000, 3,000 of whom have gone through this. How long will it take to have all 20,000 trained and tested?

Mr. MORRIS. We have exposed all 20,000 to this new program, through a second technique which I mentioned; namely, the so-called self-help kit, a copy of which we will supply to you. That has a full case example that GAO assisted us in developing, plus questions and answers. That has gone out to 54,000 people.

Chairman PROXMIRE. You intend to bring any more into this more intensive program?

Mr. MORRIS. Yes, sir.

Chairman PROXMIRE. How many—all of them?

Mr. MORRIS. In time we want to cover our entire force. The film, that is part of this program, has been widely circulated; many copies have been made of it. It is quite a useful presentation—to impress upon all of our people an understanding of the importance that we attach to this law and its implementation.

Chairman PROXMIRE. You say in time. I trust you mean just as rapidly as you can—in view of the fact you are asking for the enforcement of the Truth in Negotiations Act as of next week. I presume if it is going to be enforced and the enforcement is going to mean anything, these people have to be trained within a few months—certainly by the first quarter of 1968—I would presume some of those people would be trained by that time.

43 TRAINING COURSES

Mr. MORRIS. Right. I would like to stress we do not depend just on one-shot training. We have, as mentioned, some 43 training courses, given at several locations; 8,300 people went through that last year, and that is about the flow we expect to go through these particular programs each year.

We will incorporate training in this subject in those courses as needed.

Chairman PROXMIRE. Now, you made a direct response, I think, to our many questions that I am sure are going to develop here on the use of Government-owned equipment by contractors?

Mr. MORRIS. Yes, sir.

NEED FOR PUBLIC REPORTS ON USE OF GOVERNMENT EQUIPMENT

Chairman PROXMIRE. At the same time, I am afraid that you may not have gone to the heart of our problem.

I am sure you are aware of the Comptroller General's report and the example of a $1.4 million piece of equipment that was bought by the Government, specifically for use by a contractor for the turning out of jet blades of some kind, and the contractor apparently used it very little for this purpose—he used an old piece of equipment for Government jet blades. He used it 78 percent of the time, according to his own records, on his own private commercial use.

Then there was another example of $6 million of equipment business on behalf of a contractor who used the Government-owned equipment 58 percent of the time for his own use.

There was another example of a contractor who was warned about using this Government-owned equipment for his own commercial profit, and each succeeding year he used it more, after the warning.

Under these circumstances, you point out that you expect to have more careful auditing and more careful reporting on this?

Mr. MORRIS. Right, sir.

Chairman PROXMIRE. But, you do not indicate, to the best of my knowledge, whether you are going to have regular public reports made available, say, on a quarterly basis. And, it is hard for this Senator to understand why, in view of the fact that this equipment is owned by the taxpayer, and represents what seems to be a subsidy to the contractor when he uses it for his own use—why there should not be such regular public reports, in view of the fact that everybody in this room has to file income tax returns—everybody who has worked for a living, and most of us do—and, if we make a little more in one quarter than our withholding, or than we would normally pay, we have to file a new report each quarter. And, if this is difficult for an ordinary taxpayer, it ought to be a lot easier for the contractor who is using this Government equipment to make quarterly reports that would indicate the time that his equipment is being used for commercial private purposes, and the time it is being used for the Government.

Why can't we do that?

MACHINE-BY-MACHINE USE RECORDS AND REPORTS

Mr. MORRIS. Well, sir, I think we have outlined, in our statement, the stronger surveillance and reporting requirements which are being instituted. I believe the particular issue that Mr. Staats has addressed, and which we still must act upon, is the maintenance of what he describes as machine-by-machine utilization records, and the availability of reports covering machine-by-machine usage.

Chairman PROXMIRE. Exactly right.

DOD COMMITTED TO MACHINE-BY-MACHINE USE PROCEDURE

Mr. MORRIS. We have had this under very careful study, Mr. Chairman. The problem, as it often is in our inventory management problems, is whether we should attempt to do a thousand percent coverage

of the smallest and least valuable equipments. We are committed to adopting a machine-by-machine utilization procedure.

Chairman PROXMIRE. Certainly where the equipment, say, is worth a hundred thousand dollars or fifty thousand dollars, or some substantial amount, there should be machine-by-machine reporting on a regular basis, public and quarterly. (See pp. 52, 455.)

Mr. MORRIS. Correct, sir.

NEED FOR LEGISLATION

Chairman PROXMIRE. Would it be of any value—wouldn't it be of value to have, in view of the experience with this in the past—to have a law passed that would require this?

Mr. MORRIS. Sir, we do not see the need therefor, nor has GAO suggested this, to our knowledge.

Chairman PROXMIRE. I think they are going to suggest it. We asked them for suggestions yesterday. (See p. 65.)

DOD ACKNOWLEDGES PROBLEM

Mr. MORRIS. As in the case of the access to records, we are completely dedicated to fully implementing the wisest course of action here. We do not need to be directed to do this by law. We acknowledge the problem.

SYSTEM UNFAIR TO COMPETITORS

Chairman PROXMIRE. Well, certainly in the past you would agree that there has been a very, very serious abuse, not only from the standpoint of the taxpayer, but from the standpoint of the competitor.

After all, I would hate to be in business with a competitor, against a competitor who has Government-owned equipment worth millions of dollars that he is using to compete with me. He does not have to worry about depreciation charges, he does not have to worry about payments. He has an advantage which can just be overwhelming.

ADEQUACY OF RENTAL RATES

Mr. MORRIS. This goes to the matter of rental rates, sir, and whether they are proper. As stated in our opening statement, we are carefully examining these at this time.

Chairman PROXMIRE. I will be back. Congressman Rumsfeld?

STATEMENTS BY GAO AND DOD ON SUPPLY TO SOUTHEAST ASIA

Mr. RUMSFELD. Mr. Morris, in attachment C to your statement, dated November 24, which is apparently a memorandum by Secretary McNamara, it states that the logistic buildup in Southeast Asia has been virtually completed, and that the military departments, Defense agencies, and all commands concerned are deserving of the highest commendation for this superb achievement.

Yesterday, on November 27, the Comptroller General of the United States, made the following statement:

> The Army is not yet in a position to know within a reasonable degree of confidence what stocks are on hand and what stocks are actually excess to their needs.

Could you comment on these two seemingly contradictory statements, since you are appearing here in behalf of DOD, and DOD and GAO both work for the same Government.

Mr. MORRIS. I would be pleased to, sir. There is no lack of understanding between us and GAO. We have had several conferences on this. Mr. Brooks and I spent 3 days in Vietnam, last week, looking into this specific matter.

My statement does attempt to trace some of the background, but let me summarize it quickly.

In the early days of the buildup, as we deployed units, we had no choice but to fully equip those units with packages of supplies estimated to be everything that each unit might possibly need. We had no demand—no usage experience.

Mr. RUMSFELD. You have already traced that. GAO even commented on the difficulty of the assignment I am talking about today.

Mr. MORRIS. Yes, sir. Let me come to today.

Starting in March of this year, with the buildup reaching this virtual completion point, we sent 500 people out to the Army units—some 1,900 units. We have now pulled back from those units, to the three major depot levels, the materials we find they do not need. This is what GAO is addressing. We have those materials that came back into our depots, along about August or September, now awaiting counting and full identification, so that they can be put on the master depot inventory records. This is the area of lack of completeness and lack of accuracy, which they are referring to and which we are referring to.

Mr. RUMSFELD. Then you are saying that GAO is referring to a situation in which, as you have just described it, all excess supplies have been pulled back and are now in storage depots. The only job remaining is the compilation of an inventory list?

Mr. MORRIS. Or the entry upon our proper stock and inventory records of the actual quantities of the items which are now in depot possession—the purpose being to, (*a*) redistribute those stocks within Vietnam, that are not required by individual units, and (*b*) to pull back out of Vietnam, those that will not be required in the country at all, and make use of them elsewhere in the world.

Mr. RUMSFELD. That was not my initial impression of what GAO said. But, now that I reread the statement, it is possible that is what they meant when they said that DOD is aware of the problem and that there are various projects or programs being undertaken or planned.

Mr. MORRIS. I am sure we are quite clear among ourselves on this.

Mr. RUMSFELD. Are there any plans beyond what you have described?

I notice GAO says either undertaken or planned. Is there anything planned beyond this?

SPECIAL AGENCY TO MANAGE UTILIZATION AND REDISTRIBUTION OF EXCESSES

Mr. MORRIS. The attachment C you are looking at is one of the major new actions that is being taken—a special agency will be established by the commander in chief of the Pacific to manage the utilization and redistribution of those items found excess to Vietnam requirements—a special group to manage what will be a big operation.

Mr. RUMSFELD. Right. But, that is after the fact. The problems before the fact, that led to the instances of excess, have been dealt with?

Mr. MORRIS. Yes, sir.

Mr. RUMSFELD. I would like to get some comments, not on your testimony, but on something that has disturbed me. I have both listened to your testimony and read it. You have detailed here a report of your progress, what you are undertaking. And, I certainly commend you for the steps that are being taken.

ARTICLE BY CONGRESSMAN GONZALEZ

However, I have read an article from the Progressive magazine of August 1967, by Henry Gonzalez, who is a Democratic Member of the House of Representatives from the State of Texas, a senior Member of the House. (See also, p. 339.)

THE WAR PROFITEERS

(By Representative Henry B. Gonzalez, Democrat, of Texas)

During a war, it is necessary for a nation to mobilize both its human and material resources—men, arms, equipment, and other supplies. But there is a crucial difference in the ways by which men and property are pressed into service for war.

Men are drafted. If they are in the prescribed age bracket and otherwise qualify, they are mobilized, willing or not. The civilian who is conscripted into the military sacrifices the comforts of his family, his home, his job, his security, and possibly his life. The individual has no opportunity to bargain or negotiate for his pay and benefits. His compensation is fixed by law and it is pitifully low.

Property, on the other hand, is purchased, much of it through the awarding of contracts by the government, usually at great profit to corporations.

One would suppose that those persons who supply the government with property in time of war would be willing to do it without exacting excessive profits. In light of the heavy sacrifices by those who go to war, those who do not fight but who benefit from the war by doing business with the Government should at least be expected not to take advantage of the situation by profiteering.

But the facts make it clear that profiteering is taking place on a considerable scale and there is evidence that it is on the upswing.

"War profiteering" apparently is an unmentionable subject in Washington. Even the independent Renegotiation Board, established in 1951 to beat back the profiteers during the Korean War, prefers the term "excess profits." Nevertheless, the Board made determinations of excess profits in the amount of $24.5 million in fiscal year 1966. This money was returned to the U.S. Treasury by private contractors. In addition, $23.2 million was received by the Government through "voluntary refunds" and "voluntary price reductions" in connection with renegotiation proceedings. These recoveries, although small, are all the more remarkable in light of what Congress has done to the Renegotiation Board since it was created in 1951.

War profiteers grow fattest and richest when elected public officials, the press, and other news media ignore the issue. It is in the absence of public attention

today that the profiteer can successfully push his special interest legislation with one hand while pocketing "excess profits" with the other.

There was a time when war profiteering was a more glamorous and a more newsworthy issue. Some of us can recall the headlines made by the then Senator Harry S. Truman with his extensive Senate investigations into profiteering during World War II.

The War Contracts Price Adjustment Board, predecessor to the present Board, recovered more than $11 billion dollars in "excess profits" from private contractors doing business with their Government during World War II. More than $800 million was recovered in the aftermath of the Korean War. The real question is, how much got away?

The reason that profiteering increases in time of war is easily understood. During such periods the Government's need for supplies and materials increases suddenly to great heights. The requirement for speed in production eliminates the opportunity for often long, cautious negotiations, careful surveys, and other steps which sound purchasing policy otherwise requires. The practice of inviting bids for Government contracts is set aside; competition decreases and often disappears. The forecasting of costs of production becomes impossible except as a matter of guesswork. As a result, contractors, in seeking to guard against contingencies and often for less justifiable reasons, skyrocket their costs. It is during this crucial time, when the nation's need is greatest but its ability to proceed with caution is least that negligent and unscrupulous dealings are widely practiced.

Senator William Proxmire of Wisconsin, chairman of the Economy in Government Subcommittee, recently said that when he found out how the Defense Department is currently spending its enormous budget—an annual average of $1,600 for each American family—it "shocked me out of my chair."

No better example of the taking of "excess profits" exists than the one documented by the case of *Boeing Airplane Co.* v. *U.S.*, decided by the United States Tax Court in 1962. Boeing had attempted to charge, as a legitimate expense on its Government contract for military aircraft, the cost of the design, development, and construction of the prototype of the 707 commercial airliner.

Another item claimed by Boeing as a legitimate expense against its contract was $629,000 for "institutional" advertising, selling expense, and entertainment expense. The court found that the "institutional" advertising consisted in Boeing keeping its name before the public as a producer of commercial aircraft. This is not a new practice. Then Senator Harry S. Truman wrote in *The Progressive* in 1943 of parallel abuses in World War II, and pointed out that "the advertising costs the corporations practically nothing because the taxpayer foots the bill."

In the Boeing case the selling expenses were incurred in connection with its commercial business, and the entertainment expense was in part for the purchase of meals and the general entertainment of visitors and business associates. None of these items was allowed by the court.

Boeing had appealed a $9.8 million determination of excess profits by the Renegotiation Board. The court determined that Boeing owed the government not $9.8 million, but $13 million in excess profits, underscoring the weakness, or at least the moderation, of the Renegotiation Board. But renegotiation cases seldom reach the courts. If they did there might well be more Boeing-type cases.

A North American Aviation, Inc. case, decided by the Board in 1962, held that the company had received excess profits in the total amount of $16.5 million. And a $10 million refund of excess profits was obtained from General Motors in 1958, as a result of a Congressional investigation into the production of the F081F airplanes.

It is no surprise, then, that there is a movement to abolish the Renegotiation Board, or that among the strongest members of the movement are the aerospace industries. In a letter dated March 23, 1966, the Aerospace Industries Association of America, Inc. stated to the House Ways and Means Committee:

"This association is convinced that expiration of the [Renegotiation] Act would not harm the nation's defense effort and would not increase the cost of procurement."

It is the level of procurement and the relative rate of procurement that determines the profiteer. As an obvious example, Government procurement reached

record high levels in an extremely short period with the outbreak of World War II. A similar situation occurred with the Korean War. Vietnam, until recently, has been somewhat different. It is the sudden and tremendous upsurge in procurement that loosens up Government—mainly Defense Department—practices and sets the stage for profiteering. For Vietnam there was no sudden upsurge until last year.

For several years preceding 1966, procurement and prime contract awards by the Department of Defense had remained at a high but a fairly steady level. In fiscal year 1964, prime contract awards totaled $28.7 billion. In fiscal 1965, the figure even declined, to $27.9 billion. But in fiscal 1966 prime contract awards soared to $38.2 billion, an increase of more than $10 billion or approximately thirty-nine per cent in a one year period—a sudden and tremendous upsurge.

The figures for the first six months of fiscal year 1967 showed a twenty-eight per cent increase over the 1966 figures. The best estimate projects about a twenty per cent increase for the full year, which will place prime contract awards for 1967 at $45 billion. This amount will be the highest dollar amount in any year since World War II, including the Korean period. Inevitably these increases will add a greater workload to the Renegotiation Board and will hopefully result in large recoveries of excess profits. But how well-equipped is the Board to do a thorough job?

The Government's earliest attempts to curb profiteering resulted in the Vinson-Trammell Act of 1934. This law, as later amended, fixed profits on shipbuilding at ten per cent and on aircraft at twelve per cent. Unfortunately, neither the Vinson-Trammell Act nor subsequent attempts to restrict excessive profits by building safeguards around the contract itself worked as intended. Vinson-Trammell contractors simply padded their costs to defeat the statutory percentage limitation on profits. Cost-plus-fixed-fee contracts; lump-sum contracts; escalator clauses; permitting price adjustments in accordance with fluctuations of labor and other costs; and letters of intent to negotiate a formal contract were all tried without material success.

With the experience of World War I, when profiteering reached a zenith, and the failure of Vinson-Trammell, still fresh in Government circles, the principle of renegotiation was introduced at the outset of World War II. Under the Renegotiation Act of 1942 the Government reserved the right to renegotiate wartime contracts by procurement officials. Thus, a contractor may be called upon to refund to the Treasury that portion of his profits for the fiscal year examined—on contracts with Government departments named in the Act—which are determined by the Board to be excessive.

The Renegotiation Act of 1951 made the Board independent for the first time. But the Act is temporary and must be renewed every two years. The 1951 Act was strong and sound. It enabled the Government to recover more than $800 million in connection with contract awards during the Korean War, in addition to large voluntary refunds.

Beginning in 1954, however, a series of amendments was pushed through Congress with the intent of *reducing* the ability of the Board to do the job intended. For example, under the original Act, contractors whose prime contract awards totaled at least $250,000 during the fiscal year were subject to renegotiation. The 1954 amendments raised the floor to $500,000. In 1956 the floor was again raised to $1 million.

An even more serious limitation on the Board's ability to police the profiteers is the multitude of exemptions that have been inserted into the Act. Contracts for "durable productive equipment," meaning machinery, tools, or other productive equipment with a useful life of more than five years, are exempt. There is an exemption for "Standard Commercial Articles or Services"—articles customarily maintained in stock by the contractor, the commercial non-governmental sales from which constitute at least thirty-five per cent of the total sales of that article during the fiscal year. This covers a huge range of products and services.

Other limitations now include an exemption for construction contracts let by competitive bidding, a five year carry-forward loss provision, and elimination from the Act of a number of Government agencies which were originally cov-

ered. These agencies include the Coast Guard, Department of Commerce, Tennessee Valley Authority, Bureau of Mines, Bureau of Reclamation and the Canal Zone Government.

There is a time lag of about eighteen months between the awarding of prime contracts and the time they come before the Renegotiation Board for review, if they ever do. So the impact upon the Board's activities as a result of the huge step-up in Defense procurement for Vietnam has not yet been felt. When it does hit, it will confront a Board hamstrung not only by statutory limitations and with its jurisdiction narrowly defined. It will also find a Board seriously reduced in manpower. The Board's activities are conducted today with less than twenty-five per cent of the personnel it had during the Korean War.

The profiteers who intentionally gouge the Government for excessive profits during a time of war are also guilty of consciously withdrawing efficiency from our industrial capacity. These private-businessmen profiteers are in reality guilty of sabotage.

It is a peculiar system of national values when young men are vilified and sent to the penitentiary for refusing conscription—a method of coercion the opposition to which was responsible in large part for the formation of the United States—while contractors and corporate executives are permitted to stay home and profiteer off the people in a time of war. In light of the heavy sacrifices made by the men who do the fighting and dying, one would expect that those who do business with the Government would not take advantage of the situation by profiteering.

Our history has been one of rampant war profiteering, and I am convinced, as even the limited annual reports of the Renegotiation Board reveal, that profiteering is going on now, is increasing, and will continue to increase unless something more realistic is done to stop it. For this reason, I have introduced legislation to put some meaning into renegotiation. My bill, H.R. 6792, would bring the floor for contracts subject to renegotiation back down to $250,000, eliminate the all-important standard commercial articles exemption, eliminate the competitive bid-construction exemption, eliminate other exemptions with respect to subcontracts, and place TVA under coverage of the Act.

These changes would restore the Board to approximately the condition it was in and the strength it had at the outbreak of the Korean War. There is no excuse for not taking proper safeguards against profiteering. By confining the Board the way is it restricted at present, we have, in effect, locked up the policeman on the beat in the middle of a crime wave.

But powerful forces are moving to do just that. Last year a serious effort was made to kill the Board by not extending the Renegotiation Act. The Act was extended, until 1968. An even more serious effort to kill it will surely be made next year. In the meantime, an investigation of the Renegotiation Act was authorized. Both the law and the Board have been examined and investigated several times. The latest Congressional investigation of the Board was as recent as 1962.

What we ought to be investigating is not the Board, but profiteering itself. A full-fledged Congressional investigation into profiteering, in which the names of contractors and corporations who have taken exececessive profits in the past would be revealed, and in which the appropriate officials could be examined, would be both a revealing and an enlightening lesson. It could lead to important new legislation.

The title of his article is "War Profiteering." He states:

The facts make it clear that profiteering is taking place on a considerable scale. There is evidence that it is on the upswing.

He goes on to say:

War profiteers grow fatter and richer. When elected public officials, the press, and other news media ignore the issue. It is in the absence of public attention today that the profiteer can push his special interest legislation with one hand, while pocketing excess profits with the other.

And finally—just picking out two or three key paragraphs—he says:

The profiteers who intentionally gouge the Government for excessive profits during a time of war are also guilty of consciously withdrawing efficiency from our industrial capacity. These private businessmen profiteers are in reality guilty of sabotage. Our history has been one of rampant war profiteering, and I am convinced that even the limited annual reports of the Renegotiation Board reveal that profiteering is going on now, is increasing, and will continue to increase unless something more realistic is done to stop it.

Those are strong words.

Mr. MORRIS. I know of absolutely no evidence to support those statements, sir. The renegotiation board reports of past years certainly do not bear it out. The current year report is not yet out, won't be for a month or two. Our own data, such as it is, certainly would not lend any credence to those statements. There are undoubtedly individual cases of large profits. Mr. Pike did reveal the case of one company that overcharged us excessively for a matter of several years. There may be such individual cases. But I know of no basis for that kind of generalization.

Mr. RUMSFELD. You say Mr. Pike made you aware of an instance where there had been substantial overcharging over a period of time. You indicate there are other instances you know of?

Mr. MORRIS. No, sir; I did not say that. I said there may be other similar instances, but we have no valid information that would support statements of that type, nor has GAO brought any to our attention that I am aware of.

Mr. RUMSFELD. And Mr. Gonzalez has not. You are not aware of any information he may have along the lines of what Mr. Pike has suggested?

Mr. MORRIS. No, sir.

Mr. RUMSFELD. Does it concern you that someone outside of your agency comes to you with proof of excessive profits over a long period of years? Mechanically, all of us would have to recognize there are going to be instances that are just beyond the human ability to control. But the natural question, after you have documented an instance where there has been substantial overcharging and you did not know of it, is: What else is there? This is bothering the American people, it is bothering the Congress, and I am sure it is bothering you.

Your report today is a glowing one, documenting many steps you are taking. Are you satisfied that these measures will make you aware of all but the one or two things that might slip by you?

Mr. MORRIS. Sir, as I said, I think on page 2 of my opening statement, the vastness of this defense procurement program means that almost every transaction is an opportunity for waste or improvement. We welcome the spotlighting of these problems by this committee, by GAO, by our own auditors, by any Member of the Congress, or of the public. We try to act responsively on every opportunity to improve. With a 15-million-transaction system, $44 billion in amount last year,

we are bound to have many mistakes. If we were 99 percent perfect, we still have 150,000 errors a year—just 1 percent of 15 million.

But we want to do the best possible job. We are all devoted to this. Our 25,000 procurement professional people are. We regret that generalizations sometimes are made without specifics that we can act upon.

Mr. RUMSFELD. Senator Proxmire discussed the question of control over Government-owned property that is in the possession of contractors and used by them. The Comptroller General indicated that the total value of such property is unknown, but your DOD data shows at least three classes of such which might total $11 billion in value.

The GAO offered a guess that if you add in other classes, the figure might be $4 billion larger, or a total of $15 billion. Is that your best guess, also?

$14.8 BILLION IN GOVERNMENT PROPERTY IN HANDS OF CONTRACTORS

Mr. MORRIS. I have an itemization of $14.8 billion, if you include everything, including special test equipment; yes, sir.

Mr. RUMSFELD. How many classes are there? The $11 billion figure apparently derives from two classes.

Mr. MORRIS. Let me break it down, if I may, sir. The categories are, first, real property, with a value of about $2.6 billion. Industrial plant equipment, with a value of $4.3 billion. Material in the hands of contractors, another $4.7 billion. And, special tooling and test equipment, which is an estimated figure, of $2.9 billion. It should total $14.9 billion. I rounded it as I gave you the figures.

Mr. RUMSFELD. It does not look like it comes to $14.9. It seems too low.

Mr. CURTIS. It is $11.9 billion. We are missing $2 billion.

Mr. MORRIS. $2.6, $4.3, $4.7 billion—and I gave you $2.9 billion—the last one really should be rounded to $3 billion.

Mr. CURTIS. What was the material—$4.7 billion?

Mr. MORRIS. That is right, sir.

Mr. CURTIS. I misunderstood.

Mr. RUMSFELD. This circular or regulation which you said was hot off the presses—is there any reason why the members of the committee cannot see that?

Mr. MORRIS. We would be glad to give each of you a copy right now, sir.

Chairman PROXMIRE. That is an excellent idea. We would like to put that in the record, along with—well, there are two regulations that we have talked about in connection with the Truth in Negotiations Act.

Mr. MORRIS. It is all in one package, sir.

Chairman PROXMIRE. This will be put in the record.

(The document referred to follows:)

DEFENSE PROCUREMENT CIRCULAR

30 NOVEMBER 1967 NUMBER 57

This Defense Procurement Circular is issued by direction of the Assistant Secretary of Defense (Installations and Logistics) pursuant to the authority contained in 5 U. S. Code 301, 10 U. S. Code 2202, DOD Directive No. 4105.30, and ASPR 1-106.

All Armed Services Procurement Regulation material and other directive material published herein is effective upon receipt except as otherwise indicated.

Unless otherwise indicated in the introductory language preceding an item, each item in this Circular shall remain in effect until the effective date of that subsequent ASPR revision which incorporates the item, or until specifically canceled.

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CONTENTS

	Item
Defense Procurement Circulars	I
Prompt Payment to Contractors	II
Material Inspection and Receiving Reports	III
Revised Audit Clauses	IV
Public Law 87-653	V
Employment of Disadvantaged Persons in Sections of Concentrated Unemployment or Underemployment	VI
Equal Employment Opportunity	VII

ITEM I--DEFENSE PROCUREMENT CIRCULARS

Pending incorporation in an ASPR revision, the following change in 1-106.2(c), regarding the expiration dates of DPC's is issued for information and guidance of all concerned. The statement in paragraph 3 above is also changed in this and all future DPC's. It should be noted that all DPC items now in effect are hereby extended until incorporated in an ASPR revision. (For a listing of DPC items currently in effect, see paragraph 2, Item III of DPC #56 dated 6 October 1967.)

" (c) Unless otherwise indicated in the introductory language preceding an item, each item in Defense Procurement Circulars will remain in effect until the effective date of that subsequent ASPR revision which incorporates the item, or until specifically canceled. "

ITEM II--PROMPT PAYMENT TO CONTRACTORS

It is the policy of the Department of Defense to pay its bills promptly. Contractors plan their budgets and financial programs on the assumption that their invoices will be honored in accordance with their contract terms. It is important that contractors render bills correctly and that DoD personnel assure the prompt payment of all amounts properly due.

ASPR Appendix E, particularly Part 2, sets forth basic policies and procedures with which contracting officers and others involved in the payment process should be thoroughly familiar. Paragraphs E-201, E-202, and E-204 provide for expeditious processing of all proper payments in order to avoid undue financial burdens being placed on contractors. In this connection, the following matters are emphasized:

1. Accelerate all proper payments earned by contractors, including progress payments (see E-201), invoices, and vouchers. Utilize vigorously all proper means available for ascertainment and payment of amounts payable to contractors as rapidly as possible (see E-202). Particular attention should be given to prompt action on physically completed contracts where amounts are being withheld pending final settlements. Likewise, contracting officers should give favorable consideration to reasonable requests for billing more frequently than monthly.

2. Respond promptly to requests for contract financing provisions (see E-202). This includes not only consideration of such matters as progress payments, but also careful consideration of the provisions governing normal payments.

3. Take timely and effective action to complete negotiation and execution of contractual documents which are prerequisite to payment of amounts earned by contractors (see E-202 and E-202.1, especially the examples in (i) - (iv) in E-202).

4. Make every reasonable effort to assist small business concerns in the resolution of their problems relative to the financing of contract performance (see E-204).

* * * * *

ITEM III--MATERIAL INSPECTION AND RECEIVING REPORTS

This Item will expire 1 April 1968.

The mandatory date of 2 January 1968 for use of the new DD Forms 250 and procedures in Appendix I remains firm with the following qualifications:

a. If the contractor has a complicated, mechanized DD Form 250 procedure and can demonstrate to the contracting officer that such procedures cannot be adapted to the new forms and procedures by 2 January 1968 despite bona fide efforts to that end, the contracting officer can grant a deviation for that particular contractor.

b. Such deviation shall be in writing, shall not extend past 1 April 1968, and shall set forth specifically those portions of the new procedure to which the deviation applies.

ITEM IV--REVISED AUDIT CLAUSES

To provide adequate contractual coverage for access rights to contractor's records necessary to perform post-award reviews, when required under Public Law 87-653, changes have been made in the clauses in ASPR 7-104.41. Effective as soon as received, these revised clauses will be used in contracts as provided in 7-104.41 herein. The following letter from the Deputy Secretary of Defense explains the reasons for the changes and the limited use to be made of the broadened coverage applicable to firm fixed price contracts. (Letter is provided for informational purposes and is canceled when the ASPR coverage is incorporated in a subsequent revision of the Regulation.)

" THE SECRETARY OF DEFENSE
WASHINGTON

29 SEP 1967

MEMORANDUM FOR Secretaries of the Military Departments
Assistant Secretary of Defense (Comptroller)
Assistant Secretary of Defense (I&L)
Directors of Defense Agencies

SUBJECT: Access to Cost Performance Records on Noncompetitive Firm Fixed Price Contracts

I have given careful consideration to the arguments for and against access to contractor post-award cost performance records on noncompetitive firm fixed price contracts, for the purpose of determining the degree of contractor compliance with PL 87-653. Clearly, it has been and remains our policy that in firm fixed price contracts the cost and profit consequences are the full responsibility of the contractor since he assumes all the risk of performing in accordance with the contract. Likewise, it is our policy that such contracts be used only where there exists a reliable basis for judging reasonableness of contractor cost estimates. Where such a basis does not exist, other contract forms should be used.

The Department of Defense is required to conduct a program of review and audit sufficient to ascertain that the cost or pricing data submitted by contractors in connection with the negotiation of noncompetitive firm fixed price contracts were current, accurate and complete as required by PL 87-653. It is our policy to make such audits, as fully as possible, prior to completing the negotiation of the contract. However, when it is necessary to provide assurance that defective cost or pricing data were not submitted, audits should also be conducted of actual costs incurred after contracts are consummated. To assure that such post-award audits may be conducted when deemed appropriate, action shall be taken to include in all noncompetitive firm fixed price contracts involving certified costs or pricing data, a contractual right to have access to the contractor's actual performance records.

Circumstances which may dictate the use of a post-award cost performance audit include such cases as those where: (1) factors of urgency in placing

the initial procurement were clearly present; (2) material costs are a significant portion of the contractor's total cost estimate; (3) a substantial portion of the contract is proposed for subcontracting; or (4) there was a substantial interval between completion of the pre-contract cost evaluation and agreement on price.

In directing this action, I wish to make it clear that the purpose of any post-award cost performance audit, as provided herein, is limited to the single purpose of determining whether or not defective cost or pricing data were submitted. Access to a contractor's records shall not be the purpose of evaluating profit-cost relationships, nor shall any repricing of such contracts be made because the realized profit was greater than was forecast, or because some contingency cited by the contractor in his submission failed to materialize - unless the audit reveals that the cost and pricing data certified by the contractor were, in fact, defective.

I desire that the Assistant Secretary of Defense (Installations and Logistics) and the Assistant Secretary of Defense (Comptroller) issue implementing instructions to place the above policies into effect.

Paul H. Nitze

DEPUTY "

7-104.41 revised

7-104.41 Audit and Records.

(a) Insert the following clause only in firm fixed-price and fixed-price with escalation negotiated contracts which when entered into exceed $100,000 except where the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. In addition, the contracting officer shall include this clause with appropriate reduction in the dollar amounts provided therein, in firm fixed-price and fixed-price with escalation negotiated contracts, not exceeding $100,000, for which he has obtained a Certificate of Current Cost or Pricing Data in accordance with 3-807.3(a)(iii) in connection with the initial pricing of the contract.

AUDIT (NOV. 1967)

(a) For purposes of verifying that certified cost or pricing data submitted, in conjunction with the negotiation of this contract or any contract change or other modification involving an amount in excess of $100,000, were accurate, complete, and current, the Contracting Officer, or his authorized representatives, shall--until the expiration of three years from the date of final payment under this contract--have the right to examine those books, records, documents, papers and other supporting data which involve transactions related to this contract or which will permit adequate evaluation of the cost or pricing data submitted, along with the computations and projections used therein.

(b) The Contractor agrees to insert this clause including this paragraph (b) in all subcontracts hereunder which when entered into exceed $100,000, unless the price is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. When so inserted, changes shall be made to designate the higher-tier subcontractor at the level involved as the contracting and certifying party; to add "of the Government prime contract" after "Contracting Officer"; and to add, at the end of (a) above, the words, "provided that, in the case of any contract change or modification, such change or modification results from a change or other modification to the Government prime contract." In each such excepted subcontract hereunder which when entered into exceeds $100,000, the Contractor shall insert the following clause.

AUDIT--PRICE ADJUSTMENTS

(a) This clause shall become operative only with respect to any change or other modification of this contract which involves a price adjustment in excess of $100,000 unless the price adjustment is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation, provided that such change or other modification to this contract results from a change or other modification to the Government prime contract.

(b) For purposes of verifying that certified cost or pricing data submitted in conjunction with such a contract change or modification were accurate, complete and current, the Contracting Officer of the Government prime contract or his authorized representative shall--until the expiration of three years from the date of final payment under this contract--have the right to examine those books, records, documents, papers and other supporting data which involve transactions related to this contract or which will permit adequate evaluation of the cost or pricing data submitted, along with the computations and projections used therein.

(c) The Subcontractor agrees to insert this clause, including this paragraph (c), in all subcontracts hereunder which when entered into exceed $100,000.

(b) Insert the following clause in formally advertised contracts which are expected to exceed $100,000 when entered into; and in firm fixed-price and fixed-price with escalation negotiated contracts which when entered into, exceed $100,000 when the price is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. In negotiated contracts, delete from paragraph (b) of the clause the words "the Comptroller General of the United States".

AUDIT--PRICE ADJUSTMENTS (NOV. 1967)

(a) This clause shall become operative only with respect to any change or other modification of this contract which involves a price adjustment in excess of $100,000, unless the price adjustment is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation.

(b) For purposes of verifying that certified cost or pricing data submitted in conjunction with such a contract change or other modification were accurate, complete, and current, the Contracting Officer, the Comptroller General of the United States, or any authorized representatives, shall--until the expiration of three years from the date of final payment under this contract--have the right to examine those books, records, documents, papers and other supporting data which involve transactions related to this contract or which will permit adequate evaluation of the cost or pricing data submitted, along with the computations and projections used therein.

(c) The Contractor agrees to insert this clause, including this paragraph (c), in all subcontracts hereunder which when entered into exceed $100,000. When so inserted, changes shall be made to designate the higher-tier subcontractor at the level involved as the contracting and certifying party; to add "of the Government prime contract" after "Contracting Officer"; and to add, at the end of (a) above, the words, "provided that the change or other modification to the subcontract results from a change or other modification to the Government prime contract."

(c) Insert the following clause in any negotiated contract which is not firm fixed-price or fixed-price with escalation.

AUDIT AND RECORDS (NOV. 1967)

(a) The Contractor shall maintain books, records, documents, and other evidence and accounting procedures and practices, sufficient to reflect properly all direct and indirect costs of whatever nature claimed to have been incurred and anticipated to be incurred for the performance of this contract. The foregoing constitute "records" for the purposes of this clause.

(b) The Contractor's plants, or such part thereof as may be engaged in the performance of this contract, and his records shall be subject at all reasonable times to inspection and audit by the Contracting Officer or his authorized representative. In addition, for purposes of verifying that cost or pricing data submitted, in conjunction with the negotiation of this contract or any contract change or other modification involving an amount in excess of $100,000, were accurate, complete, and current, the Contracting Officer, or his authorized representatives, shall--until the expiration of three years from the date of final payment under this contract--have the right to examine those books, records, documents, papers and other supporting data which involve transactions related to this contract or which will permit adequate evaluation of the cost or pricing data submitted, along with the computations and projections used therein.

(c) The Contractor shall preserve and make available his records (i) until the expiration of three years from the date of final payment under this contract, and (ii) for such longer period, if any, as is required by applicable statute, or by other clauses of this contract, or by (A) or (B) below.

(A) If this contract is completely or partially terminated, the records relating to the work terminated shall be preserved and made available for a period of three years from the date of any resulting final settlement.

(B) Records which relate to (i) appeals under the "Disputes" clause of this contract or (ii) litigation or the settlement of claims arising out of the performance of this contract, shall be retained until such appeals, litigation, or claims have been disposed of.

(d) (1) The Contractor shall insert this clause, including the whole of this paragraph (d), in each subcontract hereunder that is not firm fixed-price or fixed-price with escalation. When so inserted, changes shall be made to designate the higher-tier subcontractor at the level involved in place of the Contractor; to add "of the Government prime contract" after "Contracting Officer"; and to substitute "the Government prime contract" in place of "this contract" in (B) of paragraph (c) above.

(2) The Contractor shall insert the following clause in each firm fixed-price or fixed-price with escalation subcontract hereunder which when entered into exceeds $100,000, except those subcontracts covered by subparagraph (3) below.

AUDIT--

(a) For purposes of verifying that certified cost or pricing data submitted in conjunction with the negotiation of this contract or any contract change or other modification involving an amount in excess of $100,000 were accurate, complete, and current, the Contracting Officer of the Government prime contract, or his authorized representatives, shall--until the expiration of three years from the date of final payment under this contract--have the right to examine those books, records, documents, papers and other supporting data which involve transactions related to this contract or which will permit adequate evaluation of the cost or pricing data submitted, along with the computations and projections used therein.

(b) The Subcontractor agrees to insert this clause including this paragraph (b) in all subcontracts hereunder which when entered into exceed $100,000 unless the price is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation.

(3) The Contractor shall insert the following clause in each firm fixed-price or fixed-price with escalation subcontract hereunder which when entered into exceeds $100,000 where the price is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation.

AUDIT--PRICE ADJUSTMENTS

(a) This clause shall become operative only with respect to any change or other modification of this contract, which involves a price adjustment in excess of $100,000 unless the price adjustment is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation, provided that such change or other modification to this contract must result from a change or other modification to the Government prime contract.

(b) For purposes of verifying that any certified cost or pricing data submitted in conjunction with a contract change or other modification were accurate, complete, and current, the Contracting Officer of the Government prime contract, or his authorized representatives, shall--until the expiration of three years from the date of final payment under this contract--have the right to examine those books, records, documents, papers and other supporting data which involve transactions related to this contract or which will permit adequate evaluation of the cost or pricing data submitted, along with the computations and projections used therein.

(c) The Subcontractor agrees to insert this clause including this paragraph (c) in all subcontracts hereunder which when entered into exceed $100,000.

In cost-reimbursement type contracts that have separate periods of performance and that are to include, in the Examination of Records clause prescribed by 7-203.7, the alternate subparagraph (a)(4) which is set forth in 7-203.7(b), the clause set forth above in this paragraph shall be modified by adding the following to paragraph (c) thereof:

> Notwithstanding the foregoing, the Contractor's obligation to preserve and make available his records shall not extend beyond the period of his like obligation under the "Examination of Records" clause of this contract.

Such contracts may be administered as indicated in 7-203.7(b).

(d) The requirement for inclusion of the clauses in (a) and (b) above may be waived for contracts with foreign governments or agencies thereof under circumstances where the requirement for the clauses in 7-104.29 and 7-104.42 may be waived.

ITEM V--PUBLIC LAW 87-653

Pending publication in an ASPR revision, the changes and contract clauses set forth below shall be used upon receipt thereof. This revised material is intended as clarification of the current ASPR implementation of Public Law 87-653.

Paragraphs 3-807.5(d) and (e), which are concerned with the area of subcontractor coverage, are still under study and may be revised in the near future. In event of revision, the clause in 7-104.29 will likewise be revised.

The various DD Forms 633 are in the process of revision. However, pending these revisions, the existing forms will be used.

3-807.3, .4, and .5 revised

3-807.3 Cost or Pricing Data.

(a) The contracting officer shall require the contractor to submit, either actually or by specific identification in writing, cost or pricing data in accordance with 16-206 and to certify, by use of the certificate set forth in 3-807.4, that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete, and current prior to:

(i) the award of any negotiated contract expected to exceed $100,000 in amount;

(ii) the pricing of any contract modification expected to exceed $100,000 in amount to any formally advertised or negotiated contract whether or not cost or pricing data was required in connection with the initial pricing of the contract;

(iii) the award of any negotiated contract not expected to exceed $100,000 in amount or any contract modification not expected to exceed $100,000 in amount to any formally advertised or negotiated contract whether or not cost or pricing data was required in connection with the initial pricing of the contract, provided the contracting officer considers that the circumstances warrant such action in accordance with (d) below;

unless the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. The requirements under (i) and (ii) above may be waived in exceptional cases where the Secretary (or, in the case of a contract with a foreign government or agency thereof, the Head of a Procuring Activity) authorizes such waiver and states in writing his reasons for such determination. Whenever a Certificate of Current Cost or Pricing Data is required, the applicable clause in 7-104.29 shall be included in the contract, and the appropriate clauses in 7-104.41 and 7-104.42 shall be used if required in accordance with those paragraphs.

(b) Any contractor who has been required to submit and certify cost or pricing data in accordance with (a) above shall also be required to obtain cost or pricing data from his subcontractors under the circumstances set forth in the appropriate clause in 7-104.42.

(c) When there is adequate price competition, cost or pricing data shall not be requested regardless of the dollar amount involved. As a general rule, cost or pricing data should not be requested when it has been determined that proposed prices are, or are based on, established catalog or market prices of commercial items sold in substantial quantities to the general public. Where, however, despite the willingness of a number of commercial purchasers to buy an item at such a catalog or market price, the purchaser (e.g., the contracting officer) finds that that price is not reasonable and supports such finding by an enumeration of the facts upon which it is based, cost or pricing data may be requested if necessary to establish a reasonable price; provided, that such finding is approved at a level above the contracting officer. In addition, cost or pricing data may be requested, if necessary, where there is such a disparity between the quantity being procured and the quantity for which there is such a catalog or market price that pricing cannot reasonably be accomplished by comparing the two. Where an item is substantially similar to a commercial item for which there is an established catalog or market price at which substantial quantities are sold to the general public, but the offered price of the former is not considered to be "based on" the price of the latter in accordance with 3-807.1(b)(2), any requirement for cost or pricing data should be limited to that pertaining to the differences between the items if this limitation is consistent with assuring reasonableness of pricing result.

(d) (1) Certified cost or pricing data shall not be requested prior to the award of any contract anticipated to be for $10,000 or less and generally should not be requested for modifications in those amounts. There should be relatively few instances where certified cost or pricing data and the inclusion of defective pricing clauses would be justified in awards between $10,000 and $100,000. In most such awards, the administrative costs will outweigh the benefits which might otherwise accrue from receipt of certified cost or pricing data; hence all other means of determining reasonableness of price should be utilized. When less than complete cost analysis (e.g., analysis of only specific factors) will provide a reasonable pricing result (see 3-807.2(a)) on awards under $100,000 without the submission of complete cost or pricing data, the contracting officer shall request, without certification, only that data which he considers adequate to support the limited extent of the cost analysis required.

(2) Although cost and pricing data was requested in the solicitation, a certification of cost and pricing data shall not be requested in connection with the award of any contract of any dollar value where the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation.

(e) "Cost or pricing data" as used in this Part consists of all facts existing up to the time of agreement on price which prudent buyers and sellers would reasonably expect to have a significant effect on the price negotiations. The definition of cost or pricing data embraces more than historical accounting data; it also includes, where applicable, such factors as vendor quotations, nonrecurring costs, changes in production methods and production or procurement volume, unit cost trends such as those associated with labor efficiency, and make-or-buy decisions or any other management decisions which could reasonably be

expected to have a significant bearing on costs under the proposed contract. In short, cost or pricing data consists of all facts which can reasonably be expected to contribute to sound estimates of future costs as well as to the validity of costs already incurred. Cost or pricing data, being factual, is that type of information which can be verified. Because the contractor's certificate pertains to "cost or pricing data", it does not make representations as to the accuracy of the contractor's judgment on the estimated portion of future costs or projections. It does, however, apply to the data upon which the contractor's judgment is based. This distinction between fact and judgment should be clearly understood.

(f) The requirement for submission of cost or pricing data is met when all accurate cost or pricing data reasonably available (see 3-807.5(a)(1)) to the contractor at the time of agreement on price is submitted, either actually or by specific identification, in writing to the contracting officer or his representative. The distinction between the "submission" of cost or pricing data and the "making available" of records should be clearly understood. The mere availability of books, records and other documents for verification purposes does not constitute submission of cost or pricing data.

3-807.4 Certificate of Current Cost or Pricing Data. When certification of cost or pricing data is required in accordance with 3-807.3, a certificate in the form set forth below shall be included in the contract file along with the memorandum of the negotiation. The contractor shall be required to submit only one certificate which shall be submitted as soon as practicable after agreement is reached on the contract price.

CERTIFICATE OF CURRENT COST OR PRICING DATA

This is to certify that, to the best of my knowledge and belief, cost or pricing data as defined in ASPR 3-807.3(e) submitted, either actually or by specific identification in writing (see ASPR 3-807.3(f)), to the Contracting Officer or his representative in support of _____* are accurate, complete, and current as of _____**
day month year

Firm _____
Name _____
Title _____

_____***
Date of Execution

---

* Describe the proposal, quotation, request for price adjustment or other submission involved, giving appropriate identifying number (e.g., RFP No.____).

** This date shall be the date when the price negotiations were concluded and the contract price was agreed to. The responsibility of the contractor is not limited by the personal knowledge of the contractor's negotiator if the contractor had information reasonably available (see ASPR 3-807.5(a)) at the time of agreement, showing that the negotiated price is not based on accurate, complete and current data.

*** This date should be as close as practicable to the date when the price negotiations were concluded and the contract price was agreed to.

3-807.5 Defective Cost or Pricing Data.

(a) Where any price to the Government must be negotiated largely on the basis of cost or pricing data submitted by the contractor, it is essential that the data be accurate, complete and current and in appropriate cases so certified by the contractor (see 3-807.3 and 3-807.4). If such certified cost or pricing data is subsequently found to have been inaccurate, incomplete or non-current as of the effective date of the certificate, the Government is entitled to an adjustment of the negotiated price, including profit or fee, to exclude any significant sum by which the price was increased because of the defective data. The clauses set forth in 7-104.29 give the Government in such a case an enforceable contract right to a price adjustment, that is, to a reduction in the price to what it would have been if the contractor had submitted accurate, complete and current data. In arriving at a price adjustment under a clause, the contracting officer should, after review of the record of the contract negotiation (see 3-811), consider the following:

(1) The time when cost or pricing data was reasonably available to the contractor. Certain data such as overhead expenses and production records may not be reasonably available except on normal periodic closing dates. Also, the data on numerous minor material items each of which by itself would be insignificant may be reasonably available only as of a cut-off date prior to agreement on price because the volume of transactions would make the use of any later date impracticable. Furthermore, except where a single item is used in substantial quantity, the net effect of any changes to the prices of such minor items would likely be insignificant. Closing or cut-off dates should be included as a part of the data submitted with the contractor's proposal and should be updated by the contractor to the latest closing or cut-off dates, preceding agreement on price, for which such data is available. The contracting officer and contractor are encouraged to reach a prior understanding on criteria for establishing closing or cut-off dates, and to the extent possible the understanding should relate to an approved estimating system. Notwithstanding the foregoing, significant matters are important to contractor management and to Government and any related data would be expected to be current on the date of agreement on price and therefore will be treated as reasonably available as of that date. Although changes in the labor base or in prices of major material items are generally significant matters, no hard and fast rule can be laid down since what is significant can depend upon such circumstances as the size and nature of the procurement.

(2) In establishing that the defective data caused an increase in the contract price, the contracting officer is not expected to reconstruct the negotiation by speculating as to what would have been the mental attitudes of the negotiating parties if the correct data had been submitted at the time of agreement on price. In the absence of evidence to the contrary the natural and probable consequence of defective data is an increase in the contract price in the amount of the defect plus related burden and profit or fee; therefore, unless there is a clear indication that the defective data was not used, or was not relied upon, the contract price should be reduced in that amount.

(3) As a general rule, understated cost or pricing data shall not be "set off" against overstated cost or pricing data in arriving at a price adjustment. However, where there is a question as to the accuracy of a single item of data which is an average or composite rate, overstatements in making up the rate may be set off by understatements for the purpose of correcting the rate submitted by the contractor. For example, when the contractor in his cost or pricing data submits an average rate for Class A Engineers and it is found that in the computation of the average rate the contractor has indicated that his highest price Class A Engineer was $20,000 when in fact it was only $18,000 and further where the contractor indicated that the price of his lowest paid Class A Engineer was $10,000 when in fact it was $12,000, these can be offset one against the other in recomputing the average or composite rate. Offsetting a Class A Engineer average or composite against a Class B Engineer average or composite is not permitted. Again, for example, if an overhead account had been overstated by reason of a failure to use the most recent available quarterly figures, the consequent downward price adjustment should be based on the net change in the total overhead account, including both the "minus" and "plus" elements. In addition, as a further exception to the general rule against set off, overstated data (such as unit price) relating to a single item (such as cement) may be offset by understated data (such as quantity) relating to the same item. For example, if the historical data submitted is 100 feet of pipe at $1.00 a foot for a total of $100 but it should have been 50 feet at $2.00 a foot, setoff is permitted and no price adjustment is required. In any case, the contract price shall be adjusted only if the net adjustment is downward.

(b) If at any time prior to agreement on price the contracting officer learns through audit or otherwise that any cost or pricing data submitted is inaccurate, incomplete or noncurrent, he shall immediately call it to the attention of the contractor whether that defective data tends to increase or decrease the contract price. Thereafter, the contracting officer shall negotiate on the basis of any new data submitted, or on a basis which in his opinion makes satisfactory allowance for the incorrect data as he considers appropriate and shall reflect these facts in his record of negotiation.

(c) After award, if the contracting officer obtains information which leads him to believe that the data furnished may not have been accurate, complete or current, or if he considers that the data may not have been adequately verified as of the time of negotiation, he should request an audit to evaluate the accuracy, completeness and currency of such data. In the case of negotiated firm fixed-price contracts, post-award cost performance audits, pursuant to a clause set forth in 7-104.41, shall be limited to the single purpose of determining whether or not defective cost or pricing data were submitted. Such audits shall not be for the purpose of evaluating profit-cost relationships, nor shall any repricing of such contracts be made because the realized profit was greater than was forecast, or because some contingency cited by the contractor in his submission failed to materialize--unless the audit reveals that the cost or pricing data certified by the contractor were, in fact, defective.

(a) Under 10 U.S.C. 2306(f) and the "Price Reduction for Defective Cost or Pricing Data" clauses set forth in 7-104.29, the Government's right to reduce the prime contract price extends to cases where the prime contract price was increased by any significant sums because a subcontractor furnished defective cost or pricing data in connection with a subcontract where a certificate of cost or pricing data was or should have been furnished. In some cases, as where the defective nature of a subcontractor's data is only disclosed by Government audit, the information necessary to support a reduction to prime contract and subcontractor prices may be available only from the Government. To the extent necessary to secure a prime contract price reduction, the contracting officer should make such necessary information available upon request, to the prime contractor or higher tier subcontractors; however, if the release of such information would compromise military security or disclose trade secrets or other confidential business information, it shall be made available only under conditions that will fully protect it from improper disclosure, as may be prescribed by: the Director of Procurement Policy and Review, the Office of the Assistant Secretary of the Army (Installations and Logistics), for the Army; the Naval Material Command, for the Navy; the Office of the Assistant Secretary of the Air force; and the Executive Director, Procurement and Production, for the Defense Supply Agency. Information made available pursuant to this paragraph shall be limited to that used as the basis for the prime contract price reduction.

(e) Inasmuch as price reductions under the Price Reduction for Defective Cost or Pricing Data clauses may involve first- and lower-tier subcontractors as well as the prime contractor, the contracting officer should give the prime contractor reasonable advance notice before making a determination to reduce the contract price under such clauses, in order to afford the prime contractor an opportunity to take any action deemed advisable by him, particularly in connection with any subcontracts that may be involved.

3-811(a) revised

3-811 Record of Price Negotiation.

(a) At the conclusion of each negotiation of an initial or a revised price, the contracting officer shall promptly prepare or cause to be prepared, a memorandum, setting forth the principal elements of the price negotiation, for inclusion in the contract file and for the use of any reviewing authorities. The memorandum shall be in sufficient detail to reflect the most significant considerations controlling the establishment of the initial or revised price. The memorandum should include an explanation of why cost or pricing data was, or was not, required (see 3-807) and, if it was not required in the case of any price negotiation in excess of $100,000, a statement of the basis for determining that the price resulted from or was based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. If cost or pricing data was submitted and a certificate of cost or pricing data was required (3-807.4), the memorandum shall reflect the extent

to which reliance was not placed upon the factual cost or pricing data submitted and the extent to which this data was not used by the contracting officer in determining his total price objective and in negotiating the final price. The memorandum shall also reflect the extent to which the contracting officer recognized in the negotiation that any cost or pricing data submitted by the contractor was inaccurate, incomplete, or non-current; the action taken by the contracting officer and the contractor as a result; and the effect, if any, of such defective data on the total price negotiated. Where the total price negotiated differs significantly from the total price objective, the memorandum shall explain this difference. Whenever cost or pricing data are used in connection with a price negotiation in excess of $100,000, the contracting officer shall forward one copy of the memorandum to the cognizant Defense Contract Audit Agency officer--for use by the auditor to improve the usefulness of his audit work and related reports to negotiation officials. Where appropriate, the memorandum should include or be supplemented by information on how the auditor's advisory services can be made more effective in future negotiations with the contractor. In those cases where a copy is forwarded to the auditor, a copy will also be furnished to the ACO.

7-104.29 **revised**

7-104.29 Price Reduction for Defective Cost or Pricing Data.

(a) The following clause shall be inserted in negotiated contracts which when entered into exceed $100,000, except where the price is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. In addition, the contracting officer shall include this clause in other negotiated contracts for which he has obtained a Certificate of Current Cost or Pricing Data in accordance with 3-807.3(a)(iii) in connection with the initial pricing of the contract.

PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA (NOV. 1967)

(a) If any price, including profit or fee, negotiated in connection with this contract or any cost reimbursable under this contract was increased by any significant sums because the Contractor, or any subcontractor pursuant to the clause of this contract entitled "Subcontractor Cost or Pricing Data" or "Subcontractor Cost or Pricing Data--Price Adjustments" or any subcontract clause therein required, furnished incomplete or inaccurate cost or pricing data or data not current as certified in the Contractor's Certificate of Current Cost or Pricing Data, then such price or cost shall be reduced accordingly and the contract shall be modified in writing as may be necessary to reflect such reduction.

[Contract clause continued on next page]

(b) Failure to agree on a reduction shall be a dispute concerning a question of fact within the meaning of the "Disputes" clause of this contract.
(Note: Since the contract is subject to reduction under this clause by reason of defective cost or pricing data submitted in connection with certain subcontracts, it is expected that the contractor may wish to include a clause in each such subcontract requiring the subcontractor to appropriately indemnify the contractor. However, the inclusion of such a clause and the terms thereof are matters for negotiation and agreement between the contractor and the subcontractor, provided that they are consistent with ASPR 23-203 relating to Disputes provisions in subcontracts. It is also expected that any subcontractor subject to such indemnification will generally require substantially similar indemnification for defective cost or pricing data required to be submitted by his lower tier subcontractors.)

(b) Insert the following clause in all contracts, both formally advertised and negotiated, which when entered into exceed $100,000, other than those described in (a) above.

PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA--
PRICE ADJUSTMENTS (NOV. 1967)

(a) This clause shall become operative only with respect to any change or other modification of this contract which involves a price adjustment in excess of $100,000, except where the price is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. The right to price reduction under this clause shall be limited to such price adjustments.

(b) If any price, including profit, or fee, negotiated in connection with any price adjustment under this contract was increased by any significant sums because the Contractor or any subcontractor, pursuant to the clause of this contract entitled "Subcontractor Cost or Pricing Data--Price Adjustments" or any subcontract clause therein required, furnished incomplete or inaccurate cost or pricing data or data not current as of the date of execution of the Contractor's Certificate of Current Cost or Pricing Data, then such price shall be reduced accordingly and the contract shall be modified in writing to reflect such reduction.
(Note: Since the contract is subject to reduction under this clause by reason of defective cost or pricing data submitted in connection with certain subcontracts, it is expected that the contractor may wish to include a clause in each such subcontract requiring the subcontractor to appropriately indemnify the contractor. However, the inclusion of such a clause and the terms thereof are matters for negotiation and agreement between the contractor and the subcontractor, provided that they are consistent with ASPR 23-203 relating to Disputes provisions in sub-

[Contract clause continued on next page]

contracts. It is also expected that any subcontractor subject to such indemnification will generally require substantially similar indemnification for defective cost or pricing data required to be submitted by his lower tier subcontractors.)

(c) Failure to agree on a reduction shall be a dispute concerning a question of fact within the meaning of the "Disputes" clause of this contract.

(c) The requirement for inclusion of the above clauses in contracts with foreign governments or agencies thereof may be waived in exceptional cases by the Head of a Procuring Activity, stating in writing his reasons for such determination.

Page 716.2--Par. 7-104.42(a):- Make the following Pen-and-Ink Change: 2d line from end, change "3-807.3(a)(iv)" to "3-807.3(a)(iii)".

16-206.2 revised

16-206.2 DD Form 633 (Contract Pricing Proposal) or one of the special forms authorized in 16-206.3 shall be used whenever contractor or subcontractor cost or pricing data (see 3-807.3(e)) is required pursuant to Sections 3-807.3(a) and 7-104.42; provided, however, that the "Cost Elements" and the "Proposed Contract Estimate" may be presented in a different format, acceptable to the contracting officer, where the contractor's or subcontractor's accounting system makes the use of the prescribed format impracticable or when required for a more effective and efficient presentation of cost or pricing information, and provided further that in such cases a signed DD Form 633 or one of the special forms is required to be submitted and fully accomplished as to all items except that the "Cost Elements" and the "Proposed Contract Estimate" may be accomplished by making reference to the contractor's format.

Page 1822--Par. 18-305.1(b):- Make the following Pen-and-Ink Change: 4th line, change "3-807.3" to "3-807.2".

* * * * * *

ITEM VI--EMPLOYMENT OF DISADVANTAGED PERSONS IN SECTIONS OF CONCENTRATED UNEMPLOYMENT OR UNDEREMPLOYMENT

Pending inclusion in a subsequent revision of the ASPR, the following revisions, effective on receipt, are made in 1-706.6; 2-407.6; Sec. I, Pt. 8; 16-101.1; 16-102; 16-204; 16-205; and 21-115(e). These changes reflect the amendments to Defense Manpower Policy 4, 32A CFR Ch. 1, DMP 4 (32 F.R. 14388), and Department of Labor Regulations, 29 CFR Pt 8 (32F.R. 14387) which were published in the Federal Register on 18 October 1967. These amendments provide an additional preference in the performance of set-asides to concerns which are certified by the Secretary of Labor as eligible for preference by reason of agreeing to perform portions of contracts in sections of concentrated unemployment or underemployment and to comply with regulations of the Secretary of Labor with respect to employment of disadvantaged applicants.

1-706.6(c)(1) (DPC #56 of 10/6/67) Notice revised as indicated

NOTICE OF PARTIAL SMALL BUSINESS SET-ASIDE (NOV. 1967)

(a) *General.* A portion of this procurement, as identified elsewhere in the Schedule, has been set aside for award only to one or more small business concerns. Negotiations for award of this set-aside portion will be conducted only with responsible small business concerns who have submitted responsive bids on the non-set-aside portion at a unit price within 120 percent of the highest unit price at which an award is made on the non-set-aside portion. Negotiations shall be conducted with such small business concerns in the following order of priority:

Group 1. Small business concerns which are also certified-eligible concerns.

Group 2. Small business concerns which are also persistent labor surplus area concerns.

Group 3. Small business concerns which are also substantial labor surplus area concerns.

Group 4. Small business concerns which are not labor surplus area concerns.

Within each of the above groups, negotiations with such concerns will be in the order of their bids on the non-set-aside portion, beginning with the lowest responsive bid. The set-aside shall be awarded at the highest unit price awarded on the non-set-aside portion, adjusted to reflect transportation and other cost factors which are considered in evaluating bids on the non-set-aside portion, except where a responsive bid has been submitted on the non-set-aside portion at a unit price which when so adjusted is lower than the adjusted highest unit price awarded on the non-set-aside portion but could not be accepted because of quantity limitations or other consideration (such as the bidder's responsibility). In the latter case if the quantity limitation or other considerations do not preclude consideration of the unit price of such unaccepted bid at the time of negotiation for the set-aside portion, a quantity of the set-aside portion equal to the quantity of such unaccepted bid shall be offered to eligible concerns in their order of priority at the adjusted unit price of such unaccepted bid. If no eligible bidder will take the entire quantity so offered at the adjusted unit price of the unaccepted bid, then all eligible concerns in their order of priority shall be offered any lesser portion at the same price. (In the event more than one such unaccepted bid is involved, the same procedure shall be applied successively to each such bid on negotiation for the set-aside portion.) Subject to the conditions set forth below any remaining quantity of the set-aside portion shall be offered to eligible concerns in their order of priority at the adjusted highest unit price awarded on the non-set-aside portion. If such an unaccepted bid is submitted by a concern eligible to participate in the set-aside, such concern must accept a quantity of the set-aside portion equal to the quantity of the unaccepted bid at the adjusted unit price of the unaccepted bid before any portion of the set-aside may be awarded to that concern at a higher price. If such an unaccepted bid is submitted by a concern not eligible to participate in the set-aside, a quantity of the set aside portion equal to the unaccepted bid must be awarded at the adjusted unit price of such unaccepted bid before any portion of the set-aside is awarded to any eligible concern at a higher price. The Government reserves the right not to consider token bids or other devices designed to secure an unfair advantage over other bidders eligible for the set-aside portion. The partial set-aside of this procurement for small business concerns is based on a determination by the Contracting Officer, alone or in conjunction with a representative of the Small Business Administration, that it is in the interest of maintaining or mobilizing the Nation's full productive capacity, or in the interest of war or national defense programs, or in the interest of assuring that a fair portion of Government procurement is placed with small business concerns.

[Notice continued on next page]

(b) *Definitions.* (1) A "*small business concern*" is a concern, including its affiliates, which is independently owned and operated, is not dominant in the field of operation in which it is bidding on Government contracts, and can further qualify under the criteria set forth in regulations of the Small Business Administration (Code of Federal Regulations, Title 13, Section 121.3-8). In addition to meeting these criteria, a manufacturer or a regular dealer submitting bids or proposals in his own name must agree to furnish in the performance of the contract end items manufactured or produced in the United States, its possessions, or Puerto Rico, by small business concerns: *Provided*, That this additional requirement does not apply in connection with construction or service contracts.

(2) A "*labor surplus area*" is a geographical area which is:

(i) an appropriate section of a State or "labor area" classified by the Secretary of Labor as a "section of concentrated unemployment or underemployment"; or

(ii) classified by the Department of Labor as an "Area of Substantial Unemployment" (herein referred to as an area of substantial labor surplus) and listed as such by that Department in its publication "Area Trends in Employment and Unemployment"; or

(iii) classified by the Department of Labor as "Area of Persistent Unemployment" (herein referred to as an area of persistent labor surplus) and listed as such by that Department in its publication "Area Trends in Employment and Unemployment"; or

(iv) not classified as in (ii) or (iii) above, but which is individually certified as an area of persistent or substantial unemployment by the Department of Labor at the request of a prospective contractor.

(3) *Labor surplus area concern* includes certified-eligible concerns, persistent labor surplus area concerns, and substantial labor surplus area concerns, as defined below:

(i) "Certified-eligible concern" means a concern (A) located in or near a section of concentrated unemployment or underemployment which has been certified by the Secretary of Labor in accordance with 29 CFR 8.7(b) with respect to the employment of disadvantaged persons residing within such sections, and (B) which will agree to perform, or cause to be performed by a certified concern, a substantial proportion of a contract in or near such sections; it includes a concern which, though not so certified, agrees to have a substantial proportion of a contract performed by certified concerns in or near such sections. A concern shall be deemed to perform a substantial proportion of a contract in or near sections of concentrated unemployment or underemployment if the costs that the concern will incur on account of manufacturing or production in or near such sections (by itself if a certified concern, or by certified concerns acting as first-tier subcontractors) amount to more than 30 percent of the contract price.

(ii) "Persistent labor surplus area concern" means a concern that agrees to perform, or cause to be performed, a substantial proportion of a contract in persistent labor surplus areas. A concern shall be deemed to perform a substantial proportion of a contract in persistent labor surplus areas if the costs that the concern will incur on account of manufacturing or production performed in such areas (by itself or its first-tier subcontractors) amount to more than 50 percent of the contract price.

[Notice continued on next page]

(iii) "Substantial labor surplus area concern" means a concern that agrees to perform, or cause to be performed, a substantial proportion of a contract in substantial labor surplus areas. A concern shall be deemed to perform a substantial proportion of a contract in substantial labor surplus areas if the costs that the concern will incur on account of manufacturing or production performed in substantial and persistent labor surplus areas (by itself or its first-tier subcontractors) amount to more than 50 percent of the contract price.

(4) "*Unit price*" shall include evaluation factors added for the rent-free use of Government property.

(c) *Identification of Areas of Performance.* Each bidder desiring to be considered for award as a small business labor surplus area concern on the set-aside portion of this procurement shall identify in his bid the geographical areas in which he proposes to perform, or cause to be performed, a substantial proportion of the production of the contract. If the Department of Labor classification of any such area changes after the bidder has submitted his bid, the bidder may change the areas in which he proposes to perform, *provided*, that he so notifies the Contracting Officer before award of the set-aside portion. Priority for negotiation will be based upon the labor surplus classification of the designated production areas as of the time of the proposed award.

(d) Agreement. The bidder agrees that: (i) if awarded a contract as a certified-eligible small business concern under the set-aside portion of this procurement he will perform, or cause to be performed, a substantial proportion of the contract in or near sections of concentrated unemployment or underemployment and, in the performance of such contract or subcontracts, will employ a proportionate number of disadvantaged persons residing within sections of concentrated unemployment or underemployment in accordance with plans approved by the Secretary of Labor; (ii) if awarded a contract as a small business persistent labor surplus area concern under the set-aside portion of this procurement, he will perform, or cause to be performed, a substantial proportion of the production in areas classified at the time of award, or at the time of performance of the contract, as persistent labor surplus areas; and (iii) if awarded a contract as a small business substantial labor surplus area concern under the set-aside portion of this procurement, he will perform, or cause to be performed, a substantial proportion of the production in areas classified at the time of award, or at the time of performance of the contract, as persistent labor surplus areas.

(e) Eligibility Based on Certification. Where eligibility for preference is based upon the status of the bidder or bidder's subcontractors as a "certified-eligible concern," the bidder shall furnish with his bid evidence of certification by the Secretary of Labor.

(2) In requirements contracts involving a partial small business set-aside, add the following to the above clause.

(f) *Requirements Contract.* Only one award will be made for each item or sub-item of the non-set-aside portion and only one award will be made for each item or sub-item of the set-aside portion. For the purpose of equitably distributing orders in accordance with this "Notice of Partial Small Business Set-Aside," the Government will apportion the quantities to be ordered as equally as possible between the non-set-aside Contractor and the set-aside Contractor to whom the awards are made.

Section I, Part 8, revised as indicated

Part 8--Labor Surplus Area Concerns

1-800 Scope of Part. This Part sets forth Department of Defense policy and procedures with respect to aiding areas of persistent or substantial labor surplus and sections of concentrated unemployment or underemployment, hereinafter referred to as "labor surplus areas," in the United States, its possessions, and Puerto Rico. This part implements Defense Manpower Policy No. 4 (Revised), 16 October 1967 (32A CFR Chapter 1), and U. S. Department of Labor Regulations, 29 CFR Part 8, as amended, 16 October 1967. Defense Manpower Policy No. 4 states the policy of the Government to encourage the placing of contracts and facilities in labor surplus areas and to assist such areas in making the best use of their available resources.

1-801 Definitions.

1-801.1 Labor surplus area concern includes:

(i) Concerns (A) located in or near sections of concentrated unemployment or underemployment which have been certified by the Secretary of Labor in accordance with 29 CFR 8.7(b) with respect to the employment of disadvantaged persons residing within such sections and (B) which will agree to perform, or cause to be performed by certified concerns, a substantial proportion of a contract in or near such sections; also concerns which, though not so certified, agree to have a substantial proportion of a contract performed by certified concerns in or near such sections. Such concerns, herein referred to as "certified-eligible concerns," shall be deemed to perform a substantial proportion of a contract in or near sections of concentrated employment or underemployment if the costs that the concern will incur on account of manufacturing or production in or near such sections (by itself if a certified concern, or by certified concerns acting as first-tier subcontractors) amount to more than 30 percent of the contract price.

(ii) Persistent labor surplus area concerns which will perform or cause to be performed any contracts awarded to them as labor surplus area concerns substantially in "Areas of Persistent Labor Surplus." A concern shall be deemed to perform a contract substantially in "Areas of Persistent Labor Surplus" if the costs that it incurs on account of manufacturing or production (by itself or its first-tier subcontractors) in such areas amount to more than 50 percent of the contract price.

(iii) Substantial labor surplus area concerns which will perform or cause to be performed any contracts awarded to them as labor surplus area concerns substantially in "Areas of Substantial Labor Surplus." A concern shall be deemed to perform a contract substantially in "Areas of Substantial Labor Surplus" if the costs that it incurs on account of manufacturing or production (by itself or its first-tier subcontractors) in such areas or in "Areas of Persistent Labor Surplus" amount to more than 50 percent of the contract price.

Example A. ABC Company, manufacturing in a full employment area, bids on a contract at $1,000. ABC Company will incur the following costs:

Direct labor	$200
Overhead	200

Example C. GHI Company, manufacturing in a labor surplus area, bids on a contract at $1,000. GHI Company will incur the following costs:

Direct labor	$230
Overhead	275
Purchase of materials from RST, which manufactures the materials in a full employment area	425

GHI Company qualifies as a labor surplus area concern.

1-801.2 *Labor surplus area* means a geographic area which at the time of award is:

(i) an appropriate section of a State or "labor area" classified by the Secretary of Labor as a "section of concentrated unemployment or underemployment"; or

(ii) classified by the Department of Labor as an "Area of Substantial Unemployment" (herein referred to as an area of substantial labor surplus) and listed as such by that Department in its publication "Area Trends in Employment and Unemployment"; or

(iii) classified by the Department of Labor as an "Area of Persistent Unemployment" (herein referred to as an area of persistent labor surplus) and listed as such by that Department in its publication "Area Trends in Employment and Unemployment"; or

(iv) not classified as in (ii) or (iii) above, but which is individually certified as an area of persistent or substantial unemployment by the Department of Labor at the request of a prospective contractor.

1-801.3 *Small business concern* is defined in 1-701.

1-802 General Policy. Except as provided in 1-806 with respect to depressed industries, it is the policy of the Department of Defense to aid labor surplus areas by placing contracts with labor surplus area concerns, to the extent consistent with procurement objectives and where such contracts can be awarded at prices no higher than those obtainable from other concerns, and by encouraging prime contractors to place subcontracts with concerns which will perform substantially in labor surplus areas. In carrying out this policy, to accommodate the small business policies of Section I, Part 7, preference shall be given in the following order of priority to (i) certified-eligible concerns which are also small business concerns; (ii) other certified-eligible concerns; (iii) persistent labor surplus area concerns which are also small business concerns, (iv) other persistent labor surplus area concerns, (v) substantial labor surplus area concerns which are also small business concerns, (vi) other substantial labor surplus area concerns and (vii) small business concerns which are not labor surplus area concerns. But in no case will price differentials be paid for the purpose of carrying out this policy. Heads of Procuring Activities and Heads of Field Purchasing and Contract Administration Activities are responsible for the effective implementation of the Labor Surplus Area Program within their respective activities. Responsibility for administration of the program may be assigned to small business specialists appointed pursuant to 1-704.3.

1-803(a)(iv) revised

(iv) Department of Labor certification (see 1-801.2(iv))shall be considered conclusive with respect to the particular procurement concerned;

1-804.2(b)(1) Notice revised as indicated

NOTICE OF LABOR SURPLUS AREA SET-ASIDE (NOV. 1967)

(a) *General.* A portion of this procurement, as identified elsewhere in the Schedule, has been set aside for award only to one or more labor surplus area concerns, and, to a limited extent, to small business concerns which do not qualify as labor surplus area concerns. Negotiations for award of the set-aside portion will be conducted only with responsible labor surplus area concerns (and small business concerns to the extent indicated below) who have submitted responsive bids or proposals on the non-set-aside portion at a unit price no greater than 120 percent of the highest unit price at which an award is made on the non-set-aside portion. Negotiations for the set-aside portion will be conducted with such bidders in the following order of priority:

Group 1. Certified-eligible concerns which are also small business concerns.
Group 2. Other certified-eligible concerns.
Group 3. Persistent labor surplus area concerns which are also small business concerns.
Group 4. Other persistent labor surplus area concerns.
Group 5. Substantial labor surplus area concerns which are also small business concerns.
Group 6. Other substantial labor surplus area concerns.
Group 7. Small business concerns which are not labor surplus area concerns.

Within each of the above groups, negotiations with such concerns will be in the order of their bids on the non-set-aside portion, beginning with the lowest responsive bid. The set-aside portion shall be awarded at the highest unit price awarded on the non-set-aside portion, adjusted to reflect transportation and other cost factors which are considered in evaluating bids on the non-set-aside portion except where a responsive bid has been submitted on the non-set-aside portion at a unit price which when so adjusted is lower than the adjusted highest unit price awarded on the non-set-aside portion but could not be accepted because of quantity limitations or other consideration (such as the bidder's responsibility). In the latter case if the quantity limitation or other considerations do not preclude consideration of the unit price of such unaccepted bid at the time of negotiation for the set-aside portion, a quantity of the set-aside portion equal to the quantity of such unaccepted bid shall be offered to eligible concerns in their order of priority at the adjusted unit price of such unaccepted bid. If no eligible bidder will take the entire quantity so offered at the adjusted unit price of the unaccepted bid, then all eligible concerns in their order of priority shall be offered any lesser portion at the same price. (In the event more than one such unaccepted bid is involved, the same procedure shall be applied successively to each such bid on negotiation for the set-aside portion.) Subject to the conditions set forth below any remaining quantity of the set-aside portion shall be offered to eligible concerns in their order of priority at the adjusted highest unit price awarded on the non-set-aside portion. If such an unaccepted bid is submitted by a concern eligible to participate in the set-aside, such concern must accept a quantity of the set-aside portion equal to the quantity of the unaccepted bid at the adjusted unit price of the unaccepted bid before any portion of the set-aside may be awarded to that concern at a higher price. If such an unaccepted bid is submitted by a concern not eligible to participate in the set-aside, a quantity of the set-aside portion equal to the quantity of the unaccepted bid must be awarded at the adjusted unit price of such unaccepted bid before any portion of the set-aside is awarded to any eligible concern at a higher price. The Government reserves the right not to consider token bids or other devices designed to secure an unfair advantage over over bidders eligible for the set-aside portion.

[Notice continued on next page]

(b) *Definitions.*

(1) The term "*labor surplus area*" means a geographical area which is a section of concentrated unemployment or underemployment, a persistent labor surplus area, or a substantial labor surplus area, as defined below:

(i) "Section of concentrated unemployment or underemployment" means appropriate sections of States or "labor areas" so classified by the Secretary of Labor.

(ii) "Persistent labor surplus area" means an area which (A) is classified by the Department of Labor as an "Area of Persistent Labor Surplus" (also called "Area of Persistent Unemployment") and is listed as such by that Department in conjunction with its publication "Area Trends in Employment and Unemployment," or (B) is certified as an area of persistent labor surplus by the Department of Labor pursuant to a request by a prospective Contractor.

(iii) "Substantial labor surplus area" means an area which (A) is classified by the Department of Labor as an "Area of Substantial Labor Surplus" (also called "Area of Substantial Unemployment") and which is listed as such by that Department in conjunction with its publication "Area Trends in Employment and Unemployment," or (B) is certified as an area of substantial labor surplus by the Department of Labor pursuant to a request by a prospective Contractor.

(2) The term "*labor surplus area concern*" includes certified-eligible concerns, persistent labor surplus area concerns, and subtantial labor surplus area concerns, as defined below:

(i) "Certified-eligible concern" means a concern (A) located in or near a section of concentrated unemployment or underemployment which has been certified by the Secretary of Labor in accordance with 29 CFR 8.7(b) with respect to the employment of disadvantaged persons residing within such sections, and (B) which will agree to perform, or cause to be performed by a certified concern, a substantial proportion of a contract in or near such sections; it includes a concern which, though not so certified, agrees to have a substantial proportion of a contract performed by certified concerns in or near such sections. A concern shall be deemed to perform a substantial proportion of a contract in or near sections of concentrated unemployment or underemployment if the costs that the concern will incur on account of manufacturing or production in or near such sections (by itself if a certified concern, or by certified concerns acting as first-tier subcontractors) amount to more than 30 percent of the contract price.

(ii) "Persistent labor surplus area concern" means a concern that agrees to perform, or cause to be performed, a substantial proportion of a contract in persistent labor surplus areas. A concern shall be deemed to perform a substantial proportion of a contract in persistent labor surplus areas if the costs that the concern will incur on account of manufacturing or production performed in such areas (by itself or its first-tier subcontractors) amount to more than 50 percent of the contract price.

(iii) "Substantial labor surplus area concern" means a concern that agrees to perform, or cause to be performed, a substantial proportion of a contract in substantial labor surplus areas. A concern shall be deemed to perform a substantial proportion of a contract in substantial labor surplus areas if the costs that the concern will incur on account of manufacturing or production performed in substantial and persistent labor surplus areas (by itself or its first-tier subcontractors) amount to more than 50 percent of the contract price.

[Notice continued on next page]

(3) A *"small business concern"* is a concern, including its affiliates, which is independently owned and operated, is not dominant in the field of operation in which it is bidding on Government contracts, and can further qualify under the criteria set forth in regulations of the Small Business Administration (Code of Federal Regulations, Title 13, Section 121.3-8). In addition to meeting these criteria, a manufacturer or a regular dealer submitting bids or proposals in his own name must agree to furnish in the performance of the contract end items manufactured or produced in the United States, its possessions, or Puerto Rico, by small business concerns: *Provided*, That this additional requirement does not apply in connection with construction or service contracts.

(4) *"Unit price"* shall include evaluation factors added for the rent-free use of Government property.

(c) *Identification of Areas of Performance.* Each bidder desiring to be considered for award as a labor surplus area concern on the set-aside portion of this procurement shall identify in his bid the geographical areas in which he proposes to perform, or cause to be performed, a substantial proportion of the production of the contract. If the Department of Labor classification of any such area changes after the bidder has submitted his bid, the bidder may change the areas in which he proposes to perform, *provided*, that he so notifies the Contracting Officer before award of the set-aside portion. Priority for negotiation will be based upon the labor surplus classification of the designated production areas as of the time of the proposed award.

(d) Eligibility Based on Certification. Where eligibility for preference is based upon the status of the bidder or bidder's subcontractors as a "certified-eligible concern," the bidder shall furnish with his bid evidence of certificattion by the Secretary of Labor.

(e) Agreement. The bidder agrees that: (i) if awarded a contract as a certified-eligible concern under the set-aside portion of this procurement he will perform, or cause to be performed, a substantial proportion of the contract in or near sections of concentrated unemployment or underemployment and in the performance of such contract or subcontracts, will employ a proportionate number of disadvantaged persons residing within sections of concentrated unemployment or underemployment in accordance with plans approved by the Secretary of Labor; (ii) if awarded a contract as a persistent labor surplus area concern under the set-aside portion of this procurement, he will perform, or cause to be performed, a substantial proportion of the production in areas classified at the time of award, or at the time of performance of the contract, as persistent labor surplus areas; and (iii) if awarded a contract as a substantial labor surplus area concern under the set-aside portion of this procurement, he will perform, or cause to be performed, a substantial proportion of the production in areas classified at the time of award, or at the time of performance of the contract, as persistent labor surplus areas.

(2) In requirements contracts involving a labor surplus area set-aside, add the following to the above clause:

(f) *Requirements Contract.* Only one award will be made for each item or sub-item of the non-set-aside portion and only one award will be made for each item or sub-item of the set-aside portion. For the purpose of equitably distributing orders in accordance with this "Notice of Labor Surplus Area Set-Aside," the Government will apportion the quantities to be ordered as equally as possible between the non-set-aside Contractor and the set-aside Contractor to whom the awards are made.

1-805 revised as indicated

1–805 Subcontracting With Labor Surplus Area Concerns.

1–805.1 *General Policy.* It is the policy of the Government to promote equitable opportunities for labor surplus area concerns to compete for defense subcontracts and to encourage placement of subcontracts with concerns which will perform such contracts substantially in labor surplus areas in the order of priority described in 1–802 where this can be done, consistent with efficient performance of contracts, at prices no higher than are obtainable elsewhere.

1–805.2 *Labor Surplus Area Subcontracting Program.* The Government's labor surplus area subcontracting program requires Government prime contractors to assume an affirmative obligation with respect to subcontracting with labor surplus area concerns. In contracts which range from $5,000 to $500,000, the contractor undertakes the simple obligation of using his best efforts to place his subcontracts with concerns which will perform such subcontracts substantially in labor surplus areas where this can be done, consistent with the efficient performance of the contract, at prices no higher than are obtainable elsewhere. This undertaking is set forth in the contract clause prescribed in 1–805.3(a). In contracts which may exceed $500,000, the contractor is required, pursuant to the clause set forth in 1–805.3(b), to undertake a number of specific responsibilities designed to insure achievement of the objectives referred to above and to impose similar responsibilities on major subcontractors.

1–805.3 *Required Clauses.*

(a) The "Utilization of Concerns in Labor Surplus Areas" clause set forth below shall be inserted in all contracts in amounts which may exceed $5,000, except—

(1) contracts with foreign contractors which, including all subcontracts thereunder, are to be performed entirely outside the United States, its possessions, and Puerto Rico;

(2) contracts for services which are personal in nature; and

(3) contracts for construction.

UTILIZATION OF CONCERNS IN LABOR SURPLUS AREAS (NOV. 1967)

It is the policy of the Government to place contracts with concerns which will perform such contracts substantially in or near sections of concentrated unemployment or underemployment as a certified-eligible concern or in areas of persistent or substantial labor surplus where this can be done, consistent with the efficient performance of the contract, at prices no higher than are obtainable elsewhere. The Contractor agrees to use his best efforts to place his subcontracts in accordance with this policy. In complying with the foregoing and with paragraph (b) of the clause of this contract entitled "Utilization of Small Business Concerns," the Contractor in placing his subcontracts shall observe the following order of preference: (i) certified-eligible concerns which are also small business concerns; (ii) other certified-eligible concerns; (iii) persistent labor surplus area concerns which are also small business concerns; (iv) other persistent labor surplus area concerns; (v) substantial labor surplus area concerns which are also small business concerns; (vi) other substantial labor surplus area concerns; and (vii) small business concerns which are not labor surplus area concerns.

(b) The "Labor Surplus Area Subcontracting Program" clause below shall be included in all contracts which may exceed $500,000, but which contain the clause required by (a) above and which, in the opinion of the purchasing activity, offer substantial subcontracting possibilities. Prime contractors who are to be awarded contracts that do not exceed $500,000, which in the opinion of the purchasing activity offer substantial subcontracting possibilities, shall be urged to accept the following clause:

LABOR SURPLUS AREA SUBCONTRACTING PROGRAM (NOV. 1967)

(a) The Contractor agrees to establish and conduct a program which will encourage labor surplus area concerns to compete for subcontracts within their capabilities. In this connection, the Contractor shall—

(1) Designate a liaison officer who will (i) maintain liaison with duly authorized representatives of the Government on labor surplus area matters, (ii) supervise compliance with the "Utilization of Concerns in Labor Surplus Areas" clause, and (iii) administer the Contractor's Labor Surplus Area Subcontracting Program;

(2) Provide adequate and timely consideration of the potentialities of labor surplus area concerns in all "make-or-buy" decisions;

(3) Assure that labor surplus area concerns will have an equitable opportunity to compete for subcontracts, particularly by arranging solicitations, time for the preparation of bids, quantities, specifications, and delivery schedules so as to facilitate the participation of labor surplus area concerns;

(4) Maintain records showing procedures which have been adopted to comply with the policies set forth in this clause; and

(5) Include the "Utilization of Concerns in Labor Surplus Areas" clause in subcontracts which offer substantial labor surplus area subcontracting opportunities.

(b) A "labor surplus area concern" is a concern which will perform, or cause to be performed, a substantial proportion of any contract awarded to it (i) in or near "Sections of concentrated unemployment or underemployment" as a certified-eligible concern, (ii) in "Areas of Persistent Labor Surplus" or (iii) in "Areas of Substantial Labor Surplus," as designated by the Department of Labor. A certified-eligible concern shall be deemed to perform a substantial proportion of a contract in or near sections of concentrated unemployment or underemployment if the costs that the concern will incur on account of manufacturing or production in or near such sections (by itself if a certified concern, or by certified concerns acting as first-tier subcontractors) amount to more than 30 percent of the price of such contracts; a concern shall be deemed to perform a substantial proportion of a contract in a persistent or substantial labor surplus area if the costs that the concern will incur on account of manufacturing or production (by itself or its first-tier subcontractors) in such area amount to more than 50 percent of the price of such contract.

(c) The Contractor further agrees, with respect to any subcontract hereunder which is in excess of $500,000 and which contains the clause entitled "Utilization of Concerns in Labor Surplus Areas," that he will insert provisions in the subcontract which will conform substantially to the language of this clause, including this paragraph (c), and that he will furnish the names of such subcontractors to the Contracting Officer.

2-407.6(a)(2) revised

(2) For the purposes of (1) above, preference shall be given in the following order of priority:
(i) certified-eligible concerns (1-801) that are also small business concerns (1-701),
(ii) other certified-eligible concerns,
(iii) persistent labor surplus area concerns (1-801) that are also small business concerns (1-701),
(iv) other persistent labor surplus area concerns,
(v) substantial labor surplus area concerns (1-801) that are also small business concerns,
(vi) other substantial labor surplus area concerns,
(vii) other small business concerns.

16-101.1(iii) revised

(iii) General Provisions (Supply Contract) (Standard Form 32) (Pending publication of an edition of the form later than the June, 1964 edition, the clause set forth in 1-805.3(a) shall be substituted for the present provisions of clause 22, Utilization of Concerns in Labor Surplus Areas.);

16-102, 16-204, and 16-205 caption revised and footnote added

16-102 Forms for Negotiated Supply or Services Contracts (Standard Forms 18, 26, DD ASPR Form 1270, Standard Form 32, DD ASPR Form 748*, and Standard Forms 33, 33A, 36, and 30).

16-204 General Provisions—Cost Reimbursement Supply Contracts (DD ASPR Form 748).*

16-205 General Provisions—Fixed-Price Supply Contracts (Standard Form 32).*

* Substitute the clause in 1-805.3(a) for clause 22 on Standard Form 32, 1964 edition, and for clause 25 on DD ASPR Form 748, Jan. 1965 edition; substitute clause in 1-805.3(b) for clause 43 on DD ASPR Form 748, Jan 1965 edition.

21-115(e) sentence added

Also enter this code if the action was awarded by labor surplus set-aside preference to a certified-eligible concern as defined in 1-801.1(i).

ITEM VII--EQUAL EMPLOYMENT OPPORTUNITY

A: DPC #42

In Item IV of DPC #42 dated 27 May 1966, procedures were published regarding the conduct of an equal employment opportunity compliance review prior to the award of formally advertised supply contracts of $1,000,000 or more. To reflect the reassignment of responsibility for conducting these reviews, effected by DOD Directive 1100.11, Item IV, DPC #42, is hereby canceled and superseded by the following procedures:

a. Procuring Activities shall include in each IFB for supplies a notice that prior to the award of a contract in the amount of $1,000,000 resulting from the invitation, the proposed contractor, and his first-tier subcontractor to whom he intends to make awards of $1,000,000 or more, will be subject to an EEO compliance review (ASPR 12-806.5(c)) before the award of the contract.

b. (1) Prior to the award of a formally advertised supply contract of $1,000,000 or more, the PCO shall request the performance of a compliance review of the employment practices of the prospective contractor, and all of his known first-tier subcontractors with subcontracts of $1,000,000 or more, except in those cases (i) covered by c and d below or (ii) where a compliance review has been conducted within six months prior to the award. The Office of Contract Compliance (OCC) in Defense Contract Administration Service Regions (DCASR) will conduct compliance reviews for all contractors except in special cases where this responsibility has been assigned to another agency or department. In these cases, the references to DCASR in this DPC shall be deemed to mean the agency or department responsible for compliance review of the particular contractor. In order that the DCASR may arrange for the performance of the compliance review, it will be notified by the PCO of the name of the apparently successful supplier and selected subcontractors (including the place or places where the work is to be done) concurrently with the initiation of action by the PCO to determine the responsibility of such supplier. Such notification will be forwarded by the most expeditious means to the appropriate DCASR-OCC. The appropriate DCASR office will be the Region in which performance on the contract will occur. DCASR geographic boundaries are defined in DoD Directory of Contract Administration Services Components (DoD 4105.59). Where the necessary contact is by phone, written confirmation will follow.

(2) To qualify for the award of the contract, the proposed contractor and his first-tier subcontractors specified in b(1) must be found, after such compliance review, to be in compliance with the Equal Employment Opportunity Clause (ASPR 12-802(a) as amended in Item VIII, DPC #36 dated 21 October 1965) in current contracts; or in cases where they have no current Government contracts which include such clause, be found to be able to comply with such clause in the proposed contract. The PCO will be notified within 10 working days whether, on the basis of the review, the contractor is considered to be qualified for award in terms of compliance with the EEO clause. This notification will be

given by the DCASR. If the PCO is not notified within the 10-day period and a request is not made for an extension of time, the PCO may proceed with the award, and the DCASR office involved will follow the procedure contained in e below. When the DCASR determines that a proposed contractor should not be awarded a contract due to the fact that such proposed contractor is not in compliance with the EEO clause, it will so notify the PCO. Such notice shall be independent of that contained in DD Form 1524. Similar notification will be given to the Secretary of the Department concerned by the Deputy Director, DSA Contract Administration Services (CAS).

c. The procedures set forth in a and b above and any determinations thereunder shall not apply to any contracts when the Secretary of the Department concerned determines that such contracts are essential to the national security and award without following such procedures and determinations is necessary to the national security. Such cases shall include, for example, items urgently needed for current operational requirements and commodities involving a short option period. Upon making such a determination, the Secretary of the Department involved will notify the Deputy Director, DSA-CAS, within 20 calendar days.

d. The procedures set forth in a and b above shall not apply where the PCO determines that such procedures would delay the award beyond the time for acceptance specified in the bid or extension thereof.

e. Where awards are made without a compliance review as provided in b(2) and d, a review will be performed by the DCASR-OCC as soon as possible thereafter, but in no case, later than 30 days subsequent to receipt of notification.

B: DPC #46

Item III of DPC #46 dated 30 June 1966, provides for a change in ASPR 12-806.4 which would add paragraph (f). The wording of this change is now altered as follows:

(f) The following will be included in all Invitations for Bids for supplies where the award may amount to $1,000,000 or more:

The Equal Opportunity Compliance Review

In accordance with regulations of the Office of Federal Contract Compliance, dated 3 May 1966 (31 Fed. Reg. 6881), except as otherwise authorized, an award in amount (actual or estimated) of $1,000,000 or more may not be made under this solicitation unless the bidder and each of his known first-tier subcontractors (to whom he intends to award a subcontract of $1,000,000 or more) are found on the basis of a compliance review, made within the 6 month period next preceding the award, to be able to comply with the required equal opportunity provisions of this solicitation.

Mr. RUMSFELD. Is there any reason that was not submitted with your testimony?

Mr. MORRIS. It just came off the printing press last night, sir. We did not expect it this morning, as a matter of fact.

Mr. RUMSFELD. I would like to look at it while someone else is asking questions.

Chairman PROXMIRE. Mrs. Griffiths?

Mrs. GRIFFITHS. Thank you very much. I would like to say to you, Mr. Secretary, not in criticism of you, but I do not agree with your statements. I think the Defense Department has spent 180 years trying to keep from finding out what things cost. Quoting from your statement, you point out that often, therefore—

> We have no other source for the item than the prime contractor or the source he identifies in the manual which accompanies the equipment.

Mr. MORRIS. That is right.

PRICES PRIMES PAY FOR SUBCONTRACTED ITEMS

Mrs. GRIFFITHS. The challenge we face is the degree to which we can justify adding personnel to our procurement organizations.

For years I have had a bill in here that would require that the prime supply the price he paid for subcontracted items, and the other subcontractors supply that price. The Defense Department has opposed this.

Why, may I ask, do you oppose it? Why don't you get the prices on these items, ship them out to DIPEC and let DIPEC list them on the computers. I think it would be the simplest thing in the world. It might be a little difficult to start with. But in the end, you would know what the price was and where the items were purchasable.

Mr. MORRIS. I believe that we are endeavoring to do, so far as is practical, exactly what you say. It is not DIPEC, but the Battle Creek, Mich., computer operation.

Mrs. GRIFFITHS. The last time I was out there (DLSC) they did not even have the price of any item on anything.

Mr. MORRIS. We endeavor to maintain prices on catalog items where we have it.

PRICES ON ALL ITEMS

Mrs. GRIFFITHS. Why don't you get it all?

Mr. MORRIS. As indicated in our statement, we have the problem with new equipment coming into inventory each year, of adding some 4 million potential new items to our stock. We must, at provisioning time, select that 10 to 15 percent of the items which we and the contractor think are likely to wear out and require replacement.

When we get that kind of provisioning listing, we do obtain from the contractor an identification of source, and of estimated price. Our buyers are furnished this information insofar as possible, as a guide to them when a rebuy does occur.

There are many of these 4 million items that are not identified during provisioning, and the only source of knowledge we have at the time one of them happens to require replacement—as occurred in some of Mr. Pike's cases—is to go to the manufacturers' parts manual or tech-

nical manual that he gave us with the equipment, and try to determine the stock number. Frequently the only source available, therefore, is the prime manufacturer himself. Sometimes he will give us a vendor number, in which case we can check it through Battle Creek, Mich., and go to that source, and buy without paying the overhead cost of the prime who produced the end item.

The problem is, there are just millions of items on which we cannot possibly expect to maintain this kind of complete knowledge.

Mrs. GRIFFITHS. Why not? What is wrong with maintaining it?

Mr. MORRIS. Well——

MAINTAINING PRICES WITH COMPUTERS

Mrs. GRIFFITHS. We have all these nice computers, and a whole bunch of people standing around in the Defense Department. Why don't you put them to work?

Mr. MORRIS. Mrs. Griffiths, we think our people work pretty hard. We estimate to do a theoretically perfect job on every small purchase item would take another 10,000 people. We just could not justify the cost. We could not possibly save enough to pay for their salaries.

Mrs. GRIFFITHS. If you put them to work, and you found it out once, and put it on those computers, I don't think you would have any trouble at all maintaining it. And, believe me, if you saved a billion dollars, you could put 10,000 people to work.

$25 MILLION POSSIBLE SAVINGS ON SMALL ITEMS

Mr. MORRIS. We estimate we can save posibly $25 million in this particular small purchase area we are talking about—$25 million. It would cost us at least $60 million to put enough people on the payroll to check out every possible small buy that could occur over the life cycle of a given piece of hardware.

TOTAL PACKAGE PROCUREMENT

Mrs. GRIFFITHS. I think that you underestimate the amount of money you can save.

I would like to ask you, on this total package procurement—in fact, how much money is involved in total package procurement?

Mr. MALLOY. Mrs. Griffiths, if I may, the total package procurement concept is a new procurement technique that is just now coming into use. The first use of that type of procurement was on the Air Force large purchase of the C–5–A transport, which is about a billion-dollar program in total for over a hundred of those large airplanes.

There were perhaps up to a dozen other large systems—always very large procurements—that used this technique.

The Navy's procurement, for example, of their FDL ships, the fast deployment logistic ships, which did not go through to fruition because of funding problems, was set up on the total package procurement concept.

Mrs. GRIFFITHS. Now, does this mean that the contractor supplies the specifications, then finally bids on the item—or is the person who makes the item; is that right?

Mr. MALLOY. Well, under this type of competition, all of the contractors contending for the contract, compete for the opportunity to do the development work and the production, all in one contract.

Mrs. GRIFFITHS. And how much are you going to breakout of these items and let other people bid on eventually, and how soon?

Mr. MALLOY. Well, it is hard to say how much we should breakout of a given total package procurement. We have, as we indicated in the Secretary's statement, a breakout program specifically for spare parts, and we have other policies that cover breakout of any item where this is in the Government's advantage.

PROCUREMENT OF COMPUTERS

Mrs. GRIFFITHS. How do you purchase new computers? And from whom?

Mr. MORRIS. We have had a very firm policy for several years, under which we endeavor to obtain competition among the several computer manufacturers at the time a new system is being designed. If there is any departure from that, meaning that we go sole source to only one manufacturer, this must come up on a case-by-case basis to me personally for approval. (See app. 10, p. 556.)

DEVELOPMENT OF SPECIFICATIONS BY IBM

Mrs. GRIFFITHS. Well, now, I would like to give you a few things to disapprove.

I understand that for all practical purposes IBM has written specifications and supplied the computers, and that if you break these out, broke out the parts, you would save an astounding sum of money.

I understand further that one computer manufacturer makes an item about as big as that table which would replace in the IBM system an item about half the size of this room. That the IBM part has so many moving parts that it is necessary to buy it in duplicate for one computer.

Why don't you stop this?

Mr. MORRIS. We would be very pleased to investigate the case——

Mrs. GRIFFITHS. Or look into it and supply the information?

Mr. MORRIS. Could you give us more detail?

Mrs. GRIFFITHS. I am telling you. It is IBM. I will give you the name of the part afterward.

Mr. MORRIS. Fine.

DOD DOES NOT OBJECT TO GAO NAMING CONTRACTORS HOLDING EQUIPMENT

Mrs. GRIFFITHS. Now, I would like to ask you this. Do you have any objection to the fact that GAO is going to supply the names of these 21 contractors that are using Government-owned equipment on their own commercial products?

Mr. MORRIS. No, ma'am.

Mrs. GRIFFITHS. Then I would like you also to supply the names of the contracting officers that are permitting this. And the names of any property people. Do you have some property person in the plants?

Mr. MORRIS. Yes.

Mrs. GRIFFITHS. Well, supply those names, too—and I would like to know how much experience those people have had, and what kind of training, and how long the contracting officers have been letting this go along.

I would also like to know what kind of training the contracting officer has that permitted a bid in which the contractor rented the equipment. I am sure you won't have any objection to supplying that.

Mr. MORRIS. We will be glad to respond.

Mrs. GRIFFITHS. The name of the contracting officers and what kind of training they had.

Mr. MORRIS. GAO has not yet identified to us these cases.

Mrs. GRIFFITHS. They are going to. We have got the information that they are going to.

(Information following was subsequently supplied:)

We have contacted the GAO and asked them to supply the names of the 21 contractors covered in their review of the controls of Government-owned property in contractors' plans (B–140389) dated 28 November 1967. When these contractors are identified to us, we will obtain the names of the contracting officers, the property administrators, and supply to the committee the information requested by Congresswoman Griffiths.

(DOD later supplied the following:)

We have considered how to best respond to Mrs. Griffiths' request for the names of the contracting officers who are responsible for permitting contractors to use government-owned equipment for the manufacture of commercial products. We have again reviewed the GAO report dated November 24 covering the use of government-owned property in contractors' plants and we have considered the numerous facilities contracts and the amendments thereto which govern the use of the facilities at plants reviewed by GAO.

It is apparent that the terms and conditions of the contracts, some of which were executed many years ago and which have been amended many times over the years to expand or modify the conditions covering the availability of the government-owned property, were properly executed and were in compliance with the ASPR pending at the time.

The GAO has considered the contract conditions and the individuals involved. In Appendix 2, Pages 85 through 89 of the Report to the Congress dated November 24, GAO has published the names of the principal officers they identified as responsible for the administration of the activities discussed in their report. We believe these officials are properly designated and are, in the final analysis, responsible for the performance of this function. Local contracting officers and property administrators should be held accountable for acting in accordance with published policies and procedures.

With respect to the training which contracting officers receive, the DOD testimony covered briefly the training courses now established to provide uniform joint training and career development in the procurement field. In addition to our regularly scheduled training programs, traveling teams are sent to major procurement activities to orient procurement personnel in new techniques and programs. While not all contracting officers receive training each year, we are trying to maintain schedules which permit 8,000 students each year to complete one or more of the 43 DOD approved courses.

Mrs. GRIFFITHS. Now, I would like to ask you this—because, of course, you see, this is not going to show up as war profiteering, as Mr. Rumsfeld has pointed out, because under the rules a contractor could do that, and under the rules the Renegotiation Board is going to permit him 6 percent on the cost. But, it is going to show up as a real windfall when you start handing out the dividends, or start paying the management that thought it up. So, the contracting officer, in my opinion, and the negotiator, did an exceedingly poor job, and the Defense Department ought to be very concerned about that.

SALARIES OF CONTRACTING OFFICERS

Now, I would like to ask you—how much money are you paying these 25,000 procurement personnel? What is the average amount paid a negotiator?

Mr. MORRIS. I would have to supply a precise figure. I think one could use a rough figure of $10,000.

Mrs. GRIFFITHS. And, what would you say is the largest purchase made by a negotiator that is drawing $10,000?

Mr. MORRIS. Any major purchase running into hundreds of millions would take an entire team of people to accomplish, of course. But our top negotiators—Mr. Malloy is our top procurement official. He is a grade 18 in the Department of Defense. A grade 18 earns something in excess of $25,000. The majority of our negotiators are around grade 15.

Mrs. GRIFFITHS. What is the top procurement Mr. Malloy makes? How much money do you spend at one time, Mr. Malloy—a billion dollars?

Mr. MALLOY. Mrs. Griffiths, in my present position as a Deputy Assistant Secretary in charge of procurement on Mr. Morris' staff, I do not personally place any procurements.

Mrs. GRIFFITHS. I see. I would like to know the amount that these people that are paid $10,000—what is the top purchase that they make.

Mr. MALLOY. I think we would have to do a little research in order to supply that to you.

Mrs. GRIFFITHS. I will give you some research right now, that you won't have to do. I was a procurement official; I was a negotiator. And for $5,000 I made purchases that amounted to more than $1 million at one time. I would like to know how much of that is still going on in the Defense Department.

6,094 AWARDS OF $2 MILLION OR MORE IN 1967

Mr. MORRIS. In fiscal year 1967, contract awards of $2 million or more numbered 6,094—2 percent of all actions over $10,000.

Mrs. GRIFFITHS. Because you are dealing with people that are being paid $500,000 annually. So that you have a situation where people are intimidated. I would like to know—I might say I was not.

I would like to know also what steps the Defense Department took—I read recently where some contractor went down to Cape Kennedy and inquired casually from someone standing around how things were going, and the person told him. He was immediately, at the request of the contractor, demoted. It was at the contractor's equipment he was talking about. How much of that still goes on in the Defense Department, and why did you let him do that?

Mr. MORRIS. Sounds like a rarity to me. To get into a classified site without proper credentials.

Mrs. GRIFFITHS. Well, the contractor—there wasn't a problem at all. I read this in the paper. The man took a year to get his job back.

METHOD OF MAKING LARGE PROCUREMENTS

Mr. MORRIS. I think the public does need to understand the very thoroughgoing way in which large procurements, those of several million dollars and up, are conducted.

There is a team headed by a top negotiator, let's say a $20,000-a-year man, that contains an engineer, a pricing specialist, and an audit specialist.

Mr. Petty, who is with us here today, runs an organization that spends its major time getting the facts for the negotiators on these important negotiated procurements.

Mrs. GRIFFITHS. Part of the facts that he cannot get are the facts on how much each item in the procurement costs, because you have already told us you do not have that.

Mr. MORRIS. In connection with his analysis during the negotiating phase, he goes into bills of material, our engineers determine what kind of fabrication methods are to be used, and so forth.

Mrs. GRIFFITHS. He cannot break it down very far—because you have said you do not have that information.

Mr. MORRIS. We are talking about different things, I believe.

Mrs. GRIFFITHS. Well, I am not.

Mr. MORRIS We were speaking earlier of spare parts in the supply system.

Mrs. GRIFFITHS. But, if you cannot build up the price, part by part, Mr. Secretary, you are lost.

Mr. MORRIS. We do build up the price in respect to——

Mrs. GRIFFITHS. If you can build it up part by part then, why can't you build it up when you have a spare part alone. Why don't you know the price then?

Mr. MORRIS. There is quite a difference in buying a thousand——

Mrs. GRIFFITHS. No, there is not.

Mr. MORRIS (continuing). Tanks as part of a major procurement, and later having to replace a part on one of those tanks.

Mrs. GRIFFITHS. If you know the price of one part for any purpose, then you know the price of that part for all purposes. Now, you may not know whether you are making that—whether you have a whole factory set up to run off that part, or whether you have a factory set up to run off a hundred thousand of those parts. But I would not think you would have much trouble.

Mr. MORRIS. We wish we had you back in the Department.

PROPERTY HELD BY CONTRACTORS

Mrs. GRIFFITHS. I will tell you now—we would save some money.

We were talking yesterday about the property owned by the Government, that Federal contractors have. Would you furnish us a list of the contractors and the amount of property by classes that each holds?

PARTIAL LIST OF CONTRACTORS HOLDING GOVERNMENT PROPERTY

Mr. MORRIS. We will endeavor to be responsive. This might become quite a list.

(The following was later supplied for the record:)

Approximately 5,500 manufacturers have some government Industrial Plant Equipment. The value of this equipment varies; however, one third of the firms have government equipment valued at more than $50,000. Further, contractors have plants in several locations, particularly large corporations such as General

Electric or General Motors, and the list would be extremely large. Procurement agencies in all three military departments and DSA, who have the responsibility for maintaining the records, would have to be surveyed to acquire the data, which would take several weeks to accomplish. The following examples of active IPE in major contractor's plants indicate the magnitude of the problem, but show that records are in fact maintained.

Company	Number of items	Value	Number of locations
Aerojet General	3,583	$45,628,738	12
Aerospace Corp	1,438	6,976,060	3
Boeing Co	3,232	36,403,822	18
Curtiss-Wright	2,103	35,733,313	6
Hughes Aircraft	5,031	23,153,820	11
Ling-Temco-Vought	2,923	41,823,449	6
Northrop Aircraft	2,471	23,900,585	16
Thiokol Chemical Corp	2,212	23,172,595	6
T-R-W, Inc	3,215	58,408,383	13
United Aircraft	2,080	35,860,094	8
Total	28,288	331,051,859	99

(See also app. 4(a) and 4(b), pp. 411, 463.)

Mrs. GRIFFITHS. Might take quite a long time. Since you do not have any records now.

Mr. MORRIS. We have records. I can assure you.

Mrs. GRIFFITHS. Easily available?

Mr. MORRIS. We know where the industrial plant equipment is. This is one of the responsibilities of each department, and of the Defense Industrial Production Equipment Center.

(On Jan. 15, 1968, the Department of Defense supplied the additional material below:)

ASSISTANT SECRETARY OF DEFENSE,
Washington, D.C., January 15, 1968.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee, Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to two letters received from you dated 28 December 1967 wherein you requested a revised listing of Government-owned equipment located in individual contractor's plants, and other information.

On Friday, 12 January 1968, a copy of a tabulation was hand carried to Mr. Ray Ward showing, by contractor, the dollar value of Government equipment furnished by each of the military services as of 30 November 1967. Similar data for the end of fiscal years 1964, 1965, 1966 and 1967 are being prepared and will be forwarded to you by the end of January 1968. In addition, according to your request, we are preparing a further breakdown showing the value of Government-owned Industrial Plant Equipment at each of the foregoing dates, which the Department of Defense as a whole had furnished to various classes of industry. This summary will also be furnished to your committee by the end of January 1968.

In response to your query as to the method used to ascertain the value of other plant equipment in contractor's plants, I would like to iterate that financial reports of the value of this equipment are not centrally recorded, but are maintained by property administrators at the field level. However, each year a summary report is requested for a report to the Congress of real and personal property. It was from this summary report that the $2.0 billion other plant equipment value was obtained. As I mentioned in my letter of 21 December 1967, a special report of this equipment as of 31 December 1967 will be available during February 1968. I will forward such detail to you then if it is still desired.

In order to clarify your specific questions regarding the value of industrial plant equipment located at Olin Mathieson's Saltville, Virginia facility, I am attaching a fact sheet containing full details of this matter. The amounts of $3.3 million IPE and $1.4 million real property are correct as of the 30 November 1967 data transmitted to you in my letter of 21 December 1967.

I would also like to take this opportunity to clarify a matter covered during hearings before your committee pertaining to the number of industrial plants holding Government property. Approximately 5,500 plants were cited during the hearings. Actually as of 30 November 1967, under our criteria, there were 5,361 plants, of which 2,256 possessed IPE, and the balance of 3,105 possessed only other plant equipment, material, or special tools and test equipment.

Sincerely,

THOMAS D. MORRIS,
Assistant Secretary of Defense
(Installations and Logistics).

(See p. 197.)

FACT SHEET—GOVERNMENT INVESTMENT IN PLANT EQUIPMENT AND FACILITIES—OLIN MATHIESON CHEMICAL CORPORATION, SALTVILLE, VIRGINIA

1. The Olin Mathieson's Saltville, Virginia facility consists of two (2) separate plants: (a) the Air Force Plant No. 80 complex and (b) the contractor-owned plant, which is a chemical facility and contains only $6,100 in Government-owned machines tool inventory.

2. The amount of $15.6 million reported to Congress by the General Accounting Office included the Government's total investment at the two plants at Saltville. This $15.6 million investment includes the acquisition cost of Industrial Plant Equipment (IPE) as well as the following.

a. $1.4 million for Government-owned *real property* at Air Force Plant No. 80.

b. $3.3 million for Industrial Plant Equipment (includes above mentioned $6,100 of machine tools).

c. $1.3 million for equipment other than IPE. (Other than IPE items include equipment the acquisition cost of which is less than $1,000 and which is not centrally controlled by DIPEC but managed by the property administrators.)

d. $2.2 million investment for the *installation* of Industrial Facilities.

e. $2.7 million for Government-owned non-severable items located on contractor-owned property. These items were provided under a "buy back" agreement in the facilities contract and consist of such items as water mains, sewers, boiler house, and water treatment equipment. Such non-severable equipment (when it is not on Government-owned land) is not reportable as real property.

f. $4.7 million for indirect costs (such as A&E) related to the procurement of the industrial facilities.

3. Summary of the $15.6 million *investment:*

	Millions
(*a*) Real property	$1.4
(*b*) IPE	3.3
(*c*) Other than IPE	1.3
(*d*) Installation costs	2.2
(*e*) Nonseverable Government-owned facilities	2.7
(*f*) Indirect costs	4.7
Total investment	15.6

4. Summary of the $4.7 million *acquisition cost* of IPE and real property.

	Millions
(*a*) Real property	$1.4
(*b*) IPE	3.3
Total acquisition cost	4.7

Mrs. GRIFFITHS. Thank you. My time is up.

Mr. MALLOY. If I might, Mr. Chairman, just to elaborate on that—we do require contractors to give us reports—I believe it is 12 months' intervals—of the total value of Government property in the possession of contractors and these figures are reported and usually to the Congress. So we can provide that type of information.

Mrs. GRIFFITHS. If they do that, then why did the GAO find a person who said that it would take 20 men a year to identify the Government-owned property in his plant?

Mr. MALLOY. Well, I don't really think that was the situation in the GAO report. They were talking there about keeping detailed utilization records on all items of industrial plant equipment, even though costing $1,000 or $1,200. That was the discussion as to how much administrative cost that entailed.

Mrs. GRIFFITHS. Well, they were talking also just about identifying it.

Let me explain to you that I still have some friends that work on some of these problems, and they have told me that when some of this property goes into a contractor's plant, it is lost right then. There is no identification whatsoever. I think you ought to be quite clear on checking this out, because I do not think you have records.

Thank you very much, Mr. Chairman.

Chairman PROXMIRE. Congressman Curtis.

Mr. CURTIS. Thank you, Mr. Chairman.

First, let me say how pleased I am to see you back, Mr. Secretary, in this position, and say that I think you have made a good progress report—what I said in commenting to GAO that I look upon these only as progress reports. We are right in the middle still of a most difficult and probably never-ending area of improvement.

I was pleased to receive the emphasis in this report on training personnel in the procurement area.

As you know, your previous progress reports had developed to some degree what you were doing in the contract service area of creating a special corps.

When you were talking about procurement people, I assume you are talking about the original procurement, and not service contracting personnel. Is that right? Contract servicing personnel?

Mr. MORRIS. I believe we are in agreement there; yes, sir.

Mr. CURTIS. I think it is important to distinguish the two groups, because as I understand it you have one group that handles the original procurement, and then a different group that actually works on the administration of that particular procurement contract?

Mr. MORRIS. That is right, sir—checks the deliveries, pays the bills, does the inspection work.

Mr. CURTIS. And those people are largely out in the field, I guess, at the plants where these materials are being produced to comply with the contracts?

Mr. MORRIS. Many of them are, sir. Others work out of central offices.

DEVELOPING A SPECIAL CORPS

Mr. CURTIS. I thought it was excellent, as I say, that you—that the concept was initiated of developing a corps, which would include, I would imagine, promotions within that group, special on-the-job training, and out-of-job training and so on.

I wish you would supply for the record a little progress report on where we are, that would update us. I think the last time was about a year ago.

Mr. MORRIS. Be glad to.

(The following material was subsequently filed by the Department:)

On-the-job training is a continuous program at all supervisory levels of management. It is a responsibility given to all supervisors—written into their job descriptions. This type of training takes shape in the form of "show or tell" at the employees desk, written instructions and orientation of new employees to their job.

There are both planned and "when required" type of meetings held by supervisors to continuously update their personnel.

There is local training based upon formalized courses offered by the Army Logistics Management Center, Fort Lee, Virginia. Many Military installations, by the use of their own personnel for instructors, use course material from ALMC in classroom type of training during office hours.

To supplement the "on-the-job" as well as "out-of-the-job" training, local schools and colleges are used in after duty hours classes. There is also the self development effort by employees in the use of extension or correspondence courses offered to them by the Services.

The Department of Defense has resident and traveling training courses of study for the functional areas of procurement and contract administration. In addition, there are other courses of study related to these functional areas, such as, automatic data processing, management techniques, etc.

Listed below is the index of courses listed by schools. The key to the abbreviations is as follows:

(JT) Courses offered in conformance with Department of Defense Directive 5010.9 "Defense Logistics Management Training Program".

(AF) Service peculiar courses offered by the Air Force.

(AR) Service peculiar courses offered by the Army.

(Joint Proc) Courses approved by the Defense Procurement Training Board.

The traveling courses of study (taken to the field activities) are those listed as Navy Sponsored Courses shown under the heading "Headquarters Naval Material Command." There is one exception at the present which is the "Defense Procurement Executive Refresher Course" now located in Washington, D.C.

The courses for procurement are identified with a "P" and the contract administration with a "C". Where there is an interest for both functional areas, it is marked with a "PC".

Following the index of courses is the career (Master) development chart for the Civil Service Commission procurement career field. This shows the basic training requirements for advancement in this series. The quality assurance (inspection), production and engineering functional areas that are associated with contract administration area do not have similar basic requirements for advancement.

INDEX OF COURSES LISTED BY SCHOOL

COURSE NUMBER			TITLE	PAGE NUMBER
Department of Defense Computer Institute (DODCI) Washington Navy Yard Annex Washington, D. C.				
DoD CI			Command and Control ADP Systems Course (JT)	24
DoD CI	•	PC	Intermediate Executive Course (JT)	24
DoD CI			Senior Executive Course JT)	25
Air Force Institute of Technology Defense Weapon Systems Management Center Wright-Patterson Air Force Base, Ohio				
			Defense Weapon Systems Management Course (JT)	71
Air Force Institute of Technology School of Systems and Logistics AFIT-SL Wright-Patterson Air Force Base, Ohio				
178	•	PC	Advanced Contract Administration (Joint Proc)	57
191	•	PC	Cost Analysis (JT)	58
252			Advanced Maintenance Management (AF)	48
279	•	C	Advanced Production Management (Joint Proc)	66
172	•	P	Advanced Systems Buying (JT)	58
130			AMA Directorate of Materiel Management (AF)	79
165	•	P	Base Procurement/BCE Related Management (AF)	59
550			Base Supply Management (AF)	81
168	•	PC	Business Law (AF)	59
175	•	PC	Contract Administration (Joint Proc)	60
166	•	PC	Contract Law (JT)	60
176	•	P	Cost Reimbursement Incentive Contracting (JT)	61
380	•	PC	Defense Data Management (JT)	30
385	•	C	Engineering Data Management (AF)	34
192	•	C	Evaluating Contractors' Estimating Systems (Joint Proc)	65
			Graduate Logistics Course (AF)	31
222	•	C	Industrial Maintenance Management (JT)	44
160	•	C	Industrial Property Administration (Joint Proc)	65
150	•	P	Initial Provisioning (AF)	83
355	•	PC	Intermediate Management Information Systems (AF)	29
475			Laboratory Management of Research and Development (AF)	70
580			Logistics Management (AF)	84
210			Maintenance Management Information Systems (JT)	45
242			Maintenance Management Orientation (JT)	46
560	•	C	Management of Value Engineering in Defense Contracting (Joint Proc)	95
269	•	C	Production Management (Joint Proc)	67
370			Program Evaluation Review Technique (PERT/Time and PERT/Cost) (AF)	48
440	•	C	Quality Control Management (Joint Proc)	78
189	•	PC	Quantitative Methods in Cost Analysis (JT)	61
435	•	C	Reliability (AF)	76
375			Scientific and Technical Information (JT)	31
418	•	C	Statistical Quality Control I (Joint Proc)	78
428	•	C	Statistical Quality Control II (Joint Proc)	79
570			System Program Management (AF)	70
365			Systems Simulation for Analysts and Programmers (AF)	29
232			Weapon Systems Maintenance Management (AF)	46
USAF Air Training Command Amarillo AFB, Texas				
823			Defense Metals Identification (JT)	73
AZR 61170–1			Redistribution and Marketing (AF)	74
OBR 6421			Supply Operations Officer (AF)	86
OAR 6411			Supply Staff Officer (AF)	85
OZR 6534–1	•	P	Advanced Base Procurement Management (AF)	57
USAF Air Training Command Chanute Air Force Base, Illinois				
OAR 4311			Aircraft Maintenance Staff Officer (AF)	43
OBR 4341			Aircraft Maintenance Officer (AF)	44
OZR 4344			Maintenance Analysis (AF)	45

COURSE NUMBER	TITLE	PAGE NUMBER
USAF Air Training Command Sheppard AFB, Texas		
OBR 6721	Accounting and Finance Officer (AF)	100
OZR 6784	Auditing Data Processing Systems (AF)	23
OAR 6731	Budget Officer (AF)	100
AZR 68750	Computer Programming (AF)	27
ARZ 68750-1	COBOL Programming (AF)	26
OZR 6834	Data Systems Analysis and Design (AF)	29
OZR 7500-2	Development and Management of Training Materials (AF)	75
OBR 6851	Electronic Data Processing Officer (AF)	100
AZR 68750-2	FORTRAN Programming (AF)	27
AZR 68750-3	JOVIAL Programming (AF)	27
OBR 6891	Management Analysis Officer (AF)	34
OAR 6011	Transportation Staff Officer (AF)	88
USAF TTC Keesler AFB, Biloxi, Mississippi		
OAR 3011	Communications - Electronics Staff Officer (AF)	106
OBR 3031	Communications Officer (AF)	106
USAF TTC Lowry AFB, Denver, Colorado		
OZR 6534 • P	Advanced Base Procurement Management (AF)	57
OAR 3211	Avionics Staff Officer (AF)	105
OBR 7431	Management Engineering Officer (AF)	105
OBR 6531-1 • P	Procurement Officer AF)	105
PERT Orientation and Training Center Vanguard Building 20th & L Streets, NW, Washington, D. C.		
• P C	PERT Orientation Executives (Joint Proc)	49
• P C	PERT Orientation Middle Management Training Workshop (Joint Proc)	49
Joint Military Packaging Training Center Aberdeen Proving Grounds, Aberdeen, Maryland 21005		
822-F4 • C	Basic Packing (JT)	50
8B-F6, • C 822-F6	Equipment Preservation for Shipment or Storage (JT)	51
8B-F8, 822-F8	Inspection of Packaged and Packed Household Goods for Storage and Shipment (JT)	51
8B-F5	Missile Packaging (JT)	53
8B-F4 • C	Packaging Administration (JT)	52
8B-F16	Packaging Design (JT)	56
8B-F2	Packing and Carloading (JT)	53
8B-F7, 822-F7	Preparation of Freight for Air Shipment (JT)	54
8B-F1, 822-F1	Preservation and Intermediate Protection (JT)	55
8B-F3 • C	Preservation and Packaging (JT)	56
8B-F19	Preservation for Shipment or Storage of Fixed- or Rotary-Wing Aircraft (JT)	104
U. S. Army Finance School Fort Benjamin Harrison, Indiana 46216		
7E-F5	Auditing of Automatic Data Processing Systems (AR)	101
7E-F20/ 531-F4	Financial Management Systems-Automated Application (AR)	101
7D-F6/ 541-F3	Internal Review (AR)	101
7D-F1	Military Comptrollership (AR)	102
7D-F5/ 541-F2	Programming and Budgeting (AR)	102
7D-F4/ 541-F1	Techniques of Review and Analysis (AR)	103
U. S. Army Intelligence School Fort Holabird, Maryland 21219		
3C-F8 • C	Advance Industrial Security Course (Joint Proc)	96
3C-F7 • C	Basic Industrial Security Course (Joint Proc)	96
3C-F9 • C	Industrial Security Administrative Course (Joint Proc)	97
3C-F5 • C	Industrial Security Management Course (Joint Proc)	97
3C-F6 • C	Industrial Security Orientation Course (Joint Proc)	98
United States Army Logistics Management Center Fort Lee, Virginia 23801		
8A-F1 • P C	Army Logistics Management (AR)	80
8A-F5	Associate Army Logistics Management (AR)	80
8B-F17* • C	Defense Advanced Disposal Management (JT)	72
8A-F2	Army Project Manager (AR)	67

*Nonresident courses are offered in these subjects. See Section 5, paragraph B.

COURSE NUMBER	TITLE	PAGE NUMBER
8B-F12	Defense Advanced Inventory Management (JT)	82
8D-F12 • ρ C	Defense Advanced Procurement Management (JT)	62
8B-F10*	Defense Depot Distribution Management (JT)	83
8B-F18 • C	Defense Disposal Executive Development Seminar (JT)	74
8A-F12	Defense International Logistics Management (JT)	33
8B-F11*	Defense Inventory Management (JT)	82
5K-F1	Defense Logistics Instructor Development (JT)	84
8D-4310/• ρC 4320*	Defense Procurement Management (Joint Proc)	63
8D-F1*	Defense Specification Management (JT)	63
8A-F3*	Maintenance Management (AR)	47
8D-F18 • C	Quality Control Management (Joint Proc)	78
5L-F3	Research & Development Management Orientation (AR)	103

*Nonresident courses are offered in these subjects. See Section 5, paragraph B.

U. S. Army Management Engineering Training Agency, Rock Island, Illinois 61202

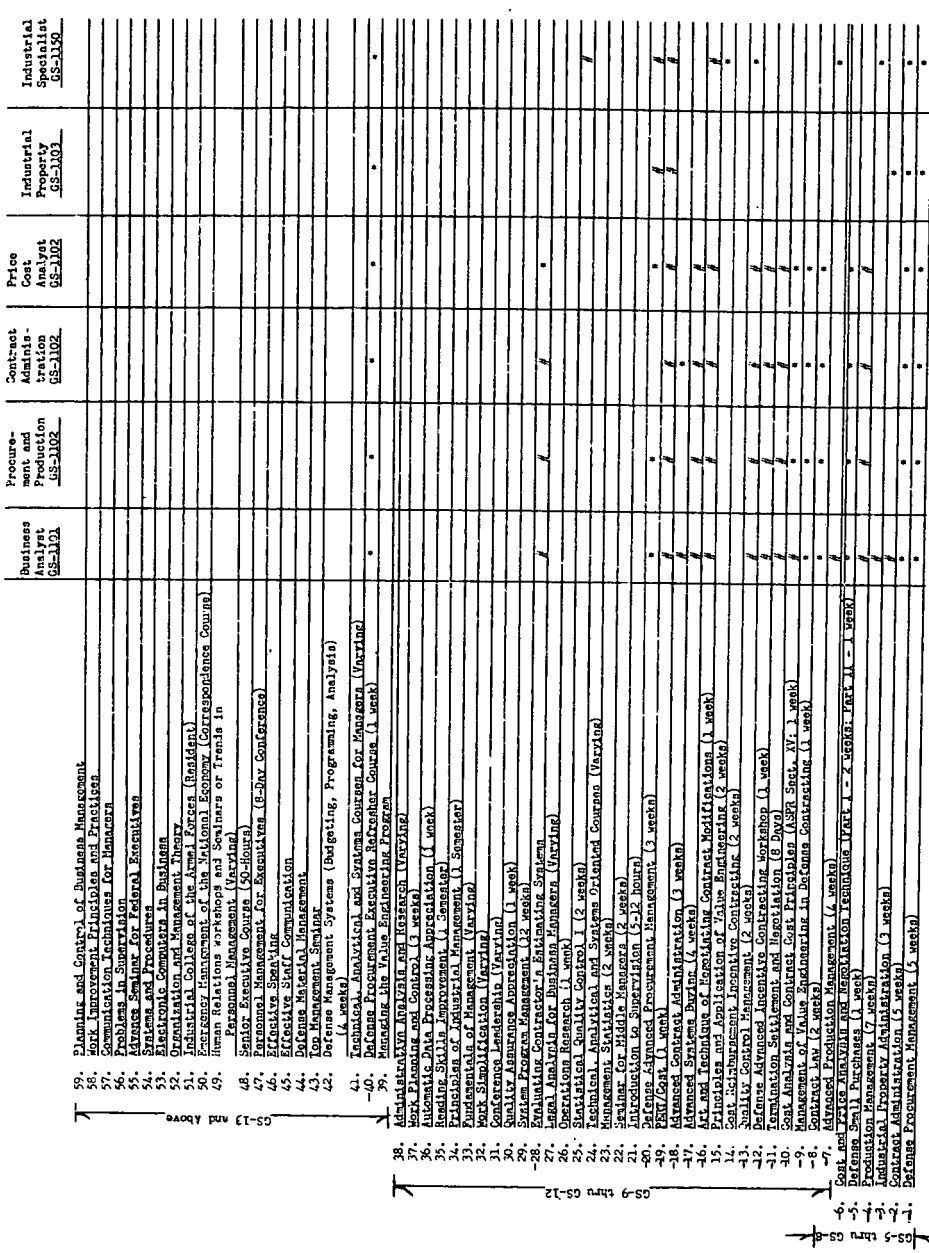
7E-F7 • ρC	Automatic Data Processing Appreciation (JT)	24
7E-F11	Common Business Oriented Language (COBOL) (JT)	26
7E-F10	Computer Programming (JT)	28
8D-F26 • ρC	Contractor Performance Evaluation (Joint Proc)	69
7E-F8	Data Collection and Transmission Appreciation (JT)	28
7E-F17	Data Processing Profitability and Application Studies (JT)	99
7E-F19	Defense Computer Installation Management Seminar (JT)	25
7E-F13	Design and Analysis of Experiments (JT)	21
8D-F19	Designing Quality Programs (AR)	75
7A-F10	Economic Analysis for Decision Making (JT)	33
5A-F2 • C	Elements of Reliability and Maintainability (JT)	76
8D-F20 • C	Evaluation of Producer's Quality Programs (JT)	77
7D-F7	Financial Management for Managers (JT)	34
8D-F25 • C	Inspection Planning (JT)	77
7E-F18	Introduction to ADP System Analysis and Design (JT)	99
7E-F15 • ρC	Management Statistics (JT)	21
7A-F26	Managerial Communication (JT)	41
8D-F28	Managing the Value Engineering Program (JT)	95
5L-F2	Managing Research and Development Activities (JT)	30
7C	Manpower Validation (AF)	35
5A-F1	Mathematical Programming (JT)	21
7A-F24	Methods-Time Measurement (MTM) (JT)	36
7A-F9 • ρC	New Organization Concepts for Top Management (JT)	37
7A-F12	Operations Research Appreciation (JT)	22
7A-F8	Organization Planning (JT)	37
7A-F13	PERT/Cost (AR)	48
7A-F14	PERT/Cost Appreciation (AR)	50
8D-F27 • ρC	Principles and Application of Value Engineering (Joint Proc)	94
5A-F3	Probabilistic Methods in Operations Research (JT)	22
7A-F15	Quantitative Decision Making (JT)	23
5L-F1	Project Planning and Control Techniques (JT)	71
8D-F21 • C	Quality Assurance Appreciation (JT)	68
8D-F18 • C	Quality Control Management (Joint Proc)	78
7A-F16	Real Time Systems (JT)	37
7A-F28 • ρC	Reliability Program Management (JT)	77
7E-F16 • C	Sampling Procedures for Reliability Testing (JT)	76
7A-F6 • ρC	Seminar for Chiefs of Management Offices (JT)	38
7A-F5 • ρC	Seminar for Middle Managers (JT)	36
8D-F22 • C	Seminar for Quality Managers (AR)	78
7A-F17	Standard Time Data (JT)	38
8D-F23 • C	Statistical Quality Control I (Joint Proc)	78
8D-F24 • C	Statistical Quality Control II (Joint Proc)	79
7A-F18	Systems and Procedures Analysis (JT)	39
7A-F27	Techniques of Managerial Communication (JT)	42
7A-F25 • ρC	Top Management Seminar (JT)	41
7A-F19	Work Methods and Standards (JT)	39

COURSE NUMBER	TITLE	PAGE NUMBER
7A-F20 • PC	Work Methods and Standards Appreciation (JT)	68
7A-F21	Work Planning and Control (JT)	40
7A-F22 • PC	Work Planning and Control Appreciation (JT)	40
5L-F2	Managing Research & Development Activities (JT)	30
U. S. Army Transportation School Fort Eustis, Virginia 23604		
822-F10	Air Transportability (AR)	93
8C-F2	Air Transportability Planning (AR)	93
8C-F3 • C	Defense Advanced Traffic Management (JT)	86
8C-F4 • C	Installation Traffic Management (AR)	89
U. S. Army Armor School Fort Knox, Kentucky 40121		
8A-F8/ 510-F2	Command Maintenance Management Inspection, Inspector (AR)	46
8A-F13	Junior Officers' Preventive Maintenance (AR)	43
8A-F6	Senior Officers' Preventive Maintenance (AR)	42
U. S. Army Quartermaster School Fort Lee, Virginia 23801		
AZA-60750 AN-461A/860-43E2P	Airdrop Loadmaster (AR)	92
8F-4210	Army-Air Force Exchange Operations (AR)	89
8G-4223/ 551-F2	Commissary Management (AR)	88
8G-F2/ 551-F3	Defense Metals Identification (JT)	73
8E-4114/ 941A	Food Service Supervision (AR)	87
8E-F2/ 801-F1	Open Mess Management (AR)	35
4N-461A/ 860-43E2P	Parachute Packing, Maintenance and Airdrop (AR)	92
8B-4960	Petroleum Officer (AR)	85
8G-F1 • C 822-F9	Property Disposal Operations (AR)	72
8D-4130	Subsistence Officer (AR)	87
U. S. Naval Postgraduate School Monterey, California		
• PC	Defense Management Systems Course (JT)	32

COURSE NUMBER	TITLE	PAGE NUMBER
U. S. Naval School Transportation Management Naval Supply Center Oakland, California		
	Advanced Transportation Management (NV)	91
	Air Traffic Management (NV)	92
	Cargo Handling (NV)	107
	Intermediate Transportation Management (NV)	91
	Introduction to Transportation Management (NV)	91
	Management Techniques for Distribution Officers (NV)	94
	Marine Terminal Management (NV)	90
	Transportation Management (NV)	90
	Transportation Staff and Planning Function (NV)	94
	Warehouse Operations (JT)	88
Headquarters Naval Material Command (MA10213) and Field Locations (See Schedule of Navy Sponsored Courses)		
CM • PC	Art and Technique of Negotiating Contract Modifications (Joint Proc)	59
PN • PC	Cost and Price Analysis and Negotiation Technique (Joint Proc)	61
ER • PC	Defense Procurement Executive Refresher Course (Joint Proc)	62
IC • PC	Defense Advanced Incentive Contracting Workshop (Joint Proc)	64
IS • PC	Defense Incentive Contract Structuring Workshop for Top Management (Joint Proc)	64
MY • PC	Defense Multi-Year Procurement and Two-Step Formal Advertising Seminar (Joint Proc)	65
SP • P	Defense Small Purchase Course (Joint Proc)	63
MT • C	Procurement Management For Technical Personnel (Joint Proc)	66
TS • PC	Termination Settlement and Negotiation (Joint Proc)	66

FIGURE III

MASTER DEVELOPMENT PLAN



LEGEND:

*Mandatory

Mandatory, if required by the mission

NOTE: Courses (or equivalent as determined by established tests or by the OSD(I&L) Coordinator for Defense Management and Education) identified by * or # must be completed within 12 months of the date of promotion to the next level or in the senior level to the next grade.

May 1966

Mr. CURTIS. How many people are in that particular corps. I understand you have 25,000 in the procurement area?

DCAS HAS A STAFF OF 23,000

Mr. MORRIS. In the DCAS, Defense Contract Administration Service, I believe another 21,000, approximately, at this time. General Hedlund can correct me.

General HEDLUND. About 23,000.

Mr. CURTIS. About 23,000. Has anything been done to develop the procurement officers, the procurement personnel, into a comparable concept of a corps?

Mr. MORRIS. Yes, sir. We have during the past 3 years been developing a career promotional program for what you have described as the original buyers. For example, we now have at Ogden, Utah, a central data center where we have the complete personnel history record on all personnel in grades 13 and above, including their periodic performance evaluations. As a vacancy occurs in any military department or DCAS, that central data bank must be interrogated by the organization having the vacancy. The data bank furnishes a list of the 20 top people located anywhere in the Department of Defense who are eligible for consideration for that opening.

Mr. CURTIS. But, you do not have the procurement group formalized to the extent that you have the contracting service people.

Mr. MORRIS. It is not a centralized organization, no sir. It is decentralized among the three military departments and DCAS.

Mr. CURTIS. Why, if you found it valuable in the contract servicing area, wouldn't it be valuable in the procurement area?

Mr. MORRIS. We have centralized procurement of common-use items in the Defense Supply Agency. That is a movement in the direction that you speak to, sir.

Procurement people, however, in terms of these complex and large contracts, must be closely associated with the systems design people, the engineers and the program managers, such as in the purchase of the C–5–A, for example. They must work hand in hand, day to day with those people who know how to make the most prudent buys. You could not centralize those people physically without denying the Department of the best kind of procurement planning correlated with development and design planning.

Mr. CURTIS. You are advancing me a theory. You are giving me an argument of why you are not—which certainly is to be borne in mind.

On the other hand, inasmuch as we are talking essentially about techniques, rather than specific knowledge—although you certainly do have to have knowledge—but the techniques, I think, probably at this stage are much more important. The techniques of procuring ought to be similar. In fact, that is the very reason, as I understand in your report here, you are calling them in and giving them these lectures and the training films and so on—because you do recognize that the techniques——

Mr. MORRIS. This is quite true, sir. Our training program of 43 courses is a centrally administered program available to all of these people. We bring them in for these purposes.

Mr. CURTIS. If I may be pardoned for uttering a suspicion, it seems to me what you really run into is the same fight we always do from the three services. If you leave them to themselves, of course, they want control over any branch they can. We have never even coordinated the Chaplains' Corps, or the procurement of materials for the chaplains in the Army, Navy, and Air Force. We are still worshipping God according to the Army, Navy, and Air Force, and so it is here.

I recognize these arguments, and some of them have validity. But with this situation we have, the vast quantities, and the need for these improved management techniques, that should be overriding. We cannot afford, in my judgment, this parochialism. And I think—I hope that just as you were able to gird your loins and develop the Service Contracting Corps, you would move toward this. Maybe you are and maybe this is just one of these problems that you just have to fight out with finesse.

1.8 MILLION ITEMS UNDER INTEGRATED MANAGEMENT

Mr. MORRIS. I think the important fact is that since 1961 we have brought 1.8 million items under integrated management, including procurement of those items, whereas there were only 40,000 in 1961.

Mr. CURTIS. If I were training procurement officers, I would train them in one common school, and then let them go to the Navy, Army, or Air Force, whichever happened to be the service—but I would know they were following what is our best information of good procurement practices.

COMMON SCHOOLS FOR PROCUREMENT

Mr. MORRIS. This we are doing, sir. We have common schools for all military departments and DSA, in the procurement field.

Mr. CURTIS. All the more reason for following it out and developing a corps that would develop this esprit de corps and exchanging of knowledge.

Mr. MORRIS. We agree, sir.

AUDIT GROUP SEPARATE FROM PROCUREMENT AND SERVICE CONTRACT GROUPS

Mr. CURTIS. Now, there is a third group, as I understand—there may be more—but then you have your audit group. They are separate and distinct from your procurement people, your Service Contract people. Am I correct?

Mr. MORRIS. That is correct, sir.

Mr. CURTIS. How is that group developing? What is the stage of its development along a corps concept, or is it still separated into the three services?

Mr. MORRIS. I think we have made much progress here. There is a Central Defense Contract Audit Agency. The head of this agency, Mr. Petty, is with us, and he may wish to comment on your question.

DCAA A SINGLE AGENCY

Mr. PETTY. We are a single agency. We have no parts in Army, Navy, or Air Force.

Mr. CURTIS. So you really are a corps?

Mr. PETTY. We have reached the point you are suggesting that these kinds of activities should reach.

Mr. CURTIS. Very good.

Have I missed any major group in this process—procurement, servicing, and auditing?

Mr. MORRIS. Those are the key tools of the whole procurement process, sir.

Mr. CURTIS. I just want to be sure.

By the way, about how many do we have in auditing? What is the total personnel?

DCAA HAS STAFF OF 3,900

Mr. PETTY. We have about 3,900 people on board in the Defense Contract Audit Agency at this time.

Mr. CURTIS. I see.

One other thing I would like—and this can go for the record. Most of these personnel in all three of these services are civilian rather than military. Am I correct in that?

Mr. MORRIS. The large majority are civilian.

Mr. CURTIS. There are in each one military personnel?

Mr. MORRIS. That is correct, sir. And they are exposed to the same kind of training the civilian gets.

ROTATION OF MILITARY STAFF

Mr. CURTIS. But your military personnel tend to be on this rotation system that you have in the military, which detracts, I would think, from this kind of concentration. Am I right in that statement?

Mr. MORRIS. More and more of the services are tending to professionalize people in the procurement occupation—the military personnel.

Mr. CURTIS. Yes. But they cannot professionalize if they rotate them. That is my point.

Mr. MORRIS. If the rotation is within the procurement organization or complex generally, it keeps building their expertise. You are quite right that they are rotated to nonprocurement jobs very frequently, and this does inhibit full career specialization.

Mr. CURTIS. There may be a reason. I am not arguing against it. Just trying to understand.

NO MILITARY PEOPLE IN DCAA

Mr. PETTY. I would like to comment that the Defense Contract Audit Agency is now an entirely civilian organization. We have no military personnel assigned.

Mr. CURTIS. Very good.

I would be interested in——

Chairman PROXMIRE. May I ask—before this gentleman sits down—Mr. Petty, will you identify yourself?

Mr. PETTY. William B. Petty, Director, Defense Contract Audit Agency.

Chairman PROXMIRE. Thank you, Mr. Petty.

MILITARY PEOPLE IN SERVICE AND PROCUREMENT AREAS

Mr. CURTIS. I would appreciate, for the record, what reason there might be—and there could be good reason—why you think you need military personnel in the service contract area, and in the procurement area.

Mr. MORRIS. Be very glad to give you this, sir.

Mr. CURTIS. And then, also, what are the ratios. You have, say, 25,000 in procurement; about how many would be military, would you say?

Mr. MORRIS. Let us furnish that for the record.

Mr. CURTIS. And, also, in the service contract; you have some there, too?

Mr. MORRIS. Fine, sir.

(The information furnished for the record follows:)

In the Procurement area the ratio military to civilian is approximately 3.5%.

In the Contract Administration area staffing runs approximately 23,000 in Defense Contract Administration Services and 17,000 in the Services, or a total of 40,000. The ratio military to civilian is approximately 3%.

Military personnel are rotated from *operating billets* to procurement and contract administration assignments and bring to these positions the experience of the "field operations". To put it differently, the military "front line" experiences with end products or the end of the line in logistics support, can, when rotated back to the procurement or administration job, aid in improving the contracting for and administration of contracts.

PRICE REDETERMINATION

Mr. CURTIS. Now, I get to the thing I am most concerned about. The relationship between the three services. Maybe I can zero in on the question I have asked before.

In your redetermination clauses, price redetermination, as I understand it your procurement group is the one that does this—not the service group or the audit. Am I right?

Mr. MORRIS. This is a negotiator's responsibility, I believe.

Mr. MALLOY. That is correct. We do not have many redetermination type contracts these days. But, if we were to take a type of contract we do use such as an incentive contract, the actual negotiation of the final pricing is done by the procuring contracting officer. However, he has had all of the support that he needs from both the Contract Audit Agency reports and the reports of the contract administration people in the field. These are support to him.

Mr. CURTIS. Well, this is what I am looking to see—to the extent—I know that is the ideal, or I would hope it is the ideal, and you are stating it reassures me of that.

I do have a concern as to how well it works, because it seems to me, whether you call it incentive contracts—it is the same thing—you are in effect looking over again what your price was. And the contract service officers seem to me to be the ones most knowledgeable in determining what the new price should be, what the incentive should be, as opposed to your original negotiators.

I can see why your original negotiators should be in it. But I would think it would almost be a team rather than a coordination—where

you have your man who did the servicing, or the team that did, and the original negotiators almost—I think they can use the audits—I do not think you need them actually aboard.

Would you comment on that.

TEAM APPROACH TO NEGOTIATION

Mr. MALLOY. Congressman, I agree completely with you—the larger procurements—we actually do have the field man, who is most knowledgeable of the details of a contractor's operation, participate in the negotiation with the men at the buying office. Quite often we do the same thing with the auditors. We bring the field auditor in and he joins the team. So this is a good system. It is one that we follow. It is one that has certain limitations, of course, in terms of the cost to bring the people back in, and the time it takes to do this. But on large procurements it is very sound.

Mr. CURTIS. Well, I think the system as we have outlined here is sound. Sure, I can see where costs could enter in. But, to maintain a system, even though on a specific contract, it might look like it is costly by maintaining the system—but, you gain the cost back many times over.

Mr. MALLOY. Yes. I might mention one other facet of this that you may be interested in.

There are many circumstances which might involve the pricing out of some spare parts under a contract, or the pricing out of a change order, particularly lower dollar value change orders under a contract, where the total responsibility for doing the pricing is delegated out to the field personnel, and they actually handle the transaction in the field—because in that area, they do have the competence you are suggesting. It is the most efficient way to do it.

Mr. CURTIS. I see my time is up.

To me, this is the essence of what is going to move us forward, in line with Mrs. Griffiths' comments. If the Government is going to do the job to represent the Government's interest vis-a-vis the private sector; I have a very high opinion, I might say, of our private sector.

Mr. MORRIS. So do we, sir.

NEED FOR COMPETENT EMPLOYEES

Mr. CURTIS. I think they are competitive. Sure, there needs to be a real competition to see to it that gouging does not develop. But it is true if we do not have people trained and competent to meet those competent people, it does not result in a good system. And this emphasis I do feel you are placing on this in upgrading the skills and the recognition that the people in these three areas deserve, if we are going to attract and hold in those services the kind of men and women that we do need, the kind of men and women like Mrs. Griffiths—she might not have been a Congresswoman if we had a good career for people like her there.

Chairman PROXMIRE. Much more valuable here, however valuable she would be as a procurement officer.

FOUR-DAY PROCUREMENT CONFERENCE

Mr. MORRIS. We had this 4-day conference of our 280 top procurement personnel just a month ago. After 4 days, I think, their prime conclusion was the human element is the most important ingredient to further progress in this field.

CONFLICT-OF-INTEREST LAWS

Chairman PROXMIRE. Of course, we have not mentioned at all the laws that prohibit procurement officials from becoming part of a firm which has supplied procurement to the Government.

Do you think that the laws are sufficiently restrictive in this regard? It concerns me very deeply, concerns all people that I have talked to about this. You have a man who—in some cases military, some cases civilian—he is a procurement official. He leaves the Defense Department—is it 1 year or 2 years?

Mr. MORRIS. One year I believe.

Mr. CURTIS. For 1 year he is not permitted to work for a firm which has sold to the Government. But, after a year he is free to do so. And, of course, the pay, the compensation can be enormous. And this can be something in the back of the mind of such procurement officers when they deal with these big firms. On the other hand, we do not like to interfere with the freedom of any American citizen.

Do you feel the laws are adequate in that regard?

Mr. MORRIS. Let me first correct myself. Mr. Malloy said it is 3 years.

Mr. MALLOY. I might say just to further clarify, that in the case of a military man, he is prohibited for all time from doing business with the service that he has served with. So he has that prohibition that lasts without limitation.

Chairman PROXMIRE. So if he is an Army man, he cannot do——

Mr. MALLOY. Cannot sell to the Army.

Chairman PROXMIRE. Cannot do business with the Army?

Mr. MALLOY. That is correct.

Mr. MORRIS. I do think, Mr. Chairman, our laws and our own administrative regulations, Executive orders and directives, are quite adequate and sufficiently restrictive to prevent abuses. (See "Standards of Conduct," Hearings, 1965, pp. 141–177.)

DEFENSE MOBILIZATION ORDER 8555.1

Chairman PROXMIRE. Is Mr. Sanderson here, of the Office of Emergency Planning?

Mr. SANDERSON. Yes, sir.

Chairman PROXMIRE. Mr. Sanderson, I understand that your office is reasonable for setting standards on the use of this equipment?

Mr. SANDERSON. That is right, sir.

Chairman PROXMIRE. Government-owned—and in the hands of the contractors. And Mr. Staats was anxious that you have a chance to be here. If you have any statement at all that you would like to make in connection with what has been said this morning, or what Mr. Staats has said before, we would welcome it.

Mr. SANDERSON. We have worked closely both with GAO and the Department of Defense on this report and are still working on it. I can submit for the record a copy of our policy that has existed for 10 years in this area.

Chairman PROXMIRE. Very good.

(The following was subsequently supplied as promised:)

[Reprinted from the Federal Register of Nov. 23, 1963 (28 F.R. 12581)]

DEFENSE MOBILIZATION ORDER 8555.1 (FORMERLY DMO VII–4, VII–1A AND VII–1B) NOVEMBER 13, 1963

EXECUTIVE OFFICE OF THE PRESIDENT,
OFFICE OF EMERGENCY PLANNING,
Washington, D.C.

DMO 8555.1—OEP POLICY GUIDANCE ON GOVERNMENT-OWNED PRODUCTION EQUIPMENT

1. *Purpose.* This Order consolidates and revises existing policies on Government-owned production equipment, including machine tools, which policies are necessary to maintain a highly effective and immediately available machine tool and equipment reserve for the emergency preparedness program of the U.S. Government.

2. *Cancellation.* This Order supersedes Defense Mobilization Order VII–4 (Revised) of March 10, 1958 (23 F.R. 1727); DMO VII–1A (DMO–18, Amdt. 1 (18 F.R. 4518), redesignated at 18 F.R. 4597 and 18 F.R. 6736); and DMO VII–1B (DMO–18, Amdt. 2 (18 F.R. 4518) redesignated at 18 F.R. 4597 and 18 F.R. 6736).

3. *Scope and applicability.* The policies and provisions of this Order apply to all Federal Departments and Agencies having production equipment emergency preparedness functions assigned by Executive Orders. They shall relate to the classes of Government-owned production equipment listed in Appendix A of this Order. This Order is not designed to affect any existing leases of Government-owned production equipment. Such exceptions as from time to time may be necessary to the policy outlined herein hall be made only with prior approval of the Office of Emergency Planning.

4. *Definitions.* a. "Production equipment," as used herein includes all items of equipment having an acquisition cost of $500.00 or more that fall within the categories of machinery and equipment listed in Appendix A of this Order.

b. "Idle production equipment," as used herein means all items of production equipment for which no use is contemplated or planned within 90 days, except such equipment as is devoted exclusively to maintenance or is on shipboard or assigned to owning agencies' developmental activities. Idle equipment does not include production equipment in packaged form, in standby lines, or in active base packages, unless or until it has been withdrawn therefrom and has no contemplated use for a 90-day period.

c. "Packaged form," as used herein means Government-owned production equipment assigned to a specific program, contractor, and plant in either an in-use, idle, or partially idle status and which equipment as an entirety, or when combined with equipment owned by the contractor, is capable of producing at a specific level, a particular military or defense-supporting item or items at that plant, by that contractor, as defense requirements may necessitate.

d. "Standby line," as used herein means a complete set of installed Government-owned equipment, in an idle status, maintained intact in reserve condition and which, when activated, is capable of producing at a specific level of output.

e. "Active base package," as used herein means idle production equipment located in an active production facility when such equipment has been retained to provide production acceleration capability in the event of emergency, or to be used following a change-over to a new modified production item.

f. "Package," as used herein means those complements of production equipment held in packaged form, standby lines, and active base packages, as defined above.

5. *Disposition of production equipment*—a. *Policy*—(1) *Department of Defense.* Production equipment owned by the Department of Defense for which there exists a known or anticipated emergency preparedness need shall be held in efficient operating condition at or near the plants which will operate them in event of an emergency. In the event no such storage arrangement is possible, the equipment may be stored in central Government warehouses, but, in such cases, all efforts

should be exerted to maintain intact complete complements of production equipment. In those cases in which complements of equipment are not wholly Government-owned, every effort should be made to keep together as much as possible of the total equipment complement.

(2) *Other Government agencies.* Production equipment owned by government agencies other than the Department of Defense, shall be stored adjacent to manufacturing establishments only if there exists a known or anticipated defense mobilization need therefor at such location and if storage arrangements provide for the maintenance of the equipment in efficient operating condition. Where adjacent storage is not required to meet a known or anticipated defense mobilization need, the equipment should be placed in storage by the owning agencies under the most economical arrangements that are compatible with maintenance of the equipmen in efficient operating condition.

b. *Provisions.* (1) All equipment in packages shall be reviewed periodically to insure their essentiality to mobilization requirements and to guard against obsolescence. Packages or parts of packages found to be obsolete or no longer essential to mobilization requirements shall be reported as idle equipment to be screened for redistribution or disposal.

(2) In any instance in which a department or agency cannot meet urgent production schedules, because equipment essential to this end is not immediately available within the department or agency or cannot be promptly obtained from other Federal agencies or from private industry, equipment in packages shall be made available on a loan or replacement basis for this purpose. Upon termination of a loan, the borrowed equipment, if required, will be returned to its package.

(3) Continued maintenance of a modern and efficient production equipment mobilization base and planning and programming toward that objective should be advanced by the inclusion and consideration, where feasible, of requests for the following purposes as a part of the regular, annual cycle:

(a) Procurement of equipment to meet current production schedules, including equipment necessary to permit return of items borrowed from packages.

(b) Replacement of obsolete items in packages by equipment currently regarded as efficient for this purpose.

(c) Provision for modernization and replacement of production equipment to keep pace with technological advances in both munitions design and in equipment essential to its efficient production.

(4) *Non-defense leasing.* No Government-owned production equipment shall be leased for non-defense production purposes except when plans for such leasing have been prepared by the owning agencies and approved by the Office of Emergency Planning.

(5) *Uniform rental rates.* All new agreements and agreement renewals entered into by any agency of the Federal Government, under which private business establishments are provided with Government-owned production equipment, shall be subject to the following schedule of rental rates (expressed as percentages of the installed acquisition cost of equipment):

Age of equipment:	*Monthly rental rates (percent)*
0 to 2 years	1¾
Over 2 to 6 years	1½
Over 6 to 10 years	1
Over 10 years	¾

These rental rates shall be uniformly charged by all Government agencies in leasing Government-owned equipment when the rental charge is to be a periodic cash payment or when it is to be utilized in computing a contract price reduction and shall be levied on an equipment availability basis without regard to the character or extent of its use under such agreements. No exception to the rates shall be made without prior Office of Emergency Planning approval.

(6) *Other leasing guidelines*—(a) *Contract provisions*—i. *Term.* Leasing agreements shall be drawn to cover the span of time needed to carry out their purpose, with latitude for adjustment to meet changed circumstances.

ii. *Purchase option.* A purchase option provision shall be included only in exceptional cases, or where prescribed by law.

iii. *Renewal option.* Provision for renewal shall be excluded from equipment leases.

iv. *Maintenance.* Agreements shall require that equipment be returned in the condition received, ordinary wear and tear excepted.

v. *Installation charges.* Agreements shall provide that the lessee bear installation charges in whatever manner is best suited to the particular circumstances.

vi. *Transportation in and out and removal costs.* Agreements shall provide that these costs be borne by the lessee in a manner best suited to the particular circumstances.

vii. *Equipment modernization costs.* Agreements shall provide that, when equipment is modernized by substantial rebuilding at Government expense, the acquisition cost of the equipment be adjusted upward to take account of the increased value that such rebuilding and modernization represents.

viii. *Statement of rental consideration.* For each contract, under which a private contractor is provided with Government-owned production equipment, a statement shall be included in the contract or the contract file, as appropriate, specifying the periodic dollar amount of rent to be paid, whether such payments are made in cash or are offset or credited against payments made to the contractor by the Government for end-products produced for Government account.

(b) *General considerations.* i. Government lessor agencies should not be regarded as being in the leasing business as an end in itself or in the same sense as private industrial establishments.

ii. Government-owned production equipment should not be leased to private industry until its unavailability from private sources has been established.

iii. The rental rates and leasing guidelines outlined herein have no application to wholly-owned Government facilities operated by private contractors on a cost-plus-fee basis.

iv. Government agencies providing Government-owned production equipment to private contracts shall insure that no contractors are afforded a favored competitive position thereby.

6. *Central inventory and effective utilization of idle Government-owned production equipment including machine tools.* The following agencies are in possession of such equipment and tools or have the right of repossession in the interest of national defense:

Department of Defense.
Department of the Army.
Department of the Navy.
Department of the Air Force.
General Services Administration.
Atomic Energy Commission.
Department of Commerce.
Department of Health, Education, and Welfare.
National Aeronautics and Space Administration.

a. *Policy.* To accomplish effective utilization of these tools and equipment two central inventory records of idle Government-owned production equipment and machine tools (for those classes listed in Appendix A, or as may from time to time be determined by the Office of Emergency Planning with the advice of directly affected agencies) will be established and maintained, one in the Department of Defense, the other in the Department of Commerce. Army, Navy, and Air Force idle equipment will be reported to the former and that of all other Federal agencies to the latter. Transfers between agencies listed above will be accomplished in accordance with the provisions of the Federal Property and Administrative Services Act of 1949, as amended, and GSA regulations.

b. *Provisions.* (1) Equipment and tools in these central inventories will be made available to the agencies listed above on the basis of essentiality and urgency of needs.

(2) The Department of Defense will exercise the functions of recording, directing on-site inspection, and directing the issuance of shipping orders when reassignment within the Department of Defense is involved.

(3) The above listed agencies will furnish the information necessary (see Appendix B for minimum descriptive requirements) to establish and currently maintain such central inventories; provide for the expeditious shipment of such equipment and tools in accordance with Department of Defense or Department of Commerce instructions; and arrange for such transfer, lease, sale, or other disposition as may be necessary in the best interests of the Government and in conformity with property accountability requirements.

(4) Procedures implementing this directive will be established by the agencies concerned in consultation with each other and conform as nearly as is practical with existing procedures governing the present idle equipment inventories.

(5) The agencies listed above will submit to the Office of Emergency Planning all listings of production equipment which are excess to their needs prior to being reported to GSA for utilization and donation screening in accordance with the Federal Property and Administrative Services Act of 1949, as amended, and

GSA regulations. Upon expiration of 30 days after submission of each listing, the agency concerned may proceed with reporting the equipment to GSA unless the Office of Emergency Planning directs otherwise.

7. *Use of idle Government-owned production equipment for disaster relief.* a. *Policy.* Idle Government-owned production equipment in the central inventories maintained by the Department of Defense and the Department of Commerce will be made available as needed to producing establishments crippled by major disasters.

b. *Provisions*—(1) *Determination of disaster.* Determinations that particular events constitute major disasters will be made in accordance with Public Law 875, 81st Congress. Authority to arrange for the immediate leasing of such equipment to damaged facilities within major disaster areas, when necessary to the resumption of normal operations, is hereby granted to the Department of Defense and the Department of Commerce with respect to items in idle inventories. The procedure established in this section shall remain in effect only for such period of time as the areas in question are classified as disaster areas under authority of Public Law 875, 81st Congress, or until the Director of the Office of Emergency Planning shall find that the application of the procedure to those areas would no longer serve to meet the objectives of this section.

(2) *Leases and rentals.* Leases authorized for disaster relief shall be only for such period of time as is necessary for lessees to obtain delivery on equipment to replace that which has been damaged or destroyed. In no case shall a lease be entered into for more than a one-year term. If at the close of a one-year term replacements are still not available, an existing lease may be extended for an additional period until deliveries can be effected or one year, whichever is the shorter. Equipment leased for disaster relief shall be subject to the uniform leasing practices set forth in subsections 5b(5) and 5b(6) of this Order, except that the monthly rental charges shall begin 90 days after the arrival of the equipment at the lessee's plant.

(3) *Issuance of authorizations.* Authorizations to lease and ship will be issued by the Department of Defense or Commerce within 24 hours of receipt of request, when duly constituted Department of Defense or Commerce officials find that such leasing is necessary to restore normal production. Details of the formal lease will be worked out as quickly as possible thereafter between the lessee and either the owning agency, or the General Services Administration acting for the owning agency.

8. *Reports.* Such reports of operations under this policy as may be required by the Office of Emergency Planning shall be submitted to the Director of the Office of Emergency Planning and made public at his discretion.

9. *Effective date.* This order is effective the date of issuance.

Dated: November 13, 1963.

JUSTICE M. CHAMBERS,
Acting Director,
Office of Emergency Planning.

APPENDIX A

CLASSES OF EQUIPMENT INCLUDED UNDER THE PROVISIONS OF THIS ORDER[1]

Class number	1956 Department of Defense production equipment code	Description
1	3411-11 through 3411-99	Boring machines.
2	3412-11 through 3412-99	Broaching machines.
3	3413-11 through 3413-99	Drilling machines.
4	3414-11 through 3414-99	Gear cutting and finishing machines.
5	3415-11 through 3415-99	Grinding machines.
6	3416-11 through 3416-99	Lathes.
7	3417-11 through 3417-99	Milling machines.
8	3418-11 through 3418-99	Planers.
9	3419-11 through 3419-99	Miscellaneous machine tools.
10	3441-11 through 3441-99	Bending and forming machines.
11	3442-11 through 3442-99	Hydraulic and pneumatic presses.
12	3443-11 through 3443-99	Presses, mechanical power.
13	3444-11 through 3444-99	Manual presses.
14	3445-11 through 3445-99	Punching and shearing machines.
15	3446-11 through 3446-99	Forging machinery and hammers.
16	3447-11 through 3447-99	Wire and metal ribbon forming machines.
17	3448-11 through 3448-99	Riveting machines and/or dimpling machines.
18	3449-11 through 3449-99	Miscellaneous bending and forming machines.

[1] Note: Classes of equipment will from time to time be added to or deleted from this listing through issuance of amendments to this appendix.

APPENDIX B

MINIMUM INFORMATION TO BE FURNISHED IN REPORTING IDLE GOVERNMENT-OWNED PRODUCTION EQUIPMENT AND MACHINE TOOLS

(a) Standard commercial description.
(b) Standard commodity classification code.
(c) Government tag number.
(d) Location.
(e) Condition.
(f) Owning government agency.
(g) Manufacturer's name.
(h) Serial number.
(i) Opinion as to whether special, single purpose, or general purpose.

[F.R. Doc. 63-12241 ; Filed, Nov. 22, 1963 ; 8 :46 a.m.]

[Reprinted from the Federal Register of Sept. 5, 1964 (29 F.R. 12646)]

(Defense Mobilization Order 8555.1; Amdt. 1)

DMO 8555.1—OEP POLICY GUIDANCE ON GOVERNMENT-OWNED PRODUCTION EQUIPMENT

DELETION OF CERTAIN PROVISIONS

1. Defense Mobilization Order 8555.1 dated November 13, 1963 (28 F.R. 12581) is hereby amended by deleting paragraph 6b(5).
2. This amendment is effective the date of issuance.
Dated : August 31, 1964.

FRANKLIN B. DRYDEN,
Acting Director,
Office of Emergency Planning.

[F.R. Doc. 64-9047 ; Filed, Sept. 4, 1964 ; 8 :47 a.m.]

Chairman PROXMIRE. We will be in touch with you later about the possibility of legislation in this area.

Thank you very much.

Now, I would like to point out—a reporter sent up to me a little note—that November 30 is the fifth anniversary of the Truth in Negotiations Act. So it just has taken apparently 5 years to make it effective. And it is good at long last that we seem to be accomplishing this.

PROGRESS STATEMENTS REQUESTED OF DOD

These things do take a long time. But I think this committee has been useful in this regard, and certainly the Comptroller General has been enormously useful, and you have been cooperative.

Now, having said that, let me disagree a little bit with my good friend Tom Curtis in his assessment of your report as a progress report. It purports to be. But I am inclined to feel it is too much of a prospective kind of report. I think it would be very helpful for us if you could report to us, say at the 6-month intervals, on the actual progress that has been made with respect to the following:

No. 1, progress in implementing the Truth in Negotiations Act—training and so forth.

No. 2, the increase in advertised bidding, or the decrease—what has happened in advertised competitive bidding. I understand it has decreased in the last year, although you point out that it increased since 1961.

Mr. MORRIS. Right, sir.

Chairman PROXMIRE. No. 3, the increase or decrease in the breakout program.

No. 4, inventory management.

No. 5, integrated management of items.

No. 6, progress with GSA, the General Services Administration, on the National Supply System.

No. 7, progress in inventorying of IPE—that is the inventory of Government-owned property in the hands of private contractors.

No. 8, purging inventory lists.

And finally, No. 9, test of effectiveness of short-shelf programs.

Mr. MORRIS. We would be pleased to do this, Mr. Chairman. We get monthly reports on most of these items, and can easily give you 6-month reports.

ADEQUACY OF MANAGEMENT IMPROVEMENT PROGRAMS IN DOD

Chairman PROXMIRE. You see, what concerns me a great deal—we know that Secretary McNamara has been a tremendously able man, and you have done a fine job in this enormous procurement job you have. And yet there does not seem to have been in our view a sufficient internal concern with making these efficiency reforms. The GAO has done a good job. It seems to me so much of the initiative has come from the GAO or from Congress, in pushing competitive bidding, short-shelf life, truth in negotiations, inventory control, the National Supply System—all these things seem to have originated with the GAO instigations. And it concerns me that this very big department that you have, very heavily staffed, with competent people, has had to wait for Congress to push you in these directions rather than taking the initiative yourself.

Mr. MORRIS. Sir, we do not like to be self-serving. But I have been in and out of Government now for 30 years. I have never seen a more able, devoted, hard-working group of managers than exists in the Department of Defense today, both in uniform and in civilian clothes.

Chairman PROXMIRE. I would not question that at all. Of course, the circumstances with the Vietnam war, and so forth, are very difficult. But the fact is, we have had to come with this again and again. And often we have to come back and keep repeating and hammering away before we make progress on some of these things.

Mr. MORRIS. Yet we do a disservice to the many people in this program if we did not give them much credit for what has happened in the past decade. These improvements have to be done by people. They have to be motivated—not just directed, but motivated. That is our job. Congress motivates us. We have to motivate our people. I think we have done a good job.

Chairman PROXMIRE. Let me give you an example. We had the testimony yesterday from the Comptroller General in which he said about Vietnam:

> The army is not yet in a position to know with a reasonable degree of confidence what stocks are on hand and what stocks are actually excess to their need.

Then in questioning we pointed out the dimensions of this. I asked Mr. Fasick to give us the estimate of what this means in terms of dollars and he said this:

We did at one time during my visit, and these figures have since been adjusted, but they cited figures out of a hundred and twenty thousand items over there, they had about 45,000 items that were in excess of three times the requisitioning objective.

I said, "Is it fair to say this means they have three times as much as they need with respect to these particular items?"

And he said, "For these items."

Now, of course, there is a war going on. But it is a war that has been pretty much the same level over the last year and a half or so.

As you say, you have had literally hundreds of officials going over to try and remedy the situation and improve it. And this seems to be—represent quite a shocking waste—to think that in a very large proportion of all these items, they have three times as much as they need.

Mr. MORRIS. Sir, to us this really suggests the opposite. Our troops have not once "been restricted in their operations against the enemy for want of essential supplies," to quote General Westmoreland.

Chairman PROXMIRE. That is the most important. I would agree. But, nevertheless, there is a terrific area of excess.

Mr. MORRIS. In hindsight, we know how this happened. We knowingly let it happen because we wanted them to be fully supplied. I think the important thing is that the data were given Mr. Fasick by people on the ground. They had found this out. They were correcting these problems. They were not waiting for GAO to find them. We are greatly encouraged—Mr. Brooks and I—by the vigor and intelligence with which General Westmoreland, General Abrams, General Palmer, General Scott, and the top logistics people, are approaching these problems in the midst of a war. They don't have to be told to do it. They are doing it because they want to prudently manage the effort over there.

PHYSICAL INVENTORIES AT ARMY DEPOTS

Chairman PROXMIRE. Well, I am still left with the feeling that we are wasting an enormous amount of money in this area. And especially when we have reports such as the report we have from the Comptroller General that 55 percent of the Army depots had had no physical inventory, and 45 percent had not even had a simple inventory over a recent 18-month period.

Mr. MORRIS. I have checked into this, sir. It is true that——

Chairman PROXMIRE. And that is in this country.

Mr. MORRIS. The Army Materiel Command did suspend its regular inventory program during the buildup. They have reinstituted the program, including the sample inventory techniques.

Chairman PROXMIRE. I make this point—not only from the fact that you cannot manage an inventory, you are bound to have excess, waste, shortages, if you don't know what you have. But also from the standpoint of recognizing if we are going to provide the most prompt and efficient kind of service to Vietnam, you have to have an inventory where you know where things are.

DISCREPANCIES IN INVENTORIES

Mr. MORRIS. And we do, really.

The report of the GAO deals with the little discrepancies that show up in a 4-million-item inventory. Their report shows that the net

difference between gains and losses in dollars was only 1 percent in 1965 and 1.4 percent in 1966.

Chairman PROXMIRE. Another point shows about a 25-percent discrepancy, as I recall.

Mr. MORRIS. That was the gross value——

Chairman PROXMIRE. From $10.4 billion to——

Mr. MORRIS. These were the gross adjustments up and down. The net trade-off between the two was only a 1-percent difference in one year and 1.4 in another. I am told our largest merchandising houses consider 2 percent net adjustment to be quite satisfactory.

Chairman PROXMIRE. How do we know, though, if we have not taken these inventories comprehensively? How do we know how far off we are?

Mr. MORRIS. These are the adjustments which were reported in 2 prior years. The Army did suspend its regular physical inventory for a period of 2 years and has now reinstituted it.

Chairman PROXMIRE. Can you give me what proportion of the depots have taken complete physical inventories in the last year—all of them? Army depots.

Mr. BROOKS. Not this last year, sir. The program is just getting going again.

Chairman PROXMIRE. Now they are getting going. When did that start?

Mr. BROOKS. It started with a location survey in, I believe, November of this year—this month—they are starting the complete round of physical inventories in January.

Chairman PROXMIRE. So that in calendar 1968, you expect that you will have a hundred percent?

Mr. BROOKS. It is intended to be completed by January 1, 1969.

Chairman PROXMIRE. Does this apply to the Navy, too?

Mr. MORRIS. Navy and Air Force did not stop their normal inventory procedures.

Chairman PROXMIRE. Yet the Comptroller General pointed out some very serious discrepancies and weaknesses as far as the Navy and Air Force inventory managements are concerned, too.

Mr. MORRIS. They all have had a very similar experience in terms of net adjustments. I checked into the Comptroller General's report. The net adjustments averaged 1 to 1½ percent. I think this is always going to be the case, with 4 million items in inventory. (See pp. 362, et seq., for further discussion on inventory controls.)

NEED FOR NAVY DAIRY

Chairman PROXMIRE. We have had some amusement and, of course, some real concern, about the waste of money—or what some of us feel is the waste of money—with regard to the Naval Academy in Annapolis maintaining a dairy in competition with dairy farmers. The President criticized this in his message when he signed the defense construction authorization act.

Is there any economic reason for continuing the Navy dairy?

Mr. MORRIS. Sir, this case apparently is somewhat unique in that you can build a case on either side of this from an economic point of view.

The studies of which I have been informed on show that our costs in-house are lower if we examine out-of-pocket expenses only, but that commercial costs are lower if we take into account all the indirect costs such as interest and depreciation. It was a sort of borderline case.

Chairman PROXMIRE. It doesn't sound borderline to me. Why not take into account all costs? After all, you have all costs.

Representative CURTIS. A–76 says you are supposed to.

Mr. MORRIS. The real issue here is from a policy point of view whether the Navy should be in the dairy business.

Chairman PROXMIRE. It looks like a pretty easy one to answer.

Mr. MORRIS. Congress——

Chairman PROXMIRE. It milks the taxpayer plenty.

Mr. MORRIS. Congress answered by prohibiting us from going out of the business in the military construction authorization bill this year. The President's message spoke eloquently to that action.

Chairman PROXMIRE. There is no health reason.

Mr. MORRIS No, sir; none that I know of.

Chairman PROXMIRE. Since the President challenged the action of the Congress on this issue, is the executive branch going to refer the matter to the Attorney General for an opinion as to whether the separation of powers has been violated?

Mr. MORRIS. There are no plans to do this, sir.

DOD PROGRAM OF EXCHANGE-SALE IMPACT ON UTILIZATION AND DONATION PROGRAMS

Chairman PROXMIRE. I would like to ask a question on behalf of Mrs. Griffiths. She certainly has done a splendid job this morning, but she had to leave. She says, "The schools in my State have need for typewriters, other office machines, trucks, cars, machines of many kinds. Getting these as surplus helps the budget of State and local governments, which lose so much tax base to the Federal Government, and especially the DOD. I understand that the DOD has or is about to embark on a large-scale exchange-sale program which will virtually dry up the donable program. The other Federal agencies will lose also, since this property never becomes excess in the technical sense. What is the status of your program and what is the rationale?"

Mr. MORRIS. Sir, the regulations of the executive branch provide that where a new typewriter or other piece of equipment is needed and a used one is in the possession of the buying agency and has a value from a trade-in point of view, that that trade-in shall be made.

EXPECT SAVINGS OF $10–$20 MILLION A YEAR

We did suspend several years ago the full operation of this exchange sale procedure. We have recently determined that it is prudent to institute that procedure, just as GSA has been practicing it for some years for budgetary reasons. This will save us, as I recall, from $10 to $20 million a year, and we think that that is an important increment of savings at this time.

EFFECT OF CONTRACTOR-HELD EQUIPMENT ON TAX BASE

Chairman PROXMIRE. Congressman Curtis raised this point I thought very well the other day, expressing his concern on the effect

of Government-owned equipment in the hands of contractors on the tax base of localities and States and of course many of them have real property taxes and this takes it off the roll.

But I will yield to Congressman Curtis. My time is up.

Representative CURTIS. Thank you, Mr. Chairman.

Let me say that I thought your criticism of my comments on the progress report is well taken and I join you. There was a great deal of future planning which of course we do want.

IMPLEMENTING CIRCULAR A–76

I had this on my list of interrogation on the implementation of circular A–76. I am very disturbed, you see—when you make statements like this—and maybe you have to—in regard to this Navy dairy.

Now, there is another problem involved here—and believe me I am about ready to do all I can to get the muzzle on it.

There is this business of executive department people lobbying Congress on their time and with their money.

The Executive has some control over them, I hope, to stop this kind of business.

COST OF U.S. PUBLICITY

I have a news item here—$425 million goes for U.S. publicity—tax money used for a wide campaign of information.

Much of this is the Executive lobbying the Congress with taxpayers' money, using their time, and then when they are successful in their lobbying, then Congress—and rightly so—Congress should be criticized. But it makes the Executive speak with two voices. And there has been just too much of this going on.

COMMISSARIES

But I might say until there is courage exhibited in the Defense Department on the subject of commissaries, which is in violation of the law right now—it is in further violation of the spirit of A–76—and I sympathize with high-ranking generals and admirals who benefit from commissary privileges here in Washington—and I certainly have made it clear I am not trying to take it out of the hides of the enlisted men—I want to raise their compensation in lieu of these benefits. But let's do it by law, and let's don't do it by violation of law.

They are not going to get A–76 implemented until these examples are eliminated.

Now, I appreciated your attachment E which shows the cases that you have shut down and applaud it, because there we can see that something is going on.

I would also like, though, if you would supply a list of examples where you made the decision the other way and permitted in-house operation to exist instead of letting it go. That would give our committee a little better insight into how you are applying A–76.

Mr. MORRIS. There is some mention in the examples, sir.

Representative CURTIS. Are there?

Mr. MORRIS. Yes.

Representative CURTIS. I assume these were where you had them out-house—I mean not in-house—I don't mean out-house.

Mr. MORRIS. Items 7 and 10 are illustrations, sir, of approvals, and we in our text did cite the case of the 10,000 contract technicians formerly procured under contract, who will now be converted to civil service.

TAXES AS AN ELEMENT OF COST

Representative CURTIS. Yes.

Well, those are good.

Now, if I may, for the record, quarrel a bit with the failure of A-76 to include local taxes as one of the cost items. The private sector bears these.

But I want to relate local taxes to what services they procure—sewage, water, police protection, fire protection, traffic, schools, parks, recreation. All of these are—whether you are doing it through the private sector or whether it is the Government doing it itself—these are services that are part of the cost of operation.

Furthermore, the burden it places on local communities when you put Government installations in an area and withdraw them from the tax base—they don't bear their fair share of the cost of sewers—and if it is public water—certainly police protection and fire protection, and these costs are real costs.

To not have this as one of the factors in the cost accounting that lies at the base of determining whether Government shall do it in-house or whether it shall be contracted out to the private sector is quite vital.

So this is simply for the record, but also to pass on to the Defense Department, who, if they will examine it from their angle, I think might agree.

The whole theory of the impacted school area bill was on the assumption that if the Federal Government moved into a community, and withdrew from the tax base certain property, that would be from school revenues, and yet the personnel gains the benefit from having a good school system—therefore pay in lieu of taxes. I think that illustrates the logic and the great importance of this factor.

RELATION OF $15 BILLION CONTRACTOR-HELD INVENTORY ON TAX BASE

This moves me now to this other area of $15 billion of Government property that is used—industrial plant, materiel, special tooling, and so forth—which I think—and this I don't know, and have asked the GAO to get me information, and anyone who can give it to me—I think is largely withdrawn from the property tax base as well as the merchant and manufacturers tax—I am referring now to inventory of material—which your private sector pays the local taxes on.

Now, there may be some communities, through their laws, that have been able to get at it through the rental provisions.

Have you a comment on that?

STATES MAY TAX USE OR POSSESSION OF GOVERNMENT PROPERTY BY CONTRACTORS

Mr. MORRIS. Sir, we did attempt to check into this briefly. It is our understanding that a State may tax a contractor's use or possession of Government-owned property if it enacts legislation authorizing such

taxation and the tax is not discriminatory. This principle was established in three Michigan tax cases decided by the Supreme Court in 1958.

Representative CURTIS. That is very helpful. And it would be helpful to know how many implemented—maybe this needs a lot of publicity so that the local communities will realize that here is a source of taxes that will make government costs go up, but this is still a good cost accounting provision. (See p. 65.)

Now, let me get into an area where I think I am quite critical—the inventory control of this Government equipment.

I asked the GAO whether this figure that they gave us of $11 billion and $4 billion, which is approximately your figure of $15 billion—whether this was acquisition cost or cost that had been depreciated. And they said acquisition cost.

Is this true?

Mr. MORRIS. That is correct, sir.

RENTAL RATES FOR EQUIPMENT

Representative CURTIS. Well, that surely is not very good inventory control as far as using this for the purposes which you described in here of how much you are going to set your rental—a piece of equipment that is depreciated by 50 percent certainly should not have the same rental that a brandnew piece has nor—I am talking about your initial contract—if it is a continued contract, you take that into account. But how can you utilize your inventory control if you don't have your depreciated values instead of your acquisition costs?

Mr. MORRIS. I would say, sir, that this question is particularly pertinent to the rental costs assessed against the contractor for the use of the equipment. The present formula was developed in years past by OEP and ourselves, and does provide a sliding scale of rental charges based on age of equipment.

INVENTORY AS A CONTROL

Representative CURTIS. We are talking about an inventory control. We are not talking about that. We are talking about—it can be passed over to you—here is the way I have described it—maybe monthly, just your list and the number of people who actually made their monthly reports on the equipment. This means, I would think, that you would have every item on your computer read, even hundred dollar items, because you are talking about things that phase in and phase out. And if the report is not—if there has been a dereliction of reporting, you know which items you don't have the report on, and then probably you have a breakdown in the report on key things that you need to know. This is what I mean by using your inventory as a control.

Mr. MORRIS. I see.

Representative CURTIS. And I don't think you have that, do you?

DOD DEDICATED TO ITEM CONTROL OF EXPENSIVE EQUIPMENT

Mr. MORRIS. We did comment, sir, we are dedicated to getting a better item-by-item utilization control and reporting over at least the expensive items of equipment.

Representative CURTIS. Yes. But I am talking about, again—I am repeating myself—the central control, which means having the full inventory—that is the central. And that has to have accurate and complete figures on acquisition costs probably in the beginning, which through your computation, through the monthly reporting, is adjusted downward, so you know what your depreciated costs are, and also when some of this is generated as obsolete equipment it then becomes surplus. But you have got to have the inventory in the beginning. I don't think you have such an inventory.

DSA TO MAINTAIN INVENTORY CONTROL OF EQUIPMENT

Mr. MORRIS. It is the function of our DSA special agency to maintain central inventory, and this we are enhancing.

Representative CURTIS. Apparently it is not even set up. I cannot get a straightforward answer to that, as to whether you really have it. I don't think you have it. And this is a lot of your trouble. If you haven't got it, just say so. I hope I am not hypercritical.

Mr. MORRIS. We want you to have the facts, sir. I would like General Hedlund to comment on this.

General HEDLUND. Yes, sir. We have an inventory of items of industrial plant equipment valued over $1,000 original cost reported to us by the military services and in DSA, and we are working toward its completion. At present this runs about $4.3 billion.

Representative CURTIS. That is one of the things I asked yesterday of GAO—maybe I said you have got some inventory like I am talking about some of the components of the $15 billion. And that is what it comes down to. What you are saying is one of these components you have.

DSA CENTRALLY MANAGES HIGH-VALUE ITEMS

General HEDLUND. Industrial plant equipment.

Representative CURTIS. Yes. But, I am talking about the whole ball of wax, the $15 billion. And, also, even on yours—I don't know why you would—now that we have data processing—why you stay below a thousand dollars, unless you are saying that anything below a thousand dollars is not capital equipment. We are only talking about capital equipment.

General HEDLUND. I would like to say we manage, centrally, those items of industrial plant equipment over $1,000 by design. These are the high-value items. We have those in our inventory records. But, this does not mean that we pay no attention to those under a thousand dollars, because in our contract administration program, we have a process by which contractors must have a property accountability system which we approve.

REVIEW ALL CONTRACTOR-HELD PROPERTY ONCE A YEAR

We go in, once a year, in all the contractor facilities which we administer, and review the extent to which they are complying with approved property accountability, for all items, of all value. This review is made by our Contract Administration Services property administrators. So, we do have a control on contractor's plant equipment or plant equipment in contractor facilities up and down the line.

Representative CURTIS. Well, maybe we are getting into semantics. You use the word "management," and I am talking about "control," which is really sort of oversight over management. I don't expect this inventory I am talking about to be used for management. I would expect your management would go on. But I am talking of something that is a control item to see what management is doing, whether they are complying—and also that you have your basic data.

GAO REPORT SEEMS TO DIFFER FROM TESTIMONY

The reason I suspect this does not exist—it may exist from what you are saying—but I suspect it does not—I am talking about the control aspect, not management—lies in the fact of the GAO report which shows such a—really a lack of control over and lack of knowledge over this tremendous amount of equipment that is in the hands of private contractors. It could not exist, in my judgment, if you had the kind of control I am speaking about.

GAO ADDRESSED ITSELF TO 400,000 TOOLS VALUED AT $4.3 BILLION

Mr. MORRIS. I believe it might be helpful to comment this way.

I think GAO has addressed this $4.3 billion segment that consists of some 400,000 tools. This is what the DSA has full central knowledge of. I believe GAO is commenting on our lack of proper supervision and surveillance of the utilization of that equipment.

Representative CURTIS. Oh, sure. But part of the reason—and I am just guessing—it would have been so clear to any management that you had to have utilization with accuracy, or you would not be doing the job. And, I think that this was not called to top management's attention because you really did not have this kind of a control setup. Otherwise it would not have taken GAO so long to dig in and come up with such a kind of record. The management would automatically say "Good night, what about these figures of how these private contractors are using our equipment or not using it."

SECRETARY MORRIS CONSIDERS GAP TO BE IN KNOWLEDGE OF USE AND NOT OF THE EQUIPMENT

Mr. MORRIS. So the gap has been central knowledge of utilization, not central knowledge of the equipment and where it is located.

INVENTORY CONTROL SEEMS LACKING

Representative CURTIS. A gap of utilization suggests that you did not have the other. I am saying it just suggests it. And the more I try to interrogate to find out what you have got there in the way of inventory in the sense of control, I think I am probably hitting paydirt—I don't know.

Mr. MORRIS. Let me summarize, sir. DSA does have an actual physical record of each equipment and its location in this 400,000 IPE area. In respect to real property, we likewise have a full inventory. DSA does not keep it; however, we must make annual reports to Congress on this.

In connection with the material item we referred to, each military department, in its appropriate bureau or command keeps inventory control over the materials in the hands of its contractors.

Representative CURTIS. Maybe—I will try again. Maybe what I am getting at is the difference, as I see it, between a library and an archive. An archive is where you have the thing but it is not in a form where it can be utilized. You may have such lists, but they are not up to date and so on, so that they can be utilized. A library has the books so that you can utilize them.

This is what I am—I dare say you have got a list. But is it up to date? That is why I used depreciation costs, the value after depreciation, as opposed to acquisition costs.

Now, it would be an archive item if all you had was the acquisition cost. And the testimony yesterday indicated that is what you did have—acquisition cost—that the $15 billion is that rather than depreciated cost. This was only a checkpoint to me, to see whether this was in a form where you used it, or was just something that was in the archives, as it were.

DOD PLUGGING UTILIZATION GAP

Mr. MORRIS. The important point to us is we must know, not only know what we have and where it is, but that we do know where it is being used, how fully it is being used, when it is not being used on our work.

Representative CURTIS. But the record shows you did not know that. You said yourself there was a gap in your knowledge of utilization.

Mr. MORRIS. Correct, sir. That is the gap we are plugging.

Representative CURTIS. All right. But I hope you will take a look to see whether the comments I am making indicate that there are not some other gaps or maybe we have a canyon here.

Mr. Chairman, I have one other question.

BUY AMERICAN ACT POLICY

There is another report here on this problem of "Buy American" differential. This is really a question more to the Bureau of the Budget, because they are supposed to be—— (See pp. 312, 550.)

Chairman PROXMIRE. They will be here Thursday.

Representative CURTIS (continuing). They are supposed to be reconciling the differences that exist in GSA, which has a 6 or 12 percent "Buy American"; Defense has a 50 percent, as I understand it. But at least on this—how much has—has Defense done anything on issuing any general policy on "Buy American" differential, or is it right across the board 50 percent?

DOD USES A 50-PERCENT DIFFERENTIAL

Mr. MORRIS. We installed, sir, in 1962, a 50-percent differential to be applied to the bids of firms offering a foreign product, meaning one that has 50 percent or more foreign content.

Representative CURTIS. That is across the board?

Mr. MORRIS. Right, sir.

Representative CURTIS. Except for those items that Congress put in under this kind of lobbying techniques I have described—not necessarily government in this instance—a complete embargoing area of textile products, and a long list.

Has the Defense Department ever taken a policy position on the complete embargo that exists in regard to purchasing materials at the most efficient and least cost?

DOD ENDEAVORING TO HELP BALANCE-OF-PAYMENTS PROBLEM

Mr. MORRIS. No, sir. We are simply trying to minimize our procurements of foreign materials chiefly by our installations located overseas in the interest of the balance-of-payments problem.

Representative CURTIS. We are talking about procurement domestically, too. People import into this country. And I would hope that the military is in the business of trying to get products at their cheapest cost, under policies that may be set elsewhere in the Government for entirely different reasons. As far as the military is concerned, I would think you would be trying to get materials and services at the lowest possible cost.

Mr. MORRIS. This is our firm policy, with the single exception of this "Buy American" problem.

Representative CURTIS. And the double exception of the complete embargo on a wide range of products. I mentioned textiles as one.

Now I am asking what—if there is a policy on this?

BERRY AMENDMENT

Mr. MALLOY. If I might respond, Congressman Curtis, I think the items that you are referring to are contained in the so-called Berry amendment, which is an annual provision of the Department of Defense Appropriation Act.

Representative CURTIS. I found out about it just a couple of years ago.

Mr. MALLOY. These provisions have been there for a number of years. I don't know of my own knowledge what position the Department took back at that time.

Representative CURTIS. How about now?

Mr. MALLOY. I do know of an instance this year in which the Congress added a new item to that list. I believe it was called synthetic coated fibers. In that instance we were asked for our views as to whether that should be added and we advised the Congress that we were opposed to the addition of that item until further study could be made. The Congress, however, did add it to the appropriation listing.

Representative CURTIS. Let me hope the policy of the Defense Department is not just to go along with what exists. This should be under review.

COST OF DOD POLICY

How much do you suppose it costs Defense to—the application of this "Buy American" differential and complete embargo? I have seen various estimates, and it is in the hundreds of millions of dollars.

Mr. MORRIS. We have no data, sir, that we can offer on this.

Representative CURTIS. Well, isn't this important—to be able to make policy. Let me take the other side of the coin, because I am concerned about our domestic producers, and I want to be sure that they have a fair shake on this thing. In order to make a policy decision of what they need—do they need 50 percent? Because certainly the Defense Department ought to have the data available to those of us who have to make policy in this other area of what it is costing.

If you are cost conscious you ought to be able to say—"Look, but for these things, and but for the small business set-aside we would—if these were not there we would be spending x hundreds of millions of dollars less." Then we are in the position of weighing the two.

Mr. MORRIS. The judgment was made that this was a desirable policy to apply in the interest of the adverse balance of payments. We know as a result many foreign bidders have ceased bidding. We thus have no way of knowing what the bids would be in many cases today and thus cannot develop precise figures.

Chairman PROXMIRE. It seems to me that Secretary McNamara told us a couple of years ago at that time he estimated the cost of the "Buy American" policy by the Defense Department, the 50 percent, was something like $67 million a year. It may have been Secretary Ignatius.

Mr. MORRIS. I have inquired, sir, and we have no figures I can offer you at this time. (See p. 86, "Hearings, 1966?")

Representative CURTIS. This I think is unfortunate.

Let me get this in context for the record.

This is not to criticize the U.S. Government vis-a-vis other governments—as frequently as reported to the American people—because the "Buy France," the "Buy Britain," the "Buy German" imposed by these societies is considerably more restrictive than "Buy American," I would observe.

But I am concerned in trying to get to the bottom of what it is costing us, the Government, to get the weapons and the services to provide our defense. And even though a policy decision may have been made, I think it is important for the Defense Department to have the figures in this area so that this policy can be reviewed.

Now, I ask that it be done. The Bureau of the Budget—I asked them several years ago. The Bureau of the Budget has not even reconciled the various "Buy American" applications of the various departments of the Federal Government. The Defense is 50 percent, GSA is 6 percent. There is no rationality on the thing at all. And this embargo that the Defense Department has on a wide range of goods has not been rationalized.

Well, I will leave the subject there for further development.

STATUS OF IPE INVENTORY

Chairman PROXMIRE. I just have a couple of very brief items.

Last May, when General Hedlund's predecessor, Admiral Lyle, appeared, he indicated that we were only a small part of the way along on getting inventory information on this Government-owned contractor-held and used equipment. He said the following, and I quote:

> We are also conducting a one-time equipment inventory reconciliation program. The program will provide adequate and compatible central inventory records of

the industrial plant equipment located at contractor facilities under Defense contract administration and services cognizance. This two-year program envisions a reconciliation of approximately 83,000 industrial plant equipment items in the hands of 1,081 contractors. At the conclusion of the first three months of 1967, 18,000—

That is 18,000 out of the 83,000—

industrial plant equipment items reported to be or found to be in the possession of 248 contractors have been reconciled and records corrected.

This suggests that as of last April 1 there was still a long way to go. We had only recognized approximately—less than 25 percent of the items that were owned by the Government in the hands of contractors.

Is that correct, General Hedlund?

General HEDLUND. I will have to speak to that in these terms.

We are trying through this overall reconciliation to purify our records. Obviously you can find errors in those records—some equipments go in and others come out. Within the Defense Supply Agency at contractors plants we administer, we have completed about 70 percent of our reconciliation at this time.

Chairman PROXMIRE. So that as of March it was about 23 or 24 percent and as of now it is about 70 percent.

DSA RECONCILIATION TO BE COMPLETED DECEMBER 1968

General HEDLUND. That is within the Defense Supply Agency.

Chairman PROXMIRE. It sounds like you are way ahead of schedule. He said it was a 2-year program.

General HEDLUND. If I may complete my statement—we will finish the DSA administered portion in December of 1968. So we have about a year to go there. The military services, as you know, also manage various contractors' facilities, basically those concerned with weapon systems and major end items.

SERVICES TO COMPLETE RECONCILIATION IN 1969

And they all have reconciliation programs which they will complete in 1969. So, again I want to leave the point that while we do have an inventory, we are trying to purify it. We will be picking up some additional items of equipment as the reconciliation program progresses, but I would hope by the end of 1969 we will have an accurate and complete inventory.

DOD'S POSITION ON 14 RECOMMENDATIONS IN GAO REPORT

Chairman PROXMIRE. Fine. I would like to ask you, for the record, Secretary Morris, if you would reconcile each of the 14 recommendations in the final GAO report, specifically, point for point with your position on them, because there do seem to be perhaps some areas of disagreement with GAO that have not been brought out. You have indicated, in general, you approve. But we are left a little fuzzy on where you are on each specific recommendation. (See app. 4(a), p. 455.)

Mr. MORRIS. We will do so.

DEPARTMENT OF DEFENSE COMMENTS ON GENERAL ACCOUNTING OFFICE REPORT

"REVIEW OF CONTROLS OVER GOVERNMENT-OWNED PROPERTY IN THE POSSESSION OF CONTRACTORS"

1. *Recommendation.*—We are therefore recommending to the Secretary of Defense that provisions of proposed ASPR changes be revised to meet the predominant need of providing utilization records and a means of analysis of whether the extent and manner of use of Government IPE is satisfactory. (Page 25).

Comment

The Armed Services Procurement Regulation (ASPR) is being revised to prescribe that the contractor be required contractually to establish and maintain a written system for controlling utilization of IPE. It also establishes the responsibility for each Contract Administration activity, and other DOD components, to conduct property system surveys to insure the effectiveness of such a system, and to show the extent and manner of use of Government-owned IPE. Finally, it provides for control, detection, and reporting of Government-owned IPE which is not being effectively and economically utilized by Defense contractors. This case is now receiving a comprehensive review throughout the Department of Defense (DOD), and by selected industrial associations.

Also, we are studying how to maintain utilization records on a machine-by-machine basis over at least the high value items of IPE. If our study proves the practicality of such an approach the ASPR will be modified accordingly.

2. *Recommendation.*—We are recommending to the Secretary of Defense that DIPEC's management controls be reviewed, and new or additional directives be initiated where required to insure that all equipment which could be utilized to meet anticipated needs is considered, and that suitable equipment is offered to authorized requisitioners in each instance when it is available. In this connection we are recommending that a program of personnel training and supervisory review be instituted to assure adherence to established policy and procedures. Further, we are recommending that the Department follow up on a DIPEC study of the 45-day screening period to insure that the period is extended as determined feasible. (Page 34.)

Comment

Defense Supply Agency (DSA) Manual 4215.1, "Defense Industrial Plant Equipment Center (DIPEC) Operations", contains DOD policies, procedures and systems for reporting idle IPE and for submitting screening requirements. When screening by DIPEC results in a determination of non-availability, or an item is allocated and then rejected for valid reasons, DIPEC issues a Certificate of Non-Availability. During the 45-day period following the certification of non-availability DIPEC continues to screen against new idle reports. If a suitable item is located within this period DIPEC advises the requesting agency. If the contract has been awarded, the requesting agency is required to provide DIPEC a copy of the contract. If procurement action has not been initiated prior to expiration of the 45-day period, re-screening is required. Extension of the screening period may be requested by identifying the initial request number and by indicating the day on which procurement action will be initiated. The examples cited by the GAO involve a failure to comply with established procedures, rather than an inadequacy in procedures. They do not demonstrate a need for a change to current existing procedures.

DIPEC has established a training program for all DIPEC commodity managers. Particular emphasis is being placed on the requirement to document the issuance of Certificates of Non-Availability or other specific conditions under which items in inventory are rejected as unsuitable for the intended use.

3. *Recommendation.*—We are recommending that ASPR 13-405 be clarified to show that prior approval is to be made on a machine-by-machine basis and that the term "25 percent non-Government use" be more precisely defined. In addition, we are recommending that ASPR be clarified to differentiate OEP approvals from local monthly approvals for rental purposes. (Pages 35, 37 and 38).

Comment

A requirement for prior approval by the Office of Emergency Planning (OEP) on a machine-by-machine basis for commercial use over 25 percent per machine would create a substantial administrative burden not commensurate with the

goals sought to be achieved. To maintain a factual utilization record by individual machine for commingled Government and contractor-owned plant equipment on a contract-by-contract basis is impractical. It would be very time consuming, disrupt the contractor's production planning process, and result in the addition of a costly administrative burden for both Government and Industry. A more practical approach, which we are pursuing, is one of more aggressive surveillance, maximum use of all plant equipment, and additional emphasis on the collection of adequate rentals. However, DOD has requested that OEP meet with us for the purpose of reaching an acceptable solution on this point, on the question of defining "25 percent non-government use," and the differentiation of OEP approvals from local monthly approvals for rental purposes. Also, as mentioned in our comment #1, we are studying how to maintain utilization records on a machine-by-machine basis for selected high value items of IPE.

4. *Recommendation.*—Accordingly, we are recommending that the Secretary of Defense, in connection with further consideration of a current DOD proposal for revision of the rental base, consider the determination, for rental purposes, of actual machine use on a machine-by-machine basis. Since it appears to us that the proposed method which is under consideration by DOD would be exceedingly complex to administer, particularly as to the effect of contract changes, we are also recommending consideration of this matter if not previously considered by the Department. (Page 42).

Comment

Several alternative proposals are being considered by the ASPR Committee concerning conditions for use of Government plant equipment. Our position regarding controls on a machine-by-machine basis is stated in the response to recommendations #1 and 3.

5. *Recommendation.*—We are recommending that, in order to improve control over the use of Government IPE, the Department consider the need for more stringent language in the present ASPR clause. (Page 45).

DOD has continuously taken the position that contractors should be held liable for any unauthorized use of IPE. However, we will consider the need for stronger language in paragraph (e) of the "use and charges" clause (ASPR 7–702.12) to assure adequate control over the use of Government-owned IPE in possession of Defense contractors.

6. *Recommendation.*—We are recommending, therefore, that DOD re-examine its current policy of not authorizing rent-free use of Air Force heavy presses used on Government work, and that priority effort be applied to increasing the Government's return through rental arrangements. (Page 50.)

Comment

The Air Force heavy press program, a unique situation because of the high cost of the presses, required special OEP approval on all leases. It continues to receive special emphasis. DOD, in conjunction with the Air Force, is re-examining existing arrangements pertaining to rental charges for use of these presses. We are considering such aspects as waiving the rental charges for Government work, increasing rental returns on commercial use, and the feasibility of selling some of the presses to Defense contractors.

7. *Recommendation.*—We are therefore recommending that the DOD place concentrated efforts on the revision and administration of the following aspects of its industrial facility modernization and replacement program: (1) inclusion in procedures of a requirement for specific consideration, and a statement, as to the contractor's ability or willingness to privately finance modernization proposals. (2) consideration of a revision of guidelines to make the provision of Government-furnished plant equipment more directly related to new, major defense programs, (3) a re-examination of the principle of recovery of savings through repricing of incentive-type contracts and subcontracts, and (4) improvement of the validity and review of justification and actual experience data, with particular attention to the aspect of commercial use. (Page 55).

Comment

It is DOD policy (DOD Directive 4275.5, Industrial Facility Expansion and Replacement) that the contractor be encouraged to replace old, inefficient government tools with more modern, efficient, privately owned tools. We will modify our current procedures to require specific consideration, and a statement, as to the contractor's inability or unwillingness to finance equipment modernization.

We will review the need to revise our guidelines as they apply to both new, and existing, major Defense programs. However, we feel that the problems highlighted in the GAO report stem primarily from administration of the modernization program, not inadequate guidelines. These deficiencies will be corrected through a program to improve the technical competency of our property administrators, by a more detailed evaluation of the validity and review of justification and experience data at the local level, and by a requirement for workload projections far enough in the future to allow for administrative and procurement lead time.

The ASPR Committee has had under consideration for some time the subject of recovery of savings under all types of contracts. The views contained in your letter of 30 March 1967 on recovery of savings in the repricing of incentive-type contracts are being considered by the committee.

8. *Recommendation.*—We are recommending that contracting practices and ASPR provisions be studied, with the objective of providing a method for appropriately accumulating, recording and reporting transportation and installation costs which are borne by the Government. (Pages 18, 68 and 69).

Comment

We agree that, as a general principle, the cost of plant equipment should include the cost of transportation for delivery to the current installation site, including the cost of installation. In order to comply wtih ASPR 7-702.12, it is necessary that cost of plant equipment include the costs of transportation to, and installation in, the present location of plant equipment in Defense contractors' plants for the purpose of charges for use of the equipment. Action will be taken to assure compliance with this requirement by amending ASPR after study of the most feasible way of obtaining equitable cost data, by accounting or statistical methods.

9. *Recommendation.*—We are therefore recommending that a study be made of methods by which DIPEC records could be used for Navy property management purposes, with the objective of eliminating duplicate recordkeeping by the Navy; and that the Department of Defense investigate the possibility of similar duplications in the other military services (Page 67).

Comment

Duplicate recordkeeping related to Navy-owned IPE in possession of contractors is being discontinued. The requirement for records will be satisfied by reliance upon both the contractor and DIPEC property records.

ASPR (Appendices B and C) is being revised to prevent duplication of property records in all Defense agencies. If other duplication is found in the Military Departments, corrective action will be initiated.

10. *Recommendation.*—We are therefore recommending that the Secretary of Defense establish a study project to determine the procedures to be used and the point in the contracting process at which financial control of special tooling should be established. Further, we are recommending that an appropriate section of ASPR be revised to require that proper internal control procedures be employed in the taking of physical inventories which would include appropriate segregation of duties of participating personnel. (Pages 20, 72, 79 and 81).

Comment

Based upon prior experience of both the Military Departments and commercial industry, special tooling has been and should continue to be considered as expendable (consumable) property. The provision of detailing in each contract the special tooling required to produce end items under the contract is considered an adequate basis of control. Normally, special tooling is produced solely for a particular process or machine. Upon determination by the contracting officer that this special tooling is no longer required by the Government, it should be disposed of in accordance with ASPR, Section VIII, Part 5. Therefore, we plan no change to the special tooling provision currently in ASPR.

DOD concurs with the recommendation that we require proper internal control procedures, which include segregation of duties of responsible contractor personnel taking physical inventories of Government property. We will further review the desirability of an ASPR revision (Appendices B and C) in this regard.

11. *Recommendation.*—Accordingly, we are recommending to the DOD that the ASPR be changed to require (1) financial accounting controls for Government-

owned material in the possession of contractors in order to assure adequate control and safeguarding of the assets and also reliable reporting of the amounts on hand, and (2) that proper internal control procedures be employed in the taking of physical inventories which would include appropriate segregation of duties of participating personnel. (Pages 20, 85, and 86).

Comment

Financial controls for material have been the subject of study for many years in DOD. These studies are being continued. In addition, a proposal will be submitted for consideration by the ASPR Committee for criteria to establish contractor requirements for accounting for contractor-acquired Government material.

DOD is currently revising its procedures to exclude from the previous definition of Government-furnished material those items sent to contractors for processing and return. Accounting for these items will be performed by the cognizant inventory control point or other activity of the DOD component in both quantitative and monetary terms. While the contractor will be required to keep item records for scheduling purposes, he will be relieved of financial property accounting.

12. *Recommendation.*—We are recommending that the Department increase management efforts to ensure compliance of ASPR requirements with regard to control of property by DIPEC. We are also recommending that the ASPR be revised to (1) require financial accounting control of Government-owned industrial plant equipment, special tooling, and special test equipment at nonprofit institutions, (2) provide more specific criteria regarding "controlled" equipment which is not to be transferred to universities, particularly with respect to its application to industrial production equipment controlled by DIPEC, and (3) require proper internal control procedures in the taking of physical inventories, which would include appropriate segregation of duties of participating personnel. (Pages 22, 91, 96, and 97).

Comment

Paragraph C211.6, Appendix C, Manual for Control of Government Property in Possession of Nonprofit Research and Development Contractors, requires colleges and universities to maintain financial accounts for Government-owned real property and plant equipment. We agree that there has been a failure to exercise compliance with this requirement. We will take the necessary steps to assure compliance.

We question the advisability of requiring financial accounting for special tooling and special test equipment provided non-profit contractors. It is DOD policy to charge special tooling and special test equipment for use on the initial contract as an operating cost. As mentioned in our comment to recommendation #10, we feel it is not desirable to require financial accounting for special tooling, We hold the same view with respect to special test equipment.

We agree that industrial plant equipment costing over $1,000 a unit, at colleges and universities, should be reported to DIPEC for management and control purposes. Also, available equipment of this type should be screened for utilization prior to donation to the nonprofit contractor under provisions of 42 U.S.C. 1892. A revision to DSA regulations and ASPR designed to meet this objective, will be processed.

13. *Recommendation.*—We are recommending that the DOD (1) place continuing emphasis on efforts to upgrade and improve the quality of property administrators and thus the effectiveness of their surveillance over Government-owned property in the possession of contractors, (2) consider what appropriate incentives should be provided to encourage the establishment and maintenance, by contractors, of an approved system for control over Government-owned property, and (3) initiate an effective program of internal audit of property administration. (Pages 23 and 99).

Comment

DOD has established a joint study project to evaluate current position classification standards for property administrators (GS–1103), establish position guidelines supplementing those of the Civil Service Commission, and provide qualification and performance standards. We consider this project of utmost importance. You may be assured that it will receive our close attention.

Under current ASPR procedures the contractor is required to establish and maintain an approved system for accounting and control of Government-owned property. We believe a specific ASPR (Appendices B and C) requirement for annual review of the contractors property accounting system is needed. The ASPR committee is considering adoption of such a requirement for both commercial and non-profit contractors. Motivation should not be in the form of an incentive or an award to accomplish a task otherwise required by the contract and sound industrial practice.

We concur that there should be additional emphasis on the audit of controls over, and utilization of, Government property in the possession of contractors. As noted in the GAO report, ASD(C) memorandum of December 27, 1966, to the Assistant Secretaries of the Military Departments (FM), the Director, Defense Contract Audit Agency, and the Comptroller, DSA, established areas of audit responsibility for both contract and internal auditors in Government property audits. Collaterally, the memorandum established procedures for assist audits as appropriate by either contract or internal auditors. This policy guidance, together with the internal audits scheduled or planned by the internal audit agencies of the Military Departments and DSA, should achieve the audit coverage contemplated by part three of the GAO recommendation.

14. *Recommendation.*—We are recommending, therefore, that the new ASPR section, which defines the duties and responsibilities of Government property administrators, incorporate a policy statement to this effect for the guidance of such officials. (Page 108).

Comment

DOD agrees it is reasonable to expect that those accounting principles and standards applicable to Government-owned property in possession of contractors should be equivalent to those applied in normal industrial practices. The new ASPR supplement, covering the duties and responsibilities of the property administrator, will be amended to require acceptable accounting principles and standards commensurate with that of sound industrial practices. If more exacting standards than sound industrial practices are necessary, the requirement will be established by contract provision.

Separate Comment

The GAO pointed out in its report that guidelines should be included in ASPR for determining when to capitalize or expense costs incurred on Government real property in possession of Defense contractors. (page 71). DOD will develop necessary criteria for capitalizing or expensing costs incurred on Government real property in possession of Defense contractors for inclusion in ASPR.

Chairman PROXMIRE. Give us as much detail on that as you can.

IDENTICAL BIDDING

Back in 1961 Senator Douglas and I were engaged—Senator Douglas took the lead, certainly—in asking about collusive identical bidding on advertised competitive procurement. In that year, later that year, the administration issued an order on collusive competitive bidding which has resulted in a steady diminution of it. This year there was an especially spectacular job—that is the latest year in which we have a record—according to the report I have before me now, issued last July, there was a drop of 32 percent in identical bids.[6]

I think Senator Douglas was right in doing this, and performed a real service in calling attention to it. But, of course, the area of collusive bidding that would be the greatest and result in the greatest cost would not be in the advertised competition bidding; I think we should continue to be alert, continue to have reports on it, and watch it very closely. But it would be in the so-called negotiated competitive bidding, it would seem to me, where the greatest danger lies.

[6] See hearings, 1961, p. 26; see also, "Identical Bidding in Procurement, Sixth Report of the Attorney General," July 1967.

In the first place, these are larger items. Secondly, it is a much bigger area of procurement.

Thirdly, because there are so often one or two or three very large supply firms—there is more of a tendency for these firms to get together. They know each other, they are familiar with this, there is a perfectly human tendency, perhaps, for one to say, "We will take this one and you take the next one, and so forth."

Is there any way, I know this is hard to get at, is there any way that you could give us a report on this or investigate it or suggest what we could do about it to watch it more closely?

It seems to me here we can get a great deal more savings than we can in the advertised competitive bidding area.

Mr. MORRIS. Let me ask Mr. Malloy to comment on this.

Mr. MALLOY. Yes—Mr. Chairman, I am familiar with the report that you have in front of you. I don't recall whether it picks up both the negotiated and formally advertised or not.

Chairman PROXMIRE. It seems to us—and Mr. Ward has advised me that it is his view, too—that this is advertised competitive bidding.

Mr. MALLOY. Fine. I think that this is a complex enough subject that it would take a little more time to consider how to do this and what the practicalities are. We would be delighted——

Chairman PROXMIRE. Wouldn't you agree that there could be a serious problem here?

Mr. MALLOY. There might be, bearing in mind that most of the incidents of tie bids—this is not a listing of collusive bids—it is a list of tie bids. I think this is demonstrative that this is not a collusive situation. That happens normally in the kind of standard items we buy. We buy most of our standard items by formal advertising. The potential in the negotiated—I would be glad to furnish that.

Chairman PROXMIRE. I wish you would give us a report on that.

(Material below was supplied by witness.)

With respect to your question concerning the possibility of identical proposals being received and the evils attendant thereto, and upon a further review of the Armed Services Procurement Regulation, we believe that the government's interest is adequately protected thereby. The regulation, ASPR 1–111.2, covers reports of identical or equal bids or proposals and contracting officers are admonished to report any evidence of violations of the anti-trust laws directly to the Attorney General for appropriate action.

In addition, ASPR 1–115, requires generally that in all formally advertised and negotiated procurements (with certain limited exceptions) each bidder or offeror certify that its prices have been arrived at independently and have not been disclosed to any other bidder or offeror. If the prices have been disclosed to other bidders or offerors a full explanation of the circumstances of the disclosure must be made and unless the government determines that such disclosure was not made for the purpose of restricting competition, such bid or offer cannot be considered for award. In the event that this certification is suspected of being false or there is an indication of collusion, the matter is handled in accordance with ASPR 1–111.2.

Further, the negotiation process involves a detailed examination and evaluation by the contracting officer of each element in the proposal and a confrontation in the "negotiation" of each of the significant elements with the contractor to arrive at a mutually acceptable price. Thus, the "adversary nature" of the negotiation is effective protection of the government's interest in the unlikely event of the receipt of tie proposals in a competitively negotiated procurement. The likelihood of identical proposals being received in competitive negotiated procurements is considered so minimal as not to justify the cost of a formal reporting system.

Copies of the ASPR regulations are attached.

ARMED SERVICES PROCUREMENT REGULATION, 1–111.2

1–111.2 *Non competitive Practices.*

(a) Unless bids or proposals are genuinely competitive, contract prices tend to be higher than they should be. If the Secretary concerned or his representative considers that any bid received after formal advertising evidences a violation of the antitrust laws, he is required by 10 U.S.C. 2305(d) to refer such bids to the Attorney General for appropriate action. Similarly, evidence of such violations in negotiated procurements should be referred to the Attorney General. Practices which are designed to eliminate competition or restrain trade and which may evidence possible violations of such laws include collusive bidding, follow-the-leader pricing, rotated low bids, uniform estimating systems, sharing of the business, identical bids, etc.

(b) Reports of identical or equal bids or proposals should not be submitted automatically, but only where there is some reason to believe that those bids or proposals may not have been arrived at independently. Such reports should be accompanied by conformed copies of the bid or proposal, other contract documents, and supporting data. The report should set forth:

ARMED SERVICES PROCUREMENT REGULATION, 1–115

INTRODUCTION

Certificate of Independent Price Determination (June 1964):

(a) By submission of this bid or proposal, each bidder or offeror certifies and in the case of a joint bid or proposal, each party thereto certifies as to its own organization, that in connection with this procurement:

(1) the prices in this bid or proposal have been arrived at independently, without consultation, communication, or agreement, for the purpose of restricting competition, as to any matter relating to such prices with any other bidder or offeror or with any competitor;

(2) unless otherwise required by law, the prices which have been quoted in this bid or proposal have not been knowingly disclosed by the bidder or offeror and will not knowingly be disclosed by the bidder or offeror prior to opening, in the case of a bid, or prior to award, in the case of a proposal, directly or indirectly to any other bidder or offeror or to any competitor; and

(3) no attempt has been made or will be made by the bidder or offeror to induce any other person or firm to submit or not to submit a bid or proposal for the purpose of restricting competition.

(b) Each person signing this bid or proposal certifies that:

(1) he is the person in the bidder's or offeror's organization responsible within that organization for the decision as to the prices being bid or offered herein and that he has not participated, and will not participate, in any action contrary to (a)(1) through (a)(3) above; or

(2) (a) he is not the person in the bidder's or offeror's organization responsible within that organization for the decision as to the prices being bid or offered herein but that he has been authorized in writing to act as agent for the persons responsible for such decision in certifying that such persons have not participated, and will not participate, in any action contrary to (a)(1) through (a)(3) above, and as their agent does hereby so certify; and (b) he has not participated, and will not participate, in any action contrary to (a)(1) through (a)(3) above.

(c) This certification is not applicable to a foreign bidder or offeror submitting a bid or proposal for a contract which requires performance or delivery outside the United States, its possessions, and Puerto Rico.

(d) A bid or proposal will not be considered for award where (a)(1), (a)(3), or (b) above has been deleted or modified. Where (a)(2) above has been deleted or modified, the bid or proposal will not be considered for award unless the bidder or offeror furnishes with the bid or proposal a signed statement which sets forth in detail the circumstances of the disclosure and the Secretary, or his designee, determines that such disclosure was not made for the purpose of restricting competition.

(b) The fact that a firm (1) has published price lists, rates, or tariffs covering items being procured by the Government, (2) has informed prospective customers of proposed or pending publication of new or revised price lists for such

items, or (3) has sold the same items to commercial customers at the same prices being offered the Government does not constitute, without more, a disclosure within the meaning of paragraph (a) (2) of the Certificate.

GENERAL PROVISIONS

(c) It is not required that a separate written authorization be given to the signer of the bid or proposal for each procurement involved where the signer makes the certification provided in paragraph (b) (2) of the Certificate, provided that with respect to any blanket authorization given, (1) the procurement to which the Certificate applies is clearly within the scope of such authorization, and (2) the person giving such authorization is the person responsible within the bidder's or offeror's organization or the decision as to the prices being bid or offered at the time the Certificate is made in a particular procurement.

(d) After the execution of an initial certificate and the award of a contract in connection therewith, the contractor need not submit additional certificates in connection with proposals submitted on "work orders" or similar ordering instruments issued pursuant to the terms of that contract, where the Government's requirements cannot be met from another source .

(e) The authority to make the determination described in paragraph (d) of the above certification shall not be delegated to an official below the level of the Head of a Procuring Activity.

(f) When a certification is suspected of being false or there is indication of collusion, the matter shall be processed in acordance with 1–111. For rejection of bids which are suspected of being collusive and for the negotiation of procurements subsequent to such rejection, see 2–404.1 (b) (viii) and 3–215.

Chairman PROXMIRE. Gentlemen, I want to thank you very much for a fine performance, a very reassuring and helpful report. I trust you are going to follow up now with the progress report in the specific areas we suggested.

Mr. MORRIS. We shall, Mr. Chairman.

Chairman PROXMIRE. You are doing an excellent job.

Tomorrow we will reconvene at 10 o'clock to hear Senator Dominick, Congressman Minshall, and our principal witness is Lawson Knott, Administrator of the General Services Administration.

(Whereupon, at 12:45 p.m., the committee adjourned to reconvene at 10 a.m., Wednesday, November 29, 1967.)

ECONOMY IN GOVERMENT PROCUREMENT AND PROPERTY MANAGEMENT

WEDNESDAY, NOVEMBER 29, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

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

Present: Senators Proxmire and Percy.

Also present: Ray Ward, economic consultant.

Chairman PROXMIRE. The subcommittee will come to order.

Our first witness this morning is the Honorable Peter Dominick, a U.S. Senator from Colorado. We are very happy to have you here, Senator Dominick. You may proceed in your own way.

STATEMENT OF HON. PETER H. DOMINICK, A U.S. SENATOR FROM THE STATE OF COLORADO

Senator DOMINICK. Thank you, Mr. Chairman and members of the subcommittee. I appreciate the opportunity to appear before you today on this matter of such great importance to the taxpayer and to efficiency in government.

I have been growing concerned, as has your committee, over the increasing percentage of our military procurement which is accomplished without open competition. Certainly, in some instances, national security reasons might justify some such noncompetitive actions, but when the average percentage of noncompetitive procurement reaches 86 percent, and the 100 largest business firms continually get a larger and larger share of our military procurement, there is cause for alarm.

I began delving into this situation last year when one of my constituents—Custom Packaging Co., a small business firm in Aurora, Colo., which developed a shoulder-borne portable, recoilless flame weapon—was given what I felt was very unfair treatment by the Army. After expending its own funds to develop and demonstrate the weapon to the Army—the first weapon of this type that had ever been produced by way of equipment for the Army—Custom also was the low bidder on the invitation for bids for the initial development of the weapon. The Army, however, awarded the development contract to Nortronics, a division of Northrop Aviation, at more than double the price bid by Custom Packaging Co., costing the taxpayer more than $200,000 above the low bid by my constituent.

I want to interpolate here that our constituent also bid on a fixed-cost basis, and the Northrop bid, which was twice what Custom's was, was on a cost-plus-incentive-fee basis. So that the cost could be just astronomical compared to what my constituent's bid was.

Now looking into other Army procurements, I found a pattern: wherever procurement was open to competition, the price was reduced dramatically.

This was true in the case of the AN/PRC–25 radio set where the unit price dropped from $2,156.91 each in the first production contract to less than $600 per unit when exposed to open competition.

It was true in reverse with the AN/GRA–6 control chest set. From May 1961 through June 24, 1964, the Army bought this control chest set under six different contracts at unit costs ranging from $145.50 to $200 each. Since June 24, 1964, this equipment has been removed from open competitive procurement and the price has more than doubled. The most recent award announced January 19, 1967, by Commerce Business Daily, in the total amount of $1,220,665, shows an average unit price of $418.94 for this same equipment.

There are literally hundreds of these cases which need investigation. With my limited staff, I certainly cannot undertake such a large task, but I hope this can be done by the appropriate committee of the Senate, whether it is this committee or Senator McClellan's Government Operations Committee.

I am also greatly concerned about one practice I have discovered being carried out by the Navy which, if allowed to continue and expand, could completely destroy open competitive procurement in the future. This involves a practice called leader-follower procurement procedure. It is an incredible story.

The Naval Research Laboratory, Washington, D.C., scored a breakthrough in airborne transponder development in late 1964 and early 1965. The Naval Research Lab assigned the nomenclature APX–72 to its transponder, which was more than 95 percent developed "in-house" by the Navy. A transponder is a small electronic device mounted in an aircraft which emits a signal permitting ground stations or other aircraft to identify it as friendly or hostile and can itself similarly interrogate other aircraft. It also is an identification device for radar identification in heavy weather flying.

In April 1965, the Navy awarded a contract in the amount of $58,000 to Bendix Radio Division, Baltimore, to "polish" or "package" the unit into a "mass-producible" model. The value of the contract with Bendix was increased to $124,000 when a requirement was added for several more prototypes and to make some minor improvements to meet the military's AIMS program.

Less than a year later, Bendix delivered a model to the Navy which was flight tested and conditionally approved for production, although certain improvements were still needed which the Navy felt could easily be made while preparation for volume production was underway.

Bendix Radio was only one of several major firms working to develop a new, lightweight, flexible transponder. Several of these firms working with other services, had been persuaded to invest their own money into this development on the promise that whichever new

transponder was eventually chosen, all competing firms would have an opportunity to bid on volume production of that transponder.

The Navy persuaded the Department of Defense that the Navy-Bendix transponder was superior to others in development. And in June 1966, Bendix was very quietly given a sole-source production contract for 2,300 APX–72 transponders. "Urgent need" was cited as justification for the sole-source contract and first production units were due for delivery in June 1967. It was thereafter decided by the Navy Department to award Bendix an "extraordinary" type of contract called a leader-follower.

Under this arrangement and without any of the usual notification through the Commerce Business Daily, Bendix's extraordinary contract provided that Bendix was to be given a contract for 8,500 additional units of the APX–72 transponders with the further proviso that of the entire total of 10,800 units, 40 percent would be shared with (or subcontracted to) a "follower" company whom Bendix would take under its wing. The Navy justified this approach on two grounds:

(1) That in the normal course of events Bendix would not have a data package for almost a year. But, by having a Bendix handpicked "follower" to understudy the initial production, at least 6 months' time could be gained in getting a second source into production; and

(2) Being able to hold Bendix responsible for the quality and precision of the "follower's" product, complete interchangeability or "commonality" could be assured.

The absence of a technical data package is open to question because Bendix issued such a technical package to its component subcontractors and to potential "followers" at the time of solicitation.

In its second point, the Navy admitted, in effect, that it did not have the ability to demand or obtain from manufacturers performing Navy contracts equipment "common" with or identical to the same equipment, turned out from identical drawings by another manufacturer.

A further part of the agreement between the Navy and Bendix is still more disturbing. This agreement with Bendix held that to perpetuate the commonality feature on future production, Bendix and its handpicked "follower" would be permitted to share all future production.

I want to emphasize that, Mr. Chairman: "all future production."

This is no small factor when you consider that the APX–72 is destined to be the transponder on all military aircraft in the future and will be bought in a civilian version by the Federal Aviation Administration.

The first notice that anyone had of these proceedings came in May 1967, when the fact was announced in the Commerce Business Daily that Bendix was conducting competition to choose the "follower." Bendix announced that it would require a complex management and technical proposal to be submitted within 10 days. Other requirements listed by Bendix were so restrictive that all small business firms were discouraged from bidding. Bendix also held a bidders' conference and disclosed at that conference that Bendix intended to put one of its teams in the "follower's" plant to keep an eye on production. Furthermore, Bendix would demand detailed cost figures and other similar data. At this point, a number of major firms dropped out, unwilling

to have a competitor given access to so much information which normally is confidential within the company itself. The result was a further limiting of competition.

Bendix was unable to work out a satisfactory contract with the eventually chosen "follower," Wilcox Electric Co., of Kansas City, until November 8, at which time Bendix itself had been able to deliver only 10 units instead of 200 units of the APX–72 as scheduled. Although the Navy has refused to disclose the "follower" price officially, the Navy has said unofficially that the follower price is just under $2,200 per unit. However, the Navy-Bendix price, which will be higher than the "follower's" price to Bendix, is still under negotiation.

There is obviously no real meaningful competition involved in this procurement, either with regard to price or in the choice of producers, and it is equally obvious that there will be no meaningful competition in future contracts under the Navy's proposed procedure. The current Navy plan to limit production to Bendix and Wilcox Electric Co., in effect, hands a free patent to a private contractor for exclusive production in perpetuity of an item developed not only at taxpayers' expense, but largely by Government personnel.

The finality with which the Navy views this transaction is evident in the response received by the Senate Select Committee on Small Business, on which I serve, from the Honorable Graeme C. Bannerman, Assistant Secretary of the Navy (Installations and Logistics). Mr. Bannerman said, and I quote:

> Your comment that small producers of transponders not participating in the current procurement will, to all intents and purposes, be foreclosed from supplying transponders to military departments in the foreseeable future, applies only to this particular transponder.

Since this particular transponder is to be the unit installed in all future military aircraft and the military need has been projected in the first 5 years at 30,000 units and will cost in excess of $70 million, it seems to me that this entire transaction is open to very serious question, and I would hope that further investigation might be conducted without delay.

Mr. Chairman, I commend you and your committee for the work you are doing in this area and would be pleased to offer you any assistance which I might render.

I do want to say that I have gone into considerable detail on the last Navy contract because it seems to me that it opens up a new method of contracting which is going to almost wholly eliminate competition.

Also, I want to say that I know a great deal of the details on the Custom Packaging case and on this ANPRC 25 radio set, and have made two or three speeches—three I believe it is at this point—on these cases in the record, which I will be happy to furnish to the committee if you would like to have them.

(The material later supplied for the record is in app. 11, p. 560.)

Chairman PROXMIRE. Has the GAO investigated these cases?

Senator DOMINICK. The GAO went into the question of whether the contract was properly given to Northrop, Inc., in the Custom Packaging case, and they came to the conclusion that it was a question of technical evaluation, and since they were not qualified to make a technical evaluation, therefore, they had to accept the Army's word for it.

Chairman PROXMIRE. Well, that certainly is not satisfactory. They have a very large and a very able staff. They have done a fine job in many other respects for this committee and for the Government Operations Committee and others.

Senator DOMINICK. Yes; they have.

This was an interesting pattern, though, Mr. Chairman.

In a number of cases that I speak about in these speeches that I put into the record, on each question, where the contract was awarded to a high bidder, and the low bidder and small businessman was eliminated, it resolved primarily around what the Army procurement people called technical evaluation. This means their evaluation of the competency of the bidder, the competency of the personnel, and the type of proposal which has been made to the Army.

In each case, the GAO has indicated that it does not have the qualified staff in order to make an independent evaluation of this judgment factor, and therefore they have to accept the judgment factor, and since this is the major item in the overall evaluation of the bids, the Army is in a position of being the last resort. You do not really have a review.

Chairman PROXMIRE. What is this—the first case?

Senator DOMINICK. This is the Custom Packaging case that I am talking about. But there are others where the same comments have been made by GAO.

Chairman PROXMIRE. Custom Packaging case—that was the case involving the firm in Aurora, Colo.?

Senator DOMINICK. Right. That is the flamethrower.

Chairman PROXMIRE. Now they did not study the Bendix case?

Senator DOMINICK. As far as I know, we have not had any study of that.

Chairman PROXMIRE. All right. We will recommend that the GAO follow up on it, and do all we can to see they check that out. That would have other elements than the competence or financial responsibility of the bidders. Because there were major firms, you say, which in effect were disqualified because of the very limited requirements, and also because Bendix was free to specify that they would have their own people on the premises of the so-called follower.

Senator DOMINICK. Right.

Chairman PROXMIRE. To follow up everything that went on. We can understand why the major firms would drop out under these circumstances.

Senator DOMINICK. They would not like it, I am sure.

Chairman PROXMIRE. I think that this is most helpful, Senator Dominick, because there is no questioning your point. The policy of the Congress is clearly expressed that competitive bidding should be the means of procurement. The amount of competitive bidding has declined. It has declined in recent years. Between 1961 and 1967 Secretary Morris testified that competitive bidding had gone up somewhat.

The Defense Department takes a pretty broad view of competitive bidding. They include not only advertised competitive bidding, but what they call competitive negotiated procurement.

Senator DOMINICK. Between a preselected group of firms.

Chairman PROXMIRE. That is right. They select the particular firms, and it can be just two firms. Of course, as most of us would recognize, this has very serious limitations.

At any rate, there also is an increasing concentration of procurement with the hundred largest firms. And, it is this kind of specific example which is most helpful. They properly resent it when we just make broad charges they are not doing their job. But, when you can come up with examples of this kind, I think it is most helpful. We will certainly follow this up as completely as we can, both with the Comptroller General and with the Defense Department. The Comptroller General is going to reappear before this committee in a few days; they were the leadoff witness. We will bring this up with them at that time, and notify them at once we want to look into it.

Senator DOMINICK. Thank you very much. I appreciate it.

Chairman PROXMIRE. Is Congressman Minshall here?

We are honored and pleased to have as our next witness the Congressman from the 23d District of Ohio, Representative William Minshall.

STATEMENT OF HON. WILLIAM E. MINSHALL, A REPRESENTATIVE IN CONGRESS FROM THE 23D CONGRESSIONAL DISTRICT OF THF STATE OF OHIO

Mr. MINSHALL. Mr. Chairman, let me preface my remarks with a word of appreciation for the splendid service you are performing in behalf of the American taxpayer. It is no exaggeration to suggest that the ultimate result of these hearings could be the saving of billions of defense dollars.

My purpose in appearing here today is to very briefly outline the action which has taken place regarding my bill, H.R. 10573, which I introduced last June 7 to strengthen the Truth in Negotiations Act.

After 2 days of testimony, and your own years of experience on this committee, I know you have little need for my reviewing the many compelling reasons why this act must be strengthened. Your distinguished chairman, Senator Proxmire, certainly ranks as an expert. He and I share a mutual concern in the matter, inasmuch as his bill, S. 1913, is identical to mine.

Our legislation would guarantee a full-fledge postaudit program by the Department of Defense of all financial records of defense contractors and subcontractors, the object being to determine whether Defense has been overcharged for materials. Minimal spot checking by the General Accounting Office has uncovered overpricing on defense contracts at the rate of about $13 million a year, and this figure undoubtedly would be multiplied many times if GAO had the vast army of auditors which the Pentagon possesses to institute a thorough postaudit.

I am pleased to report that the outlook for H.R. 10573 is encouraging. The bill has been referred to the House Armed Services Subcommittee on Special Investigations, of which Congressman Porter Hardy is chairman, and I have been advised that hearings will be held after Congress reconvenes in January.

I shall do all that I can to work vigorously for enactment of this legislation and I hope that I shall do so with the support of the members of this great committee.

There has been, as this committee knows, some positive action taken by the Pentagon in this area. Secretary Nitze, on September 29, issued a memorandum to all military departments announcing that new auditing procedures would be adopted by the Department of Defense. (See p. 409.)

On October 26 I asked the Comptroller General to give me his written opinion of the new Defense regulations. Mr. Staats' reply to me, dated November 3, stated that the regulations being promulgated by DOD substantially accomplish the purpose of the Proxmire-Minshall bills. His letter carried the assurance that GAO would keep a close eye on the manner in which the regulations were carried out.

The Comptroller General did point out, however, that Secretary Nitze's memorandum—and I quote—"is silent on the matter of the agency's right of access to subcontractors' performance records which was specifically provided for in your bill." This, in my opinion, is a serious oversight.

Chairman Mendel Rivers of the House Committee on Armed Services apparently shared my concern. He requested a report from the Defense Department on H.R. 10573. The reply Chairman Rivers received, dated November 6, from the General Counsel of DOD indicated that the Pentagon feels its new contract procurement regulations would substantially fulfill the objectives of H.R. 10573 and that the legislation therefore would not be necessary.

It is important to point out, however, that the November 9 letter from the General Counsel did add that the Defense Department "interposes no objection to its enactment."

Ever since the Truth in Negotiations Act became law, there has been a running debate in the Pentagon as to whether further clarifying legislation was necessary. It seems to me that enactment of the Proxmire-Minshall measure would put an end to that debate for all time.

With your many years' experience in the Congress, and particularly as members of this committee, I do not need to tell you that any governmental regulation is a transient thing at best.

After 13 years in Congress and 9 years as a member of the Department of Defense Appropriations Subcommittee, it has been my observation that regulations not only are subject to oversight and misinterpretation, they also are open to change without notice. They are particularly vulnerable in the advent of a new Secretary of Defense or with any change in administration.

There is great unanimity of agreement that strict postaudit checks on contractor and subcontractor financial records are needed. The GAO has urged this for years and has said that the proposed legislation has much merit. The Department of Defense has admitted the necessity for more strict controls by issuing regulations which conform to much of the language in the bill, and has indicated that it has no intention of opposing its enactment into law. The House Committee on Armed Services is prepared to give the bill a hearing.

I hope and trust that this committee will add its powerful voice to urge enactment of the Proxmire-Minshall legislation.

87-847—68——17

I thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mr. Minshall. I want to congratulate you on pressing so hard for this legislation. What you have done in the House in advancing it I think is absolutely invaluable and essential. You deserve a great deal of credit for that.

I want to tell you that—I am sure that other members of this committee, and I also, will do all we possibly can to encourage its passage in the Senate, and also, of course, in the House.

Now, you point out that—and I think this is an excellent point—the Comptroller General says—and I think that our interrogation yesterday of the Assistant Secretary of Defense for Logistics, Mr. Morris, confirmed the point—that Secretary Nitze's memorandum is silent on the agency's right of access to subcontractors' performance records, which was specifically provided for in our bill.

NEED FOR POSTAUDIT LEGISLATION

He indicated that, of course, the prime contractor would have the obligation to follow up on this. But I think that this is a special reason why this legislation should be enacted.

Now, in addition to that, even if the Nitze memorandum were revised to provide access to subcontractors on the same kind of basis, still the enactment of legislation, as you say, is most essential. And I think we are essentially aware of it today. In the last couple of days we have been made aware that the Secretary of Defense is going to move on to another job. And it could be that an entirely new administration of the Defense Department would come in. Under these circumstances, regulations of this kind could be changed very promptly.

We also know that there is always opposition. After all, it has taken a long, long time—5 years—to get any action under the Truth in Negotiations Act—any complete action. There is opposition to making this Truth in Negotiations Act effective, and that opposition could work its influence on a new Secretary of Defense. And under these circumstances, the one security that the taxpayer has would be the enactment of a law.

So I think that the points you make here this morning are most welcome, and logical.

I might clarify what I said about the response of the Defense Department. The question was as follows:

"Does this"—referring to the Nitze memorandum—"extend to subcontracts—this Nitze order—or is it only confined to prime contracts?"

Mr. Malloy stated—who was responding for Mr. Morris—

Mr. Chairman, there is a flow-down from the prime contract to the subcontract. In other words, this audit right follows the same line as the law itself. Wherever the law is applicable, and it is applicable at the subcontract level under certain conditions.

And I said where it is not applicable.

Mr. MALLOY. It is not applicable under the same conditions that it would not be applicable in a prime contract; namely, if there is adequate price competition, or if the purchase is for catalog items, or for items the price of which is set by law or regulation.

At any rate, I do feel, as you emphasized so well in your statement, that it would be most desirable to have this spelled out in a law, and then, as you say, there can be no question about it.

Mr. MINSHALL. Mr. Chairman, I want to again thank you for your cooperation. As I said in my statement, this legislation could conceivably save the taxpayers billions. I would like to point out since 1965, when our total prime contract awards for defense—they were then in fiscal 1965, $27.4 billion. In 1966 they went up to $37.2 billion. And this year, under fiscal 1967, they are $43.4. And I think they are even going up higher next year. And I think our total military expenditure this year could far exceed what they have already said it would be by up to $5 billion to $7 billion.

Chairman PROXMIRE. And then when you recognize the fact that most of this procurement is on a negotiated, not on a competitive basis, the only safeguard for the taxpayer is having current, comprehensive, and accurate records available, and the right of the auditor to have access to these records.

When you recognize that, it seems to me that this kind of legislation on the Truth in Negotiations Act is especially essential. And it is no exaggeration at all in my view to say it will save billions of dollars a year.

Mr. MINSHALL. I am glad you pointed out most of these contracts are negotiated. For the record, in case you do not have it in there already, the formally advertised contracts last year amounted to $5.8 billion out of the over $43 billion, or only 13.4 percent of all procurement contracts for the Defense Department.

Chairman PROXMIRE. They have this other category of negotiated competition—negotiated price competition—which includes another substantial percentage. But, still, the overwhelming amount of it is by negotiation without any competition.

Mr. MINSHALL. Thank you very much, Mr. Chairman.

Chairman PROXMIRE. Thank you for a fine presentation.

The Senate is scheduled to have a rollcall vote at 10:30 this morning. If you gentlemen—Mr. Knott and your assistants—would be patient, I think it might be helpful to have a recess. There is the vote right now. As soon as the voting is over, I will be back, and we will reconvene.

(At this point in the hearing a short recess was taken.)

Chairman PROXMIRE. The subcommittee will come to order.

Our principal witness this morning is the Honorable Lawson B. Knott, Jr., Administrator of General Services Administration. We are pleased to have you with us again, Mr. Knott, to give us your views on the subject outlined in my letters of November 8 and 20 of this year, which will be included in the record.

(The material to be furnished for the record follows:)

NOVEMBER 8, 1967.

HON. LAWSON B. KNOTT, JR.
Administrator, General Services Administration,
Washington, D.C.

DEAR MR. KNOTT: This letter will confirm previous information given to your staff that the Subcommittee on Economy in Government of the Joint Economic Committee will hold hearings on November 27–30, 1967. You and the associates you may wish to accompany you are scheduled to testify in Room AE–1. The Capitol, Joint Atomic Energy Committee Hearing Room, Wednesday, November

29 at 10:00 A.M. Please forward 100 copies of your prepared statement at least one day prior to your appearance.

In general, the hearings will be a follow-up on the conclusions and recommendations contained in our report of July 1967. There are a number of specific references therein to GSA which will merit special attention at the upcoming hearings:

1. Procurement policies and practices.
   a. Developments in use of Buy American Act.
   b. Program for procurement and management of Automatic Data Processing Equipment (ADPE).
   c. Public utilities. Savings and adequacy of staffing. Extent of G.S.A. participation before regulatory bodies.
   d. Competitive versus negotiated procurement. Use of principles embodied in Truth in Negotiations Act (P.L. 87-653) by G.S.A.
   e. Procurement of commercial industrial products and services pursuant to BOB Circular No. A-76, revised.
2. Inventory management.
   a. Progress in control of short shelf life items.
   b. Status report on inventory of ADPE.
   c. Utilization of excess and surplus personal property.
3. Progress in developing a National Supply System.
   a. DOD/GSA relationships.
   b. GSA civilian agency relationships.
4. Status of management of real properties pursuant to Budget Circular A-2, revised.

If additional information is required, please contact Mr. Ray Ward, Staff Consultant, Code 173—Ext. 8169.

Sincerely yours,

WILLIAM PROXMIRE.

NOVEMBER 20, 1967.

Hon. LAWSON B. KNOTT, Jr.
Administrator, General Services Administration
Washington, D.C.

DEAR MR. KNOTT: Reference is made to your scheduled appearance in my letter of November 8, 1967 advising you of the hearings of the Subcommittee on Economy in Government on November 29, 1967.

With respect to the management of short shelf life items, will you bring us up to date on the programs to use the medical stockpile, including utilization and losses since our last hearing and other pertinent information.

Best regards,

WILLIAM PROXMIRE.

Chairman PROXMIRE. Our hearings have largely been concerned with procurement and property management subjects. The declaration of policy in the act establishing GSA states, section 2:

"It is the intent of the Congress in enacting this legislation to provide for the Government an economical and efficient system for (a) the procurement and supply of personal property and nonpersonnel services, including related functions such as contracting, inspection, storage, issue, specifications, property identification and classification, transportation and traffic management, establishment of pools or systems for transportation of Government personnel and property by motor vehicle within specific areas, management of public utility services, repairing and converting establishment of inventory levels, establishment of forms and procedures, and representation before Federal and State regulatory bodies; (b) the utilization of available property; (c) the disposal of surplus property; and (d) records management."

You, therefore, have much at stake in these hearings, and I know you and your agency have made a large contribution in this broad and enormously important field. Please introduce your associates and proceed.

STATEMENT OF HON. LAWSON B. KNOTT, JR., ADMINISTRATOR, GENERAL SERVICES ADMINISTRATION; ACCOMPANIED BY H. A. ABERSFELLER, COMMISSIONER, FEDERAL SUPPLY SERVICE; HARRY VAN CLEVE, GENERAL COUNSEL; DOUGLAS E. WILLIAMS, COMMISSIONER, TRANSPORTATION AND COMMUNICATIONS SERVICE; WILLARD L. JOHNSON, JR., ASSISTANT ADMINISTRATOR FOR ADMINISTRATION; WILLIAM A. SCHMIDT, COMMISSIONER, PUBLIC BUILDINGS SERVICE; JOHN G. HARLAN, JR., COMMISSIONER, PROPERTY MANAGEMENT AND DISPOSAL SERVICE; AND JOE E. MOODY, DEPUTY ADMINISTRATOR

Mr. KNOTT. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, it is a pleasure to appear before you again to discuss the programs and activities of the General Services Administration.

I propose today to review briefly programs of particular interest to the subcommittee as evidenced by your letter to me of November 8, 1967, with emphasis on the progress we have made in implementing recommendations included in the report of your subcommittee to the Congress in July 1967.

We watch with interest the almost continuous deliberations by this committee on a wide range of subjects, including revenue sharing and other matters of national interest. We are pleased that we have this opportunity to appear.

I do apologize. I always hate to have a lengthy statement, but to cover the things that you specifically asked us about, I think it would be best if I read the statement. I think I probably can do it in 15 to 20 minutes or less, and then we can respond to questions. Since we do cover a wide area, I have with me the Commissioner of our Federal Supply Service, Mr. Abersfeller, who was with me at our last appearance; our General Counsel, Mr. Harry Van Cleve; our Commissioner of Transportation and Communications Service, Mr. Williams; our Assistant Administrator for Administration, Mr. Johnson; our Commissioner of Public Buildings—while there are no specific items here on public buildings, there may be some interest in that area—Mr. Schmidt is with us. Also, the Commissioner of our Property Management and Disposal Services, Mr. Harlan, is here. Mr. Chairman, this service represents a consolidation of all of our disposal activities, real and personal property, as well as stockpile disposals, in one service. And, my deputy, Mr. Joe Moody.

PROGRESS IN DEVELOPING THE NATIONAL SUPPLY SYSTEM

To proceed with the National Supply System, to which we always like to make at least passing reference, I would like to report that we are continuing our efforts toward full implementation of the national supply system. The cooperation of DOD activities and civilian agencies in this effort continues at the highest level.

Since my last report to you in May, agreement has been reached with the Defense Supply Agency on the transfer to GSA of the

primary management of 65 Federal supply classes. Some 51,000 items in these classes have already been transferred and 15,000 additional items will be transferred by July 1, 1968.

Chairman PROXMIRE. What is the dollar volume?

Mr. ABERSFELLER. The dollar value of the inventories transferred is approximately $80 million. This figure includes the hand tools transferred in 1963 and 1964, as well as those transferred last July.

Chairman PROXMIRE. What is the status of the inventories?

Mr. ABERSFELLER. We have a continuous inventory system. We use a statistical sampling method of taking inventory, which breaks the merchandise in the warehouse into smaller lots, and we inventory on a continuing basis.

Chairman PROXMIRE. Does this mean a 100-percent physical inventory during a period of a specific time, or does it mean that you sample a certain amount, and how big a sample do you take?

Mr. ABERSFELLER. We sample the lots, Mr. Chairman. And if the sample lot is within tolerance, and we are looking for 95-percent accuracy level—if it is within that tolerance, we take no further inventory. If it is outside that tolerance, for that particular lot, there is a total physical inventory.

Chairman PROXMIRE. If your sample shows a 5-percent error or less, you don't take an inventory?

Mr. ABERSFELLER. That is correct.

Chairman PROXMIRE. How did you arrive at this kind of standard? Isn't this pretty free and easy?

Mr. ABERSFELLER. No, sir. That is based on military standard 105, which is a regular recognized statistical sampling method of application for inventories or other things.

Chairman PROXMIRE. OK. Go ahead.

Mr. KNOTT. We are now negotiating with DOD for the transfer of general mobilization reserve inventories and their management for these classes.

This has been under discussion for a long time, and has not been concluded.

Current plans are for DSA to assume Government-wide support on electronic items on July 1, 1968. The object here is to point out this works both ways. It is not all flowing to GSA, and where the Defense Supply Agency is in a better position to handle an item or is the predominate interest agency, we are working toward their taking over the full responsibility.

Initiation of DSA support of civilian requirements for fuel will begin July 1, 1968, and full implementation will be phased to extend over a 16-month period. Here, we were the small procurers of fuel, whereas the Department of Defense is the large procurer.

Joint efforts of representatives of DOD, VA, PHS, and GSA resulted in increasing uniform specifications for hospital feeding items from 300 last year to 500.

In our testimony last May, we reported that DSA only assumed supply support to selected agencies for certain common use medical and subsistence items because of the lack of commonality of items in these groups stocked by GSA and utilized by civilian agencies.

Chairman PROXMIRE. Why not all of them?

Mr. KNOTT. Well, the principal problem is the lack of commonality, and the problem of DSA taking on items which they do not feel they can afford to get into and handle without detriment to their primary mission, which is military supply support.

Chairman PROXMIRE. How many items are there here? What agencies are there?

Mr. ABERSFELLER. I don't know, Mr. Chairman. We will provide them for the record.

The following subsequently was supplied for the record:

In connection with DOD consideration for DSA support of civilian agencies on medical and non-perishable subsistence items, we understand that 10,800 medical items are centrally managed in DOD by DSA and 3,437 are centrally managed by civilian agencies. Regarding non-perishable subsistence, DSA manages 570 items and the civilian agencies 631.

Chairman PROXMIRE. Do you know what agencies are involved?

Mr. ABERSFELLER. Yes; in the medical and food field, primarily Public Health Service and the Veterans' Administration. There are some other small ones—Federal Prisons is an example. But, the major civilian agency users of medical and subsistence is Public Health Service and the Veterans' Administration.

Chairman PROXMIRE. Proceed.

Mr. KNOTT. As a result, and in an effort to accelerate assumption of these classes of material into the national supply system, we have proposed to officials of the VA that that agency assume civil agency-wide procurement responsibility and that GSA assume the storage and distribution responsibilities for these commodities. The response we have just received from the VA objects to our proposal and suggests as an alternative that the VA be assigned responsibility for both procurement and distribution of medical and subsistence items for the civilian agencies. We will continue to work with officials of the VA to develop an integrated system for implementation by July 1, 1968.

We just received this response yesterday, and, therefore, we have not had an opportunity to discuss with them in more detail the reasons why we feel GSA ought to take on the supply and distribution responsibilities.

Senator PERCY. If they continue to object, who will make a final decision on it?

Mr. KNOTT. The Bureau of the Budget will have to make that judgment in the final analysis and it has been very helpful in the resolution of other controversies of this sort.

BUY AMERICAN ACT

We have recently furnished the Bureau of the Budget procurement and contracting information relating to domestic and foreign procurement for fiscal years 1966, 1967, as well as projections for fiscal year 1968, to assist them in their study regarding the establishment of uniform differentials to be applied to both DOD and civilian agencies.

The information furnished BOB included an analysis of the balance-of-payment savings and budgetary costs of the differential applied by civilian agencies compared to the alternative differential currently applicable to the Department of Defense.

Chairman PROXMIRE. We are very interested in this. Congressman Curtis is especially interested in the great discrepancy of the 50 percent for the Defense Department and 6 percent in much of the rest of the Government.

What does this show in terms of the balance-of-payments saving and other budgetary cost?

Mr. ABERSFELLER. We formed no conclusions, Mr. Chairman, and we simply reflected to the Bureau of the Budget, as an example, that the amount of foreign procurement has increased from fiscal year 1966 to 1967 by 65 percent.

Chairman PROXMIRE. The amount of what?

Mr. ABERSFELLER. Of procurement from foreign sources.

Chairman PROXMIRE. Has increased?

Mr. ABERSFELLER. Yes; has increased.

Chairman PROXMIRE. Despite the Buy American Act.

Mr. ABERSFELLER. With the application of the 6 percent—or 12 percent in the case of a small business or labor-distressed area—it has increased.

Chairman PROXMIRE. You show, then, that as far as the developments at present, there seems to be a decreased budgetary cost inasmuch as we are procuring more from abroad, but an adverse effect on the balance of payments inasmuch as we are procuring more from abroad; is that right?

Mr. ABERSFELLER. Yes, sir.

Chairman PROXMIRE. Does buying from foreign sources complicate procurement? It does decrease costs, I presume.

Mr. ABERSFELLER. Yes, sir.

Chairman PROXMIRE. Does it complicate it in any way?

Mr. ABERSFELLER. Not particularly complicate; no, Mr. Chairman.

Chairman PROXMIRE. What was the volume of foreign procurements by GSA last year?

Mr. ABERSFELLER. $8 million.

Chairman PROXMIRE. $8 million out of how much procurement?

Mr. ABERSFELLER. Out of approximately $900 million.

Chairman PROXMIRE. So it is about 2 percent.

Mr. ABERSFELLER. Actually, in relation to the total contracts we award, it is something less than 1 percent. The $900 million, Mr. Chairman, deals with the GSA moneys expended. In addition to that, we contract for about $1,100 million more which other agencies order direct.

Chairman PROXMIRE. Supposing we do not have a Buy American Act. Can you give us any notion as to how much this would increase foreign procurement, and decrease budget costs?

Mr. ABERSFELLER. No, sir.

Chairman PROXMIRE. You do not have any statistics on that? Don't you think that would be helpful for Congress formulating policy in this area?

Mr. ABERSFELLER. Yes, sir; I think it would be. It can be prepared.

Chairman PROXMIRE. Would it be possible for you to compute this.

Mr. ABERSFELLER. Yes, sir; it would not be difficult.

Chairman PROXMIRE. That would be most helpful to us, if you could do that in the future.

Mr. KNOTT. You know, of course, that we have fully supported the objectives of this committee in bringing about uniformity of differentials under the Buy American Act. And the report we made to the Bureau of the Budget is in line with the effort we have consistently made in the period of the last year and a half. We provide them with whatever information we develop in the course of our own experience, which points up the need for uniformity.

Chairman PROXMIRE. This particular committee then, could be especially useful to the Congress in making recommendations on Buy American, inasmuch as we make intensive studies of the balance of payments, we have some members of the committee with great expertise in this area. And, of course, this subcommittee is very concerned in keeping our costs down. These are the two conflicting elements involved here. And, the more information we can develop on this, the more useful our recommendations can be.

One other specific matter of information. Does this include kits that have foreign items in them—this procurement?

Mr. ABERSFELLER. From foreign sources?

Chairman PROXMIRE. Yes.

Mr. ABERSFELLER. It would, if the value of the foreign components of the kits represented the predominant cost of the kit.

Chairman PROXMIRE. You think 1 percent is a pretty fair estimate—of what our foreign procurement is?

Mr. ABERSFELLER. It would be less than 1 percent overall. Actually eight-tenths of 1 percent, Mr. Chairman, overall—of the value of the contracts that GSA contracts for.

Chairman PROXMIRE. Very good. Proceed.

AUTOMATIC DATA PROCESSING PROGRAM

Mr. KNOTT. Next, Mr. Chairman, to the field of automatic data processing.

Since May we have completed the initial round of testing under interim Federal specification W–T–0051a for 800 b.p.i. (bits per inch) tape. As a result four products have now been qualified and Federal supply schedule contracts have been negotiated covering individual purchases under a maximum order limitation of $25,000. A regulation is now being prepared which will require agencies to submit consolidated computer tape requirements—in excess of the $25,000 schedule maximum order limitation—to GSA for procurement on a competitive basis. This should be cleared and issued by January 31, 1968.

The new specification and purchase procedures will result in substantial reduction of tape costs. The new specification, for example, permits a maximum of less than one error per reel and by holding to this error rate, additional substantial savings in machine time will be realized.

The ADP resources utilization program continues to be emphasized and expanded. In addition to the 18 ADP sharing exchanges now in operation, four are planned to be operational by the end of fiscal year 1968. These will be located in geographical areas where computer density warrants and now are planned for Anchorage, Baltimore, Cleveland, and Louisville.

Chairman PROXMIRE. That is an amusing sentence.

You mean there is a terrific computer density in Anchorage?

Mr. KNOTT. That is right.

Chairman PROXMIRE. It certainly has nothing to do with the population. It must, of course, have to do with the Defense Establishment.

Mr. KNOTT. Yes, sir.

Chairman PROXMIRE. That startles me.

Mr. KNOTT. In fiscal year 1967, ADP sharing under the program resulted in an estimated cost avoidance of $28 million, an increase of some $2 million over the previous year.

Government-owned ADP equipment declared excess to the needs of owning agencies having an acquisition cost of $80 million was reutilized in fiscal year 1967 by Federal agencies, or donated to State agencies for educational purposes.

ADPE inventory and planned use information required for the ADP management information system has been received by GSA from designated Government agencies in accordance with Bureau of the Budget direction of April 20, 1967, in their Circular A–83, and it is now being assembled, edited, and processed. We expect to issue the printed inventory and 35 related management reports during the third quarter of fiscal year 1968.

Chairman PROXMIRE. Do you have adequate funds and facilities to conduct this program to the optimum?

Mr. KNOTT. Yes; we think we have enough, certainly, to get it moving.

This is a program that will succeed or fail in large measure depending on the extent to which we are able to sell agencies on the benefits that flow from their cooperative efforts. It is not a heavy cost program.

We would like to get further into buying equipment, and we have the initial installment on a revolving fund this year. We will be buying some equipment that we feel ought to be purchased rather than leased.

But we could not, under the present budgetary situation, purchase all of the equipment where economically we would be justified in buying it.

ROLE OF SMALL PRODUCERS IN SUPPLYING ADPE

Chairman PROXMIRE. I understand that small manufacturers have complained that they often sell a component cheaper than the big companies, but are not able to get the business. We have a witness coming in tomorrow to testify on this. I hope that you will have a man here in the audience so that you can be able to comment on his testimony.

Mr. KNOTT. Yes, sir; we will.

Chairman PROXMIRE. Are you aware of this complaint and this problem from the small manufacturers?

Mr. ABERSFELLER. No, sir.

Chairman PROXMIRE. You have not been made aware of it.

Maybe we can perform that service tomorrow.

I have an article here from the Wall Street Journal which says:

Honeywell says U.S. will ease computers. Honeywell said it has been notified in a letter of intent by U.S. Defense Supply Agency of its plan to lease 22 Honey-

well computers valued at $8.6 million. The computers will process data on Defense Department contracts. They will be used to report on the status of vendor production, quality assurance, invoice control, accounting services and other functions necessary for production and timely delivery of Defense items. The multicomputer system will lease for about $172,000 a month when the system is fully implemented, Honeywell said. The Government has the option to purchase the equipment at any time.

Do you know if these are for a pooling arrangement?

Mr. ABERSFELLER. I do not.

Chairman PROXMIRE. Does GSA have any part in these DSA transactions?

Mr. ABERSFELLER. Well, we are generally informed. I happen to be uninformed about that particular one. But, we are generally informed of the intent to procure. First the intent to buy or to lease—that notice comes to us first. And then, subsequently, any decision that might be made comes to us. I am not familiar with the case you mentioned, but I do not think it would be pooled within the general Government framework.

Chairman PROXMIRE. This looks like a big and important element, sufficient to warrant a story in the Wall Street Journal, and it is a lot of money.

Mr. ABERSFELLER. I just do not happen to be personally informed, Mr. Chairman. I would like to check with my staff and provide the details for the record.

(The following information was supplied for the record:)

The General Services Administration is responsible for contracting for the Defense Supply Agency requirements for the purchase and/or rental of 22 Honeywell Computer Model 200 Series Systems. On September 15, 1967, the Defense Supply Agency requested GSA to contract for these systems. Representatives of GSA have been meeting with Honeywell, Incorporated, in order to consummate contractual agreement. We expect to complete this by January 15, 1968.

The computers are required by the Defense Supply Agency for use in status of vendor production, quality assurance, invoice control, accounting services, and other functions related to the production and timely delivery of defense items. The multi-computer system will be located and installed during Calendar Year 1968 at various DSA installations located in Detroit, Boston, Chicago, Cleveland, St. Louis, Los Angeles, San Francisco, New York, Philadelphia, Atlanta, and Dallas.

Chairman PROXMIRE. You are confident that GSA has been informed?

Mr. ABERSFELLER. I am not; no.

Chairman PROXMIRE. Are there occasions when they do not inform you?

Mr. ABERSFELLER. Yes, sir.

Chairman PROXMIRE. How can that be? Shouldn't there be intercommunication if you are going to have an efficient operation?

Mr. ABERSFELLER. Yes, sir; it should be. And we have very recently issued a Federal property management regulation on this point, requiring that agencies do this. Until we had done that, there were occasions when we had not been informed.

Chairman PROXMIRE. I would like to ask if it is permissible, Mr. Knott—because you have, as you say, a lot of ground to cover, and Senator Percy and I will be asking you questions on it—if you would mind if Senator Brooke, who has now appeared, could come in and testify, and then we will resume your testimony?

Mr. KNOTT. All right, sir.

Chairman PROXMIRE. Senator Brooke, we are delighted to have you this morning, and welcome you to the committee.

STATEMENT OF HON. EDWARD W. BROOKE, A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

Senator BROOKE. Thank you, Mr. Chairman, for your courtesy.

Mr. Chairman, Senator Percy, I am appearing today to testify with respect to the serious situation which presently confronts the handtool industry of the United States. This subject received consideration by the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee during hearings conducted in 1966. It is now vital that the hitherto ignored recommendation of that subcommittee relative to price differentials applicable to handtool purchases by the Government be implemented without further delay.

As you are aware, the purchase of handtools for use by agencies of the U.S. Government is conducted by the General Services Administration, despite the fact that more than 90 percent of such purchases are used by the Department of Defense. Both GSA and the Department of Defense are governed by the provisions of the United States Code, title 41, sections 10a through 10d—the so-called Buy American Act.

GSA is bound in addition by the terms of Executive Order 10582, issued in 1954, which clarifies the vague "reasonable cost" criterion of the Buy American Act by authorizing a price differential of 6 percent in favor of domestic manufacturers (12 percent if small business is involved). However, the Department of Defense has departed from the guidelines set forth in Executive Order 10582, apparently on the theory that such action is necessary to prevent further inroads upon a favorable balance of payments, and has established a 50-percent price differential for its own purchases.

Purchase of handtools by GSA rather than by the Department of Defense has had an extremely negative effect upon the domestic industry. The difference between the 6-percent price differential applied by GSA and the 50-percent price differential applied by the Department of Defense is the crucial factor. Domestic handtool manufacturers who would clearly be able to bid successfully on the basis of the Department of Defense differential find that they are increasingly being underbid by foreign manufacturers as a result of the application of the inadequate GSA differential.

Thus, the awarding of contracts has been, to a large extent, influenced by an administrative decision that the purchase of handtools be the function of GSA rather than the Department of Defense. The negative effects upon domestic industry of this decision are all the more intolerable in light of the fact that the overwhelming percentage of handtool purchases are used by the Department of Defense; yet they are not subject to Department of Defense purchasing procedures.

The effect upon the U.S. handtool industry is inevitable. In 1948, the value of all mechanics hand service tools imported into the United States was approximately $169,000. But by 1966 the value had increased to approximately $14 million. And figures for the first 5

months of 1967 reveal that this year's imports are running 13.1 percent ahead of those of last year.

Chairman PROXMIRE. Do you have any statistics, Senator Brooke, on what this represents to the industry—this $14 million figure?

Senator BROOKE. No; I do not have that figure, but I can get it for you, and I will supply it to the committee, Mr. Chairman.

These inroads, which are primarily the result of activity by Japanese bidders, could have been avoided to a great extent had the purchasing of handtools been conducted on the basis of Department of Defense rather than GSA standards. The divergence of purchasing standards applied by the Department of Defense and GSA affects the domestic handtool industry in a highly discriminatory fashion. Purchases from foreign manufacturers constitute only 1½ percent of total GSA purchases; but, handtool purchases constitute some 57 percent of the GSA foreign purchase total.

Is that the figure you want?

Chairman PROXMIRE. Let me see.

Well, the 57-percent figure gives the percentage of the GSA foreign purchase total. But, what I wanted was the impact of the $14 million on the industry as a whole.

Senator BROOKE. That percentage upon the entire industry. All right, fine.

(NOTE. Material which covers the Chairman's question was subsequently received from the Service Tools Institute and appears in app. 9, p. 550.)

Obviously the application of GSA purchasing procedures has resulted in severe dislocation within the American handtool industry.

The Bureau of the Budget has the authority to order a change in the application of price differentials to end discrimination against the domestic handtool industry. However, the Bureau has temporized on the subject. Upon being asked by the Federal Procurement and Regulation Subcommittee whether it favored continued application of different price differentials, the Bureau replied as follows:

> 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 difference 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.

The subcommittee observed in its report that this response did not meet the issue, commenting:

> To the extent that GSA takes a different course and makes awards to foreign producers, the Department of Defense Balance-of-Payments program is undermined as is any existing trade agreement.

And the subcommittee recommended:

> The subcommittee strongly recommends that the Bureau of the Budget take steps to apply uniform differentials under the Buy American Act for the same items regardless of which Federal agency does the buying for the Government.

As the Federal Procurement and Regulation Subcommittee pointed out, the American balance-of-payments problem will be aggravated rather than relieved by purchasing policies which result in the capture of increasingly large segments of a given industry by foreign manu-

facturers. It is especially true in the case of purchases used primarily by the military that we have an interest in maintaining productive capacity with respect to sources which could be disrupted during an emergency. I am aware of and sympathetic to the Bureau's desire not to take actions which could have an adverse effect upon present attempts to conclude international trade agreements. My request does not represent a desire to defeat the progress and principles of the Kennedy Round. Rather, it is based upon a recognition that the domestic handtool industry has been prejudiced not by an attempt to secure freedom of international trade, but by what is in effect an arbitrary decision to apply one set of Government purchasing standards rather than another.

I believe that alteration of the present policy is especially necessary insofar as the domestic handtool industry is concerned, since this industry suffers to such an extent from present administration of Federal purchasing practices. It would, of course, be cumbersome and impractical to attempt to amend the Buy American Act for the purpose of relieving a particular industry. But, it would be entirely valid for the Bureau of the Budget to recognize the problem which has been created, and to alter the price differential applicable to such industry by administrative order. I have asked the Bureau to take such action in a letter dated November 16, 1967, addressed to the Bureau's Director, the Honorable Charles L. Schultze. I hope that this subcommittee will support this request by an emphatic reiteration of last session's recommendation that uniform price differentials be applied to the same items irrespective of which governmental agency is charged with purchasing responsibility.

Chairman PROXMIRE. Now as I understand it, the difficulty, as you say in the beginning of your statement, is that more than 90 percent of these purchases are used by the Department of Defense.

Senator BROOKE. That is correct.

Chairman PROXMIRE. Yet, the GSA makes the purchase, and applies the 6 and 12 percent differentials, rather than the 50 percent.

Senator BROOKE. That is correct.

Chairman PROXMIRE. That certainly seems to be a very legitimate complaint. One would think, just offhand, that the agency which used the tools would be the one where you would apply the differential.

Mr. Knott, do you have any observations on that?

Mr. KNOTT. It is the procuring agency that applies the rule. And as Senator Brooke has pointed out, the crux of the problem is not which agency does the buying. Unfortunately, there is a difference in the rules being applied by different agencies. It is not the agencies, but it is the rule that causes the problem.

Chairman PROXMIRE. You mean you feel the problem is that you have this discrepancy between what the Defense Department applies, the 50 percent——

Mr. KNOTT. Exactly.

Chairman PROXMIRE (continuing). And the 6 percent applies elsewhere. You should either compromise, take one or the other——

Mr. KNOTT. We have raised this very point with the Bureau of the Budget. If we are buying for Defense, why can't we use the Defense formula?

Chairman PROXMIRE. Senator Brooke raises the point that it is going to be extremely hard to introduce and get legislation passed to apply to the handtool industry. On the other hand, the administration has provided a 50-percent differential as part of our balance-of-payments approach. And, they could just as easily, it would seem to me, provide that in view of the fact that the Defense Department uses 90 percent of these tools, they should be the agency that is recognized as the procurement agency.

Mr. KNOTT. I have no quarrel with that. I have no quarrel with his recommendation. I think his recommendation is fine. And, in fact, to do otherwise is to do just to the contrary to what you read in the preamble to the Federal Property and Administrative Services Act—the declaration of policy there was to establish for the Government an efficient and economical system for centralized procurement. And yet this nonuniform differential tends to dissipate that problem. If you followed the principle that has been suggested here—for the Defense Department to buy its own requirements when it uses 50 percent—then you get back to a system whereby each agency is in the business of buying for itself, and the whole idea of the national supply system, which I have described earlier this morning, where we have turned over to Defense the procurement of fuel and electronics and other commodities which we think they are best able to buy—and they have turned over to us the things that they think we are best able to buy—this would all go down the drain.

Chairman PROXMIRE. Has there been any rationale in principle for this discrepancy; for having the Defense Department apply the 50 percent? We all know that Secretary McNamara is enormously respected and very influential. And, I take it, this was an order of his that was first applied.

Mr. KNOTT. Yes.

Chairman PROXMIRE. Why is it that there is this difference? Is there any justification that you know of—why the Defense Department should have a 50-percent differential, and the rest have so much less?

Mr. KNOTT. No. I can only speculate to this extent. It goes back several years, and much of the implementation of the national supply system that has brought about these changes, whereby GSA, for example, does do all the procuring of handtools, does do all the procuring of paint—these have taken place since that time.

His rule was in effect at that time; ours, the 6-percent rule, was also in effect. The Bureau of the Budget felt that we should not change during the period that the Kennedy round discussions were underway.

Chairman PROXMIRE. I see. So, it is possible now that the Kennedy round discussions are over, that you could have a resolution of this with the 50 percent applying across the board.

Senator BROOKE. By an administrative order.

Mr. KNOTT. Yes; and we have urged that this be done.

Chairman PROXMIRE. And what would this mean in terms of the purchasing? The Defense Department buys what proportion of total procurement?

Mr. KNOTT. Our percentage is relatively small, because we are dealing only in the common-use items.

Chairman PROXMIRE. Would they buy 75, 80, 90 percent?

Mr. ABERSFELLER. Yes; in that range, Mr. Chairman, out of the $49 billion in the budget for supplies and equipment——

Chairman PROXMIRE. So in terms of increased costs, the difference would not be very great. It would mean that you would eliminate these discriminations that we now have against the handtool industry, and I imagine there may be some other industries that are adversely affected, too.

Mr. KNOTT. There are some others. I think this is one of the more conspicuous ones.

Chairman PROXMIRE. You see, this committee feels guilty on this to some extent, because in the past it has asked that handtool purchasing be transferred to the GSA, which could do a better job, and the industry agreed that this would be the best way to handle it. But since then, the differential developed.

Mr. KNOTT. This is true.

Chairman PROXMIRE. And a great disadvantage to the handtool industry.

Mr. KNOTT. Senator Percy's distinguished predecessor was one of those who consistently urged this transfer.

Senator PERCY. Are they for the most part standard stock items, that are purchased from the commercial market and used by Defense?

Mr. KNOTT. Yes.

Senator PERCY. It seems to me I recall the Senator traveling around Illinois some years ago, with a big bag of parts, taking out a screwdriver, and saying the Defense Department paid $3.50 for it, and he could buy it at the local hardware store for 19 cents. I wonder if Senator Douglas wasn't one of the powers instrumental in transferring this to GSA so that it would not have to be put through the whole labor of the specialized procurement of Defense, but rather have GSA just negotiate open bids on commercial items and have them available. I think that is probably the rationale that was used. The logic originally was perfectly sound for the transfer.

Chairman PROXMIRE. And the industry strongly supported the transfer.

Senator BROOKE. Yes; and I do not think the industry objects, except for this differential, which is being applied now. Obviously, they are being very seriously injured by it.

Chairman PROXMIRE. Well, Mr. Knott, you say you concur in the Brooke recommendations.

Mr. KNOTT. Yes, sir.

Chairman PROXMIRE. You would recommend that to the Budget Bureau. Would the Budget Bureau be the proper agency for this committee to direct our——

Mr. KNOTT. Yes; that is right. And I believe your committee did that last year, after the Deputy Director of the Bureau of the Budget appeared here.

Chairman PROXMIRE. He is going to appear tomorrow. We will take it up with him tomorrow.

Senator BROOKE. And, of course, I further ask, Mr. Chairman, that this committee reiterate its stand of its last meeting.

Chairman PROXMIRE. You have made a very strong case, Senator Brooke. We will certainly take it up with the Budget Bureau tomorrow,

and do our very best to try and eliminate what is obviously an unintended discrimination against handtools.

Senator BROOKE. Thank you very much, Mr. Chairman.

STATEMENT OF HON. LAWSON B. KNOTT, JR., ADMINISTRATOR, GENERAL SERVICES ADMINISTRATION—Resumed

Senator PERCY. Mr. Chairman, before we go on to public utilities, could I ask one question about computer systems.

Computer systems for any agency or company are almost a status symbol. Everyone has to have his own, and they all like to have the system under their own control. How much authority do you have when a Government agency puts in a request for a system, to scour around to see whether a modified or up-dated system some place else would not serve their purpose, and direct them to use such service, and get it transferred to them or made available to them, rather than them having their own system installed and put in, which might be utilized only a smaller percentage of the time against maximizing 7 days a week, 24-hour-a-day utilization of a system that exists some place else?

Mr. KNOTT. Yes.

This was the whole thrust of some legislation that was enacted a couple of years ago.

The unfortunate thing is that in the course of a last minute compromise, the act ostensibly gave GSA some broad authority for management of computer systems, it dropped its voice, so to speak, in a later section when it reserved to the agencies the final authority for determination as to the type and kind of equipment that it needed to carry on its program mission.

In other words, GSA, as a service agency, is always in the position that it must stand aside when whatever it attempts to perform in the way of a service function can be said to interfere with the mission of the other agency involved.

However, despite this fact, there are ways in which we can approach the problem.

For example, the Comptroller General—within the last 10 days or 2 weeks—has made it eminently clear in a rather lengthy opinion that he believes that GSA's authority for the purchase of—the acquisition of—ADP equipment supersedes the authorities of other agencies, and that they must clear purchases with us. I believe that is the substance of the opinion. (See app. 10, p. 556.)

We believe this reaches a new plateau in GSA assumption of a greater role of management of ADPE.

The ADP sharing exchanges, as I pointed out earlier, have been largely voluntary, but with some pretty good salesmen scattered around the country, this has been a fairly successful effort.

Now, one other device——

Chairman PROXMIRE. I am going to have to interrupt you. You might make a note so you can return to it. Senator Percy and I have to go down and vote again. We will be back in a very few minutes. We apologize.

(At this point in the hearing a short recess was taken.)

Chairman PROXMIRE. Senator Percy is not back. But, why don't you go ahead with your answer to his question—if you can recall.

Mr. KNOTT. All right, sir.

The only additional point I was going to make is this. I had just stated we had been able to accomplish a great deal, by people strategically located, dealing with agencies that had need for equipment, and we had been able to get agencies to cooperate. NASA for example, has, in one recent instance, actually canceled a procurement because we were able to show them where they could get the equipment that was already available through another agency. This type of cooperation is going on.

Another example is that the Federal Communications Commission has entered into an 18-month agreement that will save over half a million dollars for the Navy by providing services to the Navy on FCC equipment, in lieu of new procurement or leasing by the Navy.

These are simply two of a number of examples that could be cited.

The final point I was going to make about indirect means of control is that many of the public buildings that were authorized several years ago, particularly in the larger cities, have reached the point where we are laying out space in them for occupancy. One of the controls that we can properly and do exercise is not only the amount of space that agency is going to occupy per person, but, for example, control over the printing and duplicating shops. We simply will not allow the duplicate assignment of space for printing and duplication plants. In a similar manner, we simply will not allow agencies to have, on different floors in the same building, several different computer operations. We insist that if they will not share, or cannot share the same computers, that they be placed side by side, looking forward to the day when the walls that may exist between them now can come down—because the installation costs themselves are rather extensive.

These are then, indirect controls that we can exercise through our assignment responsibility on space that does give us a control over the utilization.

Chairman PROXMIRE. Now, would you favor repealing that last paragraph or last part of the last which gives the agency the final word on whether or not they can hold on to their own computer?

Mr. KNOTT. Certainly, Mr. Chairman, I believe that it could be stronger than it is now. Perhaps not repeal it, but certainly——

Chairman PROXMIRE. Just that last part.

Mr. KNOTT. We should place the burden on the agency to make a case, which it does not have to do now. The agencies now make determinations to share equipment or to obtain other equipment where sharing will interfere with their program mission.

Chairman PROXMIRE. In your view, this could save some of the $3 billion annually we spend on computers?

Mr. KNOTT. Yes; I think this would be simply another step along the way toward strengthening the hand of the agency that has been vested with the authority and responsibility to move in this direction.

Chairman PROXMIRE. Would you suggest to us the wording of such an amendment?

Mr. KNOTT. We would be happy to. (See letter below.)

Chairman PROXMIRE. Fine. I think that would be very helpful. We will take it up with the committee and very possibly put it in.

GENERAL SERVICES ADMINISTRATION,
Washington, D.C., December 6, 1967.

HON. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR MR. CHAIRMAN: You will recall that during the course of my testimony before your subcommittee on November 29 you asked, in effect, whether we regarded the authority vested in General Services Administration with respect to ADP by the so-called Brooks bill (P.L. 89–306) as adequate to enable us effectively to discharge our general responsibilities under the bill.

In response I indicated that the limitations on our authority contained in the last provision of the bill (Section 111(g) of the Federal Property and Administrative Services Act of 1949, as amended) detracted from what otherwise would have been a clearer mandate vested by preceding provisions, namely Section 111 (a) and (b).

However, in response to your further question as to whether I would favor repeal of the Section 111(g) limitations on GSA's authority, I indicated preference for amendment of the limiting provisions so as to clarify the respective roles of GSA and the agencies using ADPE with respect to determination of requirements for and selection of equipment on the one hand and the actual procurement of such equipment on the other hand, and so as to more explicitly place the burden of proof on using agencies in any instances where they object to proposed determinations by GSA "specifically affecting them or the automatic data processing equipment or components used by them".

You will recall, also, my testimony to the effect that, generally speaking, we were receiving good cooperation from using agencies in the general field of automatic data processing as a result of which substantial progress had been made in implementing the Brooks bill and significant savings have been realized. This has been made possible, despite the statutory limitations, through consultation and cooperation with other agencies, persuasion, and through indirect controls available to us, such as limiting the amount and location of space we will assign in public buildings for ADPE installations.

I pointed out, also, that a very recent decision by the Comptroller General of the United States (B–151204/B–157587 dated November 21, 1967) holding, in effect, that the Brooks bill vested in GSA exclusive authority to procure all general-purpose ADPE and related supplies and equipment for use by other Federal agencies will importantly strengthen our effectiveness. (NOTE. See p. 556.)

During my testimony, in response to your request, I agreed to prepare and submit to the subcommittee amendatory legislation along the lines indicated above.

Upon further reflection, however, I have concluded that, all factors considered, amendatory legislation at this time would be inadvisable. The overall ADP management improvement task is stupendous and, as recognized during the legislative process on the Brooks bill, must be brought about on a progressive basis.

Regardless of the precise wording of the statute, our success, as the agency charged with central responsibility, will be impacted to a major extent by the degree of cooperation we are successful in generating on the part of the using agencies. In view of the cooperation currently being received from using agencies, the magnitude of the task, accomplishments to date under the existing law, the fact that the law is relatively new and unproven, and the recent Comptroller General's decision, I believe it would be the better part of wisdom to defer any effort to amend the present law to allow us more time to evaluate our potential for its full implementation as presently worded. We will be prepared to report further in this regard to your subcommittee during hearings next year and to make recommendations at that time concerning the need for amendment of the law in the light of experience gained by that date.

Sincerely yours,

LAWSON B. KNOTT, Jr., *Administrator.*

Mr. KNOTT. On the subject of public utilities, which was of some interest to the subcommittee last May, and you asked that we report on it again—your report of July 1967, concluded that it is important to economy in Government that GSA have the capability and motivation to carry out its responsibility to protect the Government as a user of utility services. We are in full agreement with that conclusion and our policies and our operation are in accord with it.

Our responsibility under title II of the Federal Property Act is to protect the Government as a user of utility services. Our role is not that of a "people's counsel," representing all rate payers, nor are we assigned responsibility for regulating the overall earnings of public utilities. The task of protecting the Government as a user is our sole statutory concern.

Also, Mr. Chairman, our first effort in protecting the Government as a user of utility services is through our utility management and negotiation activity and, as the subcommittee report puts it, "if necessary, to represent or have the Government represented in rate cases * * *."

If necessary to protect the Government's interest, we will and do initiate or intervene in such proceedings; we represent the Government through our own staff or jointly with other agencies; or we arrange to have the Government represented by delegation of our representation authority to other agencies. We are firmly convinced, however, that management and negotiation efforts should first be exhausted before resorting to litigation.

In the course of the hearings last spring, I advised the subcommittee that our savings for the period fiscal year 1960 through May 15, 1967, were $11.5 million.

Chairman PROXMIRE. How did you calculate that?

Mr. KNOTT. These were the rates that we were being charged at the time, or the rates that were proposed, and which, through our negotiation, we were able to reduce.

Since that report to you, our effort has produced additional recurring annual savings of some $481,000, and nonrecurring savings of $1,322,389, of which $1.2 million was a refund from the American Telephone & Telegraph Co., resulting from a coordinated effort on the part of our Office of General Counsel and the Office of the Judge Advocate General, Department of the Air Force. This coordinated effort exemplified both our policy of negotiation and our utilization of the total Government staff available without regard to department or agency in the effective protection of the Government's interest as a user of utility services.

We have in the past and will continue to discharge our responsibility in the utility rate area in close cooperation with other agencies, particularly major users such as the Department of Defense, National Aeronautics and Space Agency, and the Atomic Energy Commission.

The subcommittee report also recommended that the BOB investigate the adequacy of GSA's capability and efforts on behalf of the Government as a user of utilities. We have had several informal discussions of this matter with the Bureau and we have advised it of our belief that additions to our utility management staff at the regional

level would be productive of beneficial results. We will continue to explore this matter with the Bureau.

Chairman PROXMIRE. In what way?

Mr. KNOTT. It simply puts people out on the frontline—our staff has been principally a staff located here in Washington. It would give us broader representation, particularly in some regions where we have a larger demand for utilities—for example the west coast, Chicago, and some of the larger regional areas, where there are a number of these transactions going on all the time. It will give us a greater opportunity to get the information at an early date, and get into negotiations at an early date, rather than sometimes rather tardily.

SAVINGS ON TELECOMMUNICATIONS

Chairman PROXMIRE. In your telecommunications network, have you computed how much you save per word, or minute, or other unit of usage?

Mr. KNOTT. Well, our rate now on long-distance telephone calls is down to 73 cents—the average call.

Chairman PROXMIRE. Does that mean our bill has been going down—or have the words increased so much?

Mr. KNOTT. Well, I don't think there are any fewer calls, Senator.

Chairman PROXMIRE. I am sure there are many more. I am just wondering if this works out to a reduction in overall cost, because your rates have been going down, but the number of calls have been increasing. What is the net effect?

Mr. KNOTT. The system now extends to some 435 cities.

The pro rata use of the system is distributed to the agencies.

This means, while we occasionally have to add additional lines, and in that way——

Chairman PROXMIRE. My question is whether or not you have made any computations as to the overall cost now of communications. Whether it has been diminishing or increasing. Do you know?

Mr. KNOTT. Our bill, I think, runs $32 million a year. Do you have the figures on that, Mr. Williams?

Mr. WILLIAMS. $38 million. And the going call rate is about 52 million calls per year.

Chairman PROXMIRE. How does that compare with what it has been over the past 4 or 5 years? Has it been going up?

Mr. WILLIAMS. The call rate is coming down.

Chairman PROXMIRE. Yes, but the bill.

Mr. WILLIAMS. The system cost is going up, but not in direct proportion to the increased call volume. We are making gains on the thing—through increased efficiency of the system. We get higher utilization. The cost per call comes down. But the corresponding increase in systems costs I think is the question that you are asking.

Chairman PROXMIRE. We have to make some assumptions about this, and one is that increased communication is desirable, and necessary, in a growing country, and increasingly complex government. And that while the overall cost is going up, on a per-unit basis it is going down, and you are confident the efficiency is increasing all the time; is that correct?

Mr. WILLIAMS. That is correct. This condition is illustrated by comparing the first 4 months of fiscal year 1967 with the first 4 months of fiscal year 1968. During these comparative periods, the record communications system cost was up $40,000 or 3 percent from the fiscal year 1967 period and the number of words transmitted was also up 106 million or 71 percent. However, the cost per word was down 37 percent from the fiscal year 1967 period. Similarly, the Intercity Voice Communications System cost was up $800,000 or 6 percent from the fiscal year 1967 period and the number of calls completed was up 4 million or 30 percent but the cost per call was down 18 percent from the fiscal year 1967 period.

Chairman PROXMIRE. Is there any way at all that we can put reasonable limits on this? It seems to me you open it up in a way that makes it so simple, there might be a lot of unnecessary calls.

As I understand it, now you can make unlimited long-distance calls through GSA without charge to an agency pretty much, can't you—and you make a modest initial payment?

Mr. WILLIAMS. No, sir. The agencies pay for the calls that they make.

Chairman PROXMIRE. On a per-call basis?

Mr. WILLIAMS. Yes, sir.

Chairman PROXMIRE. How do you control it?

Mr. WILLIAMS. The only controls which are possible are through administrative means which the agencies themselves must apply.

Mr. JOHNSON. Mr. Chairman—one of the things that forms a brake here, or a control, is that the total cost of the system is equally prorated among its users by statistical sampling. Therefore, each Government agency must pay for that service.

Now, in the administrative practices within an agency, therefore, they control the amount of usage that they have of the system. Now, we continually argue with them about the price, and the administrative officers around town have various means of controlling the usage of the system, to keep their costs from rising. But the more they use it, the more their costs will go up, in terms of volume of calls they make.

Chairman PROXMIRE. How do you do it? A fellow picks up the phone and calls San Francisco. How do they exercise this control?

Mr. WILLIAMS. What was the question, sir?

Chairman PROXMIRE. What I am thinking about is—we have just gotten into this in my own office. I have a man out in Wisconsin who is on a system where you make a certain payment, and then you can call any place in the country. Senators can get on that, too, now.

Mr. KNOTT. Seventy-five Senators receive FTS service from GSA.

Chairman PROXMIRE. And, I take it that you can put people throughout the Government on this kind of thing?

Mr. KNOTT. Yes.

Chairman PROXMIRE. And, my question is how you control excessive use of this, or doesn't it matter how much it is used?

DIFFICULT TO CONTROL USE OF SYSTEM

Mr. KNOTT. I do not think that it is economically feasible to mechanically control use. There are no reasonably priced mechanical con-

trols that can be employed. We explored this thoroughly in the early stages of the system and the cost of mechanical device control or making a ticketed record of calls is more costly than the cost of allowing the mechanically unlimited use. This involves to some extent, of course, a selling campaign to agencies based on the fact that if they overburden the system, and we have to add to the system, then the agencies are going to have to pay. And we try to give cost-cutting tips to agencies on how to limit usage.

Chairman PROXMIRE. Very hard to discipline them, though.

Mr. KNOTT. It is very hard.

Chairman PROXMIRE. If one agency overburdens it, and you have to add to the system, all the agencies share in the additional cost; isn't that right?

Mr. KNOTT. That is true. But you can get to the point with a small regulatory agency where it is not even worthwhile billing them for their share of the use. It is so small in comparison to a large agency.

The Treasury Department is a large user of the system. But, in its Internal Revenue Service primarily—Internal Revenue Service has found that in terms of the payoff, that this has been one of the most tremendous advances that they have made—equal in terms of importance to them to the computer system that they have installed. They have been able to avoid sending a man to see somebody about a delinquent tax account, because they can pick up the phone and call him, talk to him, make an appointment, know that he is there when they go.

The Post Office can arrange by telephone for a whole force that otherwise would come on at a distant point to take over a mail delivery, to delay reporting for 3 hours, when they know mail is going to be delayed for 3 hours.

Chairman PROXMIRE. Can there be conference calls that eliminate the need for travel?

Mr. KNOTT. Agencies vary on this point. I do not think I have used conference calls three times in the time the system has been in use. Civil Service Commission has used it fairly extensively for this purpose. And, it has cut down on travel. Veterans' Administration finds it most helpful in meeting emergency situations in connection with patient care, and so on.

Chairman PROXMIRE. It seems that there is an opportunity here for an agency like yours, which is right in the center of it, to perhaps—if you could do so—to make some inquiries, and then perhaps pass on some of the cost-saving techniques that some agencies have found through using this communications system.

Mr. KNOTT. We have done that. And, we point out to them——

Chairman PROXMIRE. You have done that?

Mr. KNOTT. Yes. In fact, we have considered the possibility that we might even give them a reduced rate—a reduction in their rate if they use the system between 8 and 10 in the morning, and between 4 and 6 in the afternoon, rather than the other hours, which are heavy-load hours. We are constantly exploring inducements that we can offer to them.

Now, of course, if you add to this communications system cost the cost of terminal equipment, we think we have made real substantial savings there. And we started this in GSA: we conducted courses

among the agencies. Nearly a thousand people in Government have received instruction in the things they can do to cut out the costly devices that would otherwise be sold to them when they set up a new office. Buzzers and call directors and that type of thing.

We have saved well over a million dollars per year in terminal equipment.

Chairman PROXMIRE. All right. Go ahead.

COMPETITIVE VERSUS NEGOTIATED PROCUREMENTS, TRUTH IN NEGOTIATIONS ACT

Mr. KNOTT. To get to the competitive versus negotiated procurements Truth in Negotiations Act—although the requirements of the Truth in Negotiations Act of 1962 (Public Law 87–653) are applicable by its terms only to those agencies subject to the Armed Services Procurement Act, GSA, as a matter of procurement policy, has incorporated the provisions of the act in the Federal procurement regulations thereby making the statutory procedures mandatory on all Government agencies in the executive branch.

Chairman PROXMIRE. That is good.

Mr. KNOTT. Both our Federal Supply Service and Public Buildings Service are implementing directly the cost or pricing data provisions of the regulations. As a result of a GAO report of July 1967 which noted some instances where construction contracts entered into after June 1964 did not contain the prescribed defective pricing data clause, the Public Buildings Service issued clarifying instructions to contracting officers for guidance and such contracts will hereafter contain this clause.

In negotiations with architects, for example, where the fee exceeds $100,000, we get into dollar details and apply the regulation to those negotiations.

GSA HAD 76 PERCENT ADVERTISED SUPPLY PROCUREMENT IN 1967

The regulations emphasize that procurements shall be made by formal advertising whenever such method is feasible or practicable even though the circumstances present would otherwise satisfy the statutory requirements for negotiations. We are firm in continuing this policy. In fiscal year 1967, 76 percent of GSA supply 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 by other agencies under term contracts and Federal supply schedule contracts.

Chairman PROXMIRE. How does this compare? Is this more competitive advertised bidding than before?

Mr. KNOTT. It runs about the same. It has not improved a great deal. We have a considerable amount of supplies still under the Federal supply schedules, and those are difficult to handle in that form.

On small business, while we continue to try to emphasize that, mergers have not helped us a great deal on that. There has been

a changing structure of small business, so that your percentage has remained about the same.

Chairman PROXMIRE. Well, I hope you will keep emphasizing this, because, of course, it is one method of procurement which really complies with congressional policy. Your purchases are by and large more amenable to competitive bidding than the Defense Departments—much more. After all, they only have 13 or 14 percent—you have 76 percent—advertised competitive bidding.

Mr. KNOTT. Right.

Chairman PROXMIRE. It is hard to ask you to criticize the Defense Department—but at the same time, is there anything you are doing in your procurement processes which they could do which would enhance and increase their proportion of advertised competitive bidding?

Would you think about that?

Mr. KNOTT. Mr. Abersfeller was with the Quartermaster Corps a good many years and works day in and day out with Defense.

Chairman PROXMIRE. We are after them all the time. Frankly, they are hard put to come up with many constructive proposals in this area.

Mr. ABERSFELLER. Mr. Chairman, I am not privy to all the information incident to the negotiations that Defense makes. But it seems to me in the large procurements that constitute most of their negotiations we would be hard put to do it any other way than they are now doing.

The basic problem is one of the absence of specifications.

Chairman PROXMIRE. How about breaking out some of their component parts?

Mr. ABERSFELLER. This is possible, Mr. Chairman; but one of the real risks that you take is that it might cost more over the long term if you do this, in the sense that you then do not have a single contractor to look to regarding the performance of a given product. This could take the form of Government-furnished material as an example, and you could provide on a separate breakdown for the procurement of components, and provide that to an assembler or a contractor. But one of the real risks you take, then, is the contractor, should there be a deficiency in the end product, would simply point to the fact that you forced him to take these components which you had provided from other sources.

Chairman PROXMIRE. Do you buy handtools by advertising?

Mr. ABERSFELLER. Yes.

Chairman PROXMIRE. And did the Defense Department do this when they had the responsibility?

Mr. ABERSFELLER. Yes; in the same instances. They do, however, I understand, buy some handtools under negotiation where the handtools were provisioned with an end item, radar trailer, for example. They then had the supplier of the radar trailer, for example, provide the handtools.

Chairman PROXMIRE. I hope you will think about this, and if you can, in the course of going over the record in the next few days, come up with whatever you can in the way of suggestions as to what we can do to help the Defense Department get more into the advertised competitive bidding. They admit there is a saving of 25 percent when they can procure on competitive basis.

Mr. ABERSFELLER. Yes, sir.

Procurement of Industrial Products and Services Pursuant to BOB Circular A–76 (See App. 13, P. 611)

Mr. Knott. Bureau of the Budget Circular A–76, revised, has to do with the question of buying, or relying on private enterprise system to provide the services and products which are needed by the Government. The inventory by GSA of the commercial and industrial type of products and services which could be procured through private sources rather than produced or performed in-house by GSA has recently been completed. Thirteen activities meriting analysis and study were identified in the inventory. Four studies have been completed and the remaining nine studies are scheduled for completion by June 30, 1968.

The four completed studies are—

(1) Cleaning of public buildings;
(2) Maintenance and repair of Government-owned buildings;
(3) Operation of interagency motor pools; and
(4) Repair of office machines.

Studies of the first two activities justify distribution of the work between Government and commercial contractors based on a cost comparison for each building. The third study indicates that continued operation of interagency motor pools by the Government is more economical than operation of the pools under commercial contracts. The study of the fourth activity—office machine repairs—justifies the continuation of the operation of facilities located in Denver, Colo., and Washington, D.C., by the Government on the basis of cost and local shortages of qualified repair technicians and facilities. In all other geographical areas office machine repairs are being performed by commercial concerns.

Chairman Proxmire. You do not use prison labor?

Mr. Knott. We have arrangements with the prison industries, yes, sir: for certain products. Do you have some examples?

Mr. Abersfeller. Yes; we buy paintbrushes and several items from the prisons—furniture.

Mr. Knott. Some of the rehabilitation of furniture is done by them.

On short-shelf-life items—I am pleased that we were able to clear a report on your bill, I believe, just yesterday.

Chairman Proxmire. Good. That is mighty welcome.

Mr. Knott. The report is with the committee now.

Chairman Proxmire. Fine.

(Note: Bill is S. 1717. See also p. 309.)

Control of Short-Shelf-Life Items

Mr. Knott. We advised you in May that 186 items valued at $42.5 million were subject to rotation by December 1968. We now understand—

That $9.9 million of these items have been transferred to other Federal agencies for utilization or will be transferred prior to expiration of shelf life;

An additional $5.4 million of items have been discontinued as stockpile items and will be declared excess by December 1968; also, $3.3 million in biologicals and antibiotics have been determined by

the Food and Drug Administration to be unfit for human use and will be destroyed;

The remaining $23.9 million of shelf items have useful life established through December 1969; reinspection and testing at that time should result in extension of usable shelf life.

Chairman PROXMIRE. This $3.3 million that were destroyed—how does this compare—is this a better record than you had in the past?

Mr. KNOTT. Yes.

Chairman PROXMIRE. Considerably better?

Mr. KNOTT. Considerably better. I think we had a figure, at one time, that ran as high as $24 million.

Chairman PROXMIRE. That was the reason I put the bill in.

Did the life of these items expire, or was there some other cause?

Mr. KNOTT. The larger volume, or the improvement?

Chairman PROXMIRE. I am talking about the $3.3 million, this particular item.

Mr. KNOTT. This particular item. Yes, these simply were determined to be unfit for human use. We have been attempting to redistribute these before the shelf-life time expired. But, we just did not make it on this $3.3 million.

Public Health Service has reported that excess materials valued at approximately $10.1 million were utilized by VA and DOD from May 1965 to September 30, 1967.

We also reported to you last May that, with respect to the problem of short-shelf-life items in the civil defense medical stockpile, an interagency committee composed of representatives of GSA, DOD, PHS, and VA had developed a plan to assure utilization of stockpile materials prior to expiration of their shelf life. During the final clearance of this plan it developed that existing stockpile facilities were unable to handle the redistribution of small quantities of stock.

As a result we are investigating the feasibility of bringing required stocks into the existing Federal Supply Service distribution system in bulk for subsequent redistribution to the smaller users. Under this plan bulk distribution to large users direct from the stockpile storage points would continue to be made. We expect to have the feasibility of this approach decided by February 1, 1968, and if no further problems develop we expect to implement the plan no later than June 30, 1968.

Until this plan is completely developed and implemented, we will continue to utilize short-shelf-life medical stockpile items under the interim arrangements we discussed in May 1967.

DHEW also advises that the Office of Emergency Planning's Task Force on Emergency Health Preparedness has, to the extent possible, selected all military specification or Federal specification items for inclusion in the current program involving community and packaged disaster hospitals.

This should facilitate greater utilization of expiring shelf-life items in this program in future years. As I indicated in May, this same task force has developed a plan whereunder a 30-day inventory of certain of these items will be located at and rotated by community hospitals. The goal is to distribute 1,800 units consisting of 30-day supplies for 200-bed capacity hospitals over the next 5 years.

Chairman PROXMIRE. Congratulations. I am glad you are making this kind of progress. It is very encouraging.

Senator PERCY. Mr. Chairman, may I interrupt?

I regret I have a 12 o'clock meeting.

May I just simply say—I know this agency is one of the less glamorous ones. The glamor agencies are the ones that spend all the money. It is never headlines when you save money or procure frugally. But my own personal experience in manufacturing over the years, being on the other end of GSA, has shown that their procurement practices have measured up to the highest standards of the highest and most efficient corporations in this country. In fact, sometimes we thought they were too efficient, too tough.

Now that I am at this end, where we have to raise the money, I certainly can appreciate everything that your people do to instill a sense of efficiency, honesty, and decency, and the highest standards of procurement.

I think the Government and certainly as one Senator I am so grateful for the dedication of the men that you have in your service, and for yourself. As a tenant in the Federal Building of Chicago, I can again testify to the efficiency of your operations out there.

Mr. KNOTT. Thank you, Senator. With your background, that is very meaningful.

Senator PERCY. Thank you, sir.

EXCESS PERSONAL PROPERTY

Mr. KNOTT. General Services Administration continues to promote the utilization of all types of excess personal property throughout the Government in lieu of new procurement and in support of the President's cost-reduction program.

During my testimony at the hearing on May 16, 1967, I stated that while the quantity of available excess personal property decreased significantly in 1966 due to the military buildup in Southeast Asia, the quantity of such property transferred for further Federal use remained high at 585,497 line items costing $617.1 million. I can now report that in 1967 excess personal property transferred to Federal agencies totaled 642,951 line items costing $643.5 million, an increase of $26.4 million over 1966. This increase, in utilization in 1967, was accomplished in spite of a 23.3-percent decrease in the amount of excess personal property available as compared to the previous year. In 1967, excess property available for utilization totaled $2.3 billion, at Government acquisition cost, contrasted with the availability of excess property costing $3 billion in 1966.

For the first 3 months of fiscal year 1968 the decline in excess personal property generations was reversed slightly, with property costing $653 million becoming available. Federal transfers for the 3-month period, however, increased significantly, totaling $199 million at acquisition cost.

The type of excess personal property being generated continues to include an increasing proportion of special technical equipment with limited utilization potential, such as electronic communications equipment, weapons systems material, and instruments and laboratory equipment.

GSA has continued to place special emphasis on the utilization of excess inventory in the possession of Government contractors. In May

1967, we reported that in fiscal year 1966 transfers of contractor inventory totaled $117.5 million at Government acquisition cost. This reduction from $140.4 in 1965 was due to the declining volume of property available for transfer. The decline in volume of excess contractor inventory continued into 1967, and transfers for the year were reduced slightly from 1966 to property totaling $115.9 million. For the first 3 months of 1968 generations of excess contractor inventory continued to decrease. Volume was $49.6 million of excess generations. Transfers, however, are increasing substantially, totaling property costing $31.4 million.

Chairman PROXMIRE. How is the cost of contractor inventory known to you?

Mr. KNOTT. This is a reported cost. It is not a cost that we——

Chairman PROXMIRE. It is their estimate?

Mr. KNOTT. It is their estimate; yes.

Chairman PROXMIRE. How does this cost compare to your costs?

Mr. KNOTT. On acquisition costs?

Chairman PROXMIRE. What I am talking about is whether or not you could select a fair sample of these items from four or five of your regions, and compare the costs with your costs and let us know.

Mr. KNOTT. That is an interesting thought. I would like to try that. I do not think we have made any such comparison. But I would like to——

Chairman PROXMIRE. Could you do that for us?

Mr. KNOTT. Yes.

Chairman PROXMIRE. Fine.

(NOTE. Report will be made in 2 or 3 months.)

Mr. KNOTT. Surplus personal property costing $285.9 million was donated by GSA for education, public health, civil defense, and public airport purposes in 1967, a decrease of $143.3 million compared to 1966. This significant decline was due to the overall drop in the availability of property coupled with our highly successful effort to effect the reuse of excess personal property by Federal agencies. This trend has continued for the first 3 months of 1968, when donations of surplus personal property totaled $64.6 million, at Government acquisition cost. During fiscal year 1967, property having an original cost to the Government of $99.7 million has been reconditioned or repaired. This represents an increase of 10 percent over the previous year. The cost of reconditioning and repairing was $15.6 million, which is less than 20 percent of the overall original cost. Approximately 95 percent of this work is being accomplished by over 2,000 small business concerns.

Chairman PROXMIRE. How much was the saving to the Government in the utilization of excess personal property last year?

Mr. KNOTT. $643.5 million.

Chairman PROXMIRE. $643.5 million. Where did most of the property come from?

Mr. KNOTT. Most of it from Defense.

Chairman PROXMIRE. What would it have brought by sale?

Mr. KNOTT. Our recovery on personal property runs across the board generally around 12 to 18 percent, in that area. That is on personal property.

Chairman PROXMIRE. Twelve to 18 percent of the cost?

Mr. KNOTT. Of the cost; yes.

Chairman PROXMIRE. When you sell it?

Mr. KNOTT. That is right.

Chairman PROXMIRE. Then you really saved how much? Can you make an estimate? So this would reduce——

Mr. KNOTT. About $547 million.

Chairman PROXMIRE. If the Defense Department embarks upon a greatly expanded exchange-sale program, how much property will be removed from the excess category?

Mr. KNOTT. It is a little bit early to tell, because they have only recently embarked on a tighter program. We have recently issued a new regulation on exchange-sale which has not worked all one way. That is, we have not simply added to the list of items that would be subject to exchange-sale. We have actually taken some of the exchange-sale column and put them over into the donation column.

But, we continue to include, in the exchange-sale area, items such as vehicles and typewriters and that type of thing, which are in frequent use, and continue to be needed, so that they don't become available to the donation program.

I would imagine that it is going to result, however, in cutting down on the donation program. It is hard to estimate how much.

Chairman PROXMIRE. Does this mean that your utilization program will be denied this property through the technicality of definition of excess and exchange-sale?

Mr. KNOTT. I think that is a fair statement; yes, sir.

Chairman PROXMIRE. Do you favor changing the law so utilization will take precedence over exchange-sale?

Mr. KNOTT. I do not think so.

Chairman PROXMIRE. You do not?

Mr. KNOTT. No.

Chairman PROXMIRE. What does it cost GSA to prepare for sale and sell surplus personal property? DOD reports that it takes about 80 percent of the proceeds—79 percent.

Mr. KNOTT. Is that for sale, or is that for their utilization and sale?

Chairman PROXMIRE. For sale——

Mr. KNOTT. Only?

Chairman PROXMIRE. What does it cost GSA to prepare for sale and sell. DOD reports it takes 79 percent of the proceeds to do this.

Mr. KNOTT. I was asking whether their statement covered utilization and sale, or sale only. Certainly our costs for sale do not run 80 percent.

Chairman PROXMIRE. Preparation and sale.

Mr. KNOTT. It runs approximately 30 percent on sales.

Chairman PROXMIRE. Do you recommend that surplus real property not be donated to non-tax-supported donees?

Mr. KNOTT. Not be donated; yes.

Chairman PROXMIRE. Would you apply a kind of Morse formula? You know, Senator Morse has——

Mr. KNOTT. I know it well; yes, sir. Yes; I think that the Government should recover for property that it no longer needs. There are enough exceptions to the law now, specifically providing for discount for public health and education, airports, and other recognized public

uses. The efforts to expand to other areas is fruitless in that there is simply not that much property to go around.

Chairman PROXMIRE. Well, it sounded as if most of the disposal of property was to nonprofit—as I read your report—was to these nonprofit sources from which there was no return.

Mr. KNOTT. Yes, sir; that is right.

Senator PROXMIRE. How much has there been donated to non-tax-supported donees since your act was passed in 1949? Do you have any figures on that?

Mr. KNOTT. I do not think I have any summaries regarding donations as between tax-supported and non-tax-supported levels.

But, it is a figure that we could compile and furnish. We would like to do it.

(The following was later furnished for the record:)

Donations of Real and Personal Property F.Y. 1958–F.Y. 1967 inclusive. (Records are not available prior to F.Y. 1958.)

Real property:
Numbered: 1,470
Acquisition cost: $960,000,000

Personal property:
Acquisition cost: $3,660,000,000

Records are not available from which to determine donations between "tax-supported" and "non-tax-supported" institutions.

Chairman PROXMIRE. Does that take us up to real property?

EXCESS REAL PROPERTY

Mr. KNOTT. Yes, sir. As I indicated in my last report to the committee, I had hoped that the recently revised Bureau of the Budget Circular A–2 of April 5, 1967, with its new provisions, requiring the holding agencies to make a detailed annual report of their real property to the BOB, would give added impetus to the identification and reporting of excess real property not required to meet program objectives. (Text of Circular A–2 appears in hearings, 1967, pt. 1, p. 234.)

Although the expected increase in the reporting of excess real property has not yet materialized, it is still too early to make a judgment on the effectiveness of the circular. The first reports from the holding agencies to the BOB are only now being submitted under the revised Circular A–2, and the review and critique of those reports by the BOB may serve to further the excess program.

We continue to provide for the further Federal utilization of real property wherever feasible. During fiscal year 1967, 59 excess real properties were transferred to other Federal agencies for continued use. An additional 18 properties have been transferred to other Federal agencies during the period from July 1 to October 31 of this fiscal year.

Exchanges of excess property for other privately owned lands needed by Federal agencies are fostered by GSA in an effort to reduce the amount of appropriated funds needed for new acquisition. Nine such exchanges were accomplished during fiscal year 1967.

Chairman PROXMIRE. What did this amount to in terms of dollars, roughly?

Mr. KNOTT. We would be glad to supply that. Just one quick passing example. We had 115 acres of land near Portland, Oreg.—a Federal Communications field office. That was exchanged for city property adjoining the Federal building, which houses the Bonneville Power Administration in Portland. This was land that was needed, not only for motor pool operations, but for the future expansion of the building. We are trying to use properties where we can effect these exchanges rather than make other dispositions.

(The following information was later furnished for the record:)

Value of nine real property exchanges during fiscal year 1967—$3.4 million.

We have exchanged properties outside of forest preserves for privately owned properties within the boundaries of the preserves that the Department—the Forest Service—wanted to acquire. This has also been true with respect to lands administered by the Department of the Interior, National Park Service.

We continue to stress the disposal of surplus property by sale in order to—

(1) Return its full cash value to the Treasury;
(2) Reduce maintenance costs; and
(3) Return property to the local tax tolls and to the civilian economy as a source of jobs and payrolls in local communities.

During the fiscal year 1967 GSA sold a total of 406 real properties valued at $39½ million. Prices obtained from the sale of this surplus real property totaled $46 million. In the first 4 months of the current fiscal year, sales have totaled $30.2 million.

The preceding fiscal year disposals totaled $125 million, for an all-time high. But, our annual sales levels depend on the mix of properties, rather than the number of properties, and the value of the available properties.

A large portion of the surplus property disposed of each year is conveyed at price discounts for public non-Federal uses. Under existing procedures, prior to public sale, State and local governmental agencies and eligible nonprofit organizations are given notice by the GSA of the possible availability of surplus real property for disposal for health, education, park and recreation, historic monument, wildlife conservation, and public airport purposes, without charge or at price discounts, and afforded the opportunity of submitting a plan for the acquisition and use of the property. During the first 4 months of fiscal year 1968, 51 surplus real properties have been conveyed for public uses. Federal investments in these properties amounted to $79 million.

Under the Land and Water Conservation Fund Act (Public Law 88–587, approved September 3, 1964) a fund was established to assist in providing moneys for the planning, acquisition, and development of lands for park and other outdoor recreation uses, including matching grants-in-aid to States for these purposes. Receipts from surplus real property sales are deposited in and form the bulk of the fund.

Turning to another subject, during fiscal year 1967, in a number of large cities, contracts for the maintenance, repair, and overhaul of electric typewriters and certain other office machines were awarded to local companies. Previously, only services by manufacturers had been made avaialble by GSA for Government-wide use. The results of this shift in contractual base have demonstrated sufficient savings to

warrant use of local contractors in other geographic areas, and this is planned for next year.

Mr. Chairman, it has been a pleasure to give you this summary. If you have any further questions, we would be happy to spend with you whatever time you like.

Chairman PROXMIRE. I think we have asked questions right along. I am just about through with my questioning.

I would like to point out what seems to be a very substantial improvement in your identical bid procurement. I notice that you had 8 million—nearly $9 million in 1962, identical procurement, $3 million in 1963, just under $3 million in 1964, $3.8 million in 1965, and you were down to $1.3 million in 1966—a steady improvement.

Now, I am still somewhat shocked and concerned with the percentage of identical bid procurement if this statistic is right; it indicates it had been 22.5 percent in 1962. It declined to 5.4 percent. As I recall, when we were questioning the Defense Department about it, the identical bid procurement was below—way below 1 percent. An identical bid was very exceptional and unusual that they had identical bids.

I raised the point on their so-called negotiated competition, that would have a different kind of a collusion that they had to be very wary of, and be much more likely, and much more tempting. There are all kinds of ways two or three selected suppliers can get together.

But this percentage—Mr. Ward tells me—I had asked him before, and we were not able to figure this out. But now he says he thinks this is perhaps the total amount of all agencies' identical bidding, only 5 percent is from GSA. This would include all agencies, Federal, State, and local. Federal agencies are 64 percent, Department of Defense is a large percentage of that. And GSA is a relatively small percentage.

But you have improved in that respect as well as in so many others.

We are very grateful to you.

Congressman Widnall, a member of this committee, has a series of questions, some eight questions he would like to have you answer. I won't ask you these at the moment, orally, but I would appreciate it if you could give us your answers for the record.

Mr. KNOTT. I shall be happy to.

(The information to be supplied for the record follows:)

GENERAL SERVICES ADMINISTRATION,
Washington, D.C., December 18, 1967.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to your letter of December 12, 1967, which requested our response to a series of eight questions for inclusion in the recent hearings of the Subcommittee on Economy in Government.

The requested answers are appended hereto.

Sincerely yours,

LAWSON B. KNOTT, Jr.,
Administrator.

1. *Question:* Numerous bids offering foreign made hand tools must be further considered for award after application of the present Buy-America criteria used by GSA. Are any delays encountered in the final disposition of such bids and awards involving foreign source products?

Answer: In determining whether a low responsive bidder is responsible and capable of performing on a proposed award of a substantial contract, a financial

report is obtained on the bidder, and a plant facilities inspection is made on the manufacturing source, whether foreign or domestic. Usually, more time is required for such inspection in foreign countries. The additional time varies from a few days to several weeks, depending on the circumstances and whether qualified Government personnel are available in such countries, or commercial firms must be employed to perform the inspection.

2. *Question:* It is understood that GSA buys approximately 15 million dollars worth of tool kits annually for military users and that growing numbers of foreign made tools are supplied as components of those needs. As components of a kit such tools are excluded from provisions of the Buy-America Act. Does GSA have means for determining the dollar value of such foreign components?

Answer: Procurement of tool kits by GSA is subject to the Buy American Act. Substantially all kits purchased have been certified as domestic products. Under the Buy American Act, as implemented by Executive Order 10582, the kit is considered of foreign origin, if the cost of foreign products used constitutes 50 percent or more the cost of all the products used in such kits. We do not have any valid measure of the value of components of foreign origin within this limit.

3. *Question:* Does GSA have the necessary qualified people to understand both software and hardware in a total computer system to be able to write the technical specifications which will be used for requests for quota when seeking bids from computer manufacturers and peripheral manufacturers? (If the answer is "yes") : Then is there any reason or justification for having to ask a computer manufacturer to write the specification for the government?

Answer: GSA does not have qualified specialists who understand both software and hardware to the extent necessary to permit the development of technical specifications which, strictly speaking, would relate to the development and preparation of finite equipment system specifications. Generally, requests for proposals contain data system specifications which are required to be developed by using agencies in such a manner so that they ensure free competition among equipment manufacturers. In accordance with BOB policy guidance as contained in their Circular No. A–54, these specifications delineate the objectives which the system is intended to accomplish; indicate the data processing requirements in terms of data input and output, volumes of data, frequencies, and timing.

4. *Question:* Can you break apart a computer system in order to put individual pieces out for bid? In other words, can you put out for bid, for example, an IBM system which would include the break out of the main frame, the central processor memory, the line printers, the card reader, the card punch, the high capacity storage memories and the other peripheral equipment? If not, why not? If yes, has the Government done this; and is it standard practice to do so?

Answer: It is possible to break apart a computer system in order to put individual pieces out for bid provided adequate resources are available. However, at this time, neither the practicality nor the economic advantages that may obtain as a result of such a technique have been determined. Further study and evaluation to determine the relative efficiency and economy, including a careful study of alternative courses of action, is required. It is not a standard practice to segregate the various elements of a computer system and to put out individual pieces for bid, although we understand that in certain limited cases involving research and development, this technique has been used.

5. (a) *Question:* Do you have the necessary qualified people to assemble a total system?

Answer: No. GSA does not have the engineering staff necessary to assemble individual components, make modifications, and perform other work required to do this. GSA does not have an inventory of such qualified personnel within the Federal Government to be able to form a judgment on this as it relates to other agencies.

(b) *Question:* Is the government assembling its own computers or do we buy an entire system from one manufacturer?

Answer: As indicated in the answer to Question 5(a) above, we generally do not assemble a total system, but buy an entire system.

6. *Question:* Do you know whether any independent peripheral equipment is in any system purchased by the government from a major computer manufacturer?

Answer: We understand that there are systems supplied by major computer manufacturers which contain peripheral equipment purchased from another manufacturer.

7. *Question:* Would there be a significant saving to the government if both the independent peripheral manufacturers and the computer manufacturers were permitted to bid on any part of any total computer system required by the United States Government?

Answer: As stated earlier in reply to Question 4, this matter requires further study and evaluation.

8. *Question:* If a computer system is sold to the government by a manufacturer who does not make all the peripheral equipment which goes into the system, does the GSA have the prices paid by the systems manufacturers for each individual periphery and the main frame? (If "yes") In other words, is there any reason why the government should be paying more for the peripheral part than the cost to the systems manufacturer.

Answer: No.

Chairman PROXMIRE. We want to thank you once again for a very competent and reassuring performance. I want to echo the eloquent words of Senator Percy. We are certainly very grateful to you.

Tomorrow we will conclude our testimony from our scheduled witnesses and welcome the return of the Comptroller General.

The witnesses will be Lewis R. Caveney, of the Bryant Computer Products, and Philip S. Hughes, Deputy Director, Bureau of the Budget.

We will convene here at 10 o'clock in the morning.

(Whereupon, at 12:15 the subcommittee was recessed, to reconvene at 10 a.m., Thursday, November 30, 1967.)

ECONOMY IN GOVERMENT PROCUREMENT AND PROPERTY MANAGEMENT

THURSDAY, NOVEMBER 30, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m., in room S–407, the Capitol, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire; and Representatives Griffiths and Rumsfeld.

Also present: Ray Ward, economic consultant.

Chairman PROXMIRE. The subcommittee will come to order.

Our first witness this morning is Mr. Lewis R. Caveney, representing the Bryant Computer Products. I should add that Congressman Widnall, a member of this committee, Congresswoman Griffiths, and others have expressed an interest in the views of Mr. Caveney.

Since we spend $3 billion per year for purchase and lease of automatic data processing equipment, this is an important subject. I understand that you will give us a brief of your statement, Mr. Caveney, and we will insert the entire statement in the record without objection. It is quite a long statement. I understand you may abbreviate it.

STATEMENT OF LEWIS R. CAVENEY, ASSISTANT TO THE VICE PRESIDENT, BRYANT COMPUTER PRODUCTS, DIVISION OF EX-CELL-O CORP., WALLED LAKE, MICH.

Mr. CAVENEY. Mr. Chairman, I am Mr. Lewis R. Caveney and I appear here as assistant to the vice president of Bryant Computer Products, a division of Ex-Cell-O Corp., located at 850 Ladd Road, Walled Lake, Mich.

These hearings are extremely significant not only to my company but to all of the 50 major so-called independent manufacturers of computer peripherals. In fact, Mr. Chairman, I appear here today not only as a representative of my company, but as an unofficial voice for the independent manufacturers of computer peripherals nearly all of whom suffer from the problems I wish to bring to this committee's attention.

Our division is involved in research, development, and manufacturing of data handling equipment which are those memory devices required of total computer systems. Our division manufactures memory storage drums, memory storage disk files, and the controllers necessary to interface a memory device with a computer. We are an independent peripheral manufacturer in that we, including the total corporation we are a part of, do not build computers nor total computer systems but only specialize in the data handling equipment, or more frequently called, the memory devices for total computer systems.

Mr. Chairman, the problem that confronts the independent peripheral manufacturer is the continuous position by the executive branch of Government of maintaining an objective of freezing out the small independent peripheral manufacturers from selling directly to the Government as part of large EDP systems such as the large controversial Air Force phase II contract. If this practice is allowed to continue it will decrease the national economy in that it will decrease the growth of independents and the direct result will be a stagnation of technology and a decrease in employment and in some cases independents will be forced to go out of business with the end result being less competition.

The independents consist of over 50 major manufacturers of peripheral equipment consisting of divisions of large corporations who do not build computers or total computer systems and separate firms whose entire objective of profit is derived from peripheral manufacturing, thus, several thousands of citizens of the United States receive income direct from such independents and indirectly several hundreds of thousands more U.S. citizens are employed to support those employees of independents with consumer goods and service, therefore, the independents have quite an effect on the national economy and should not be deprived of their basic right to bid on a part of an EDP system in an attempt to receive their share of the Government buying power—after all, part of the Government's buying power is derived from independents in the form of taxes. The national economy with all its variables will without any doubt decrease if the Federal Government does not cease its current policy in acquisition of total computer systems, and I do not mean a token effort, but an open policy to allow independents to bid on any part of any total EDP system requirement.

Former President of the United States Harry S. Truman said in his White House letter dated February 19, 1948, when he signed into law H.R. 1366, which granted unprecedented freedom to the executive branch from specific procurement restrictions during peacetime, that this bill had a hidden danger. This freedom, he said, was

given to permit the flexibility and latitude needed in national defense activities. The basic need, however, remains to assure favorable price and adequate service to the Government. To the degree that restrictions have been diminished, therefore, responsibility upon the executive branch of Government, which includes the Defense Establishment, has been increased. The danger, he said, is the natural desire for flexibility and speed in procurement will lead to excessive placement of contracts by negotiation and undue reliance upon large concerns, and this he said must not occur—it has and is.

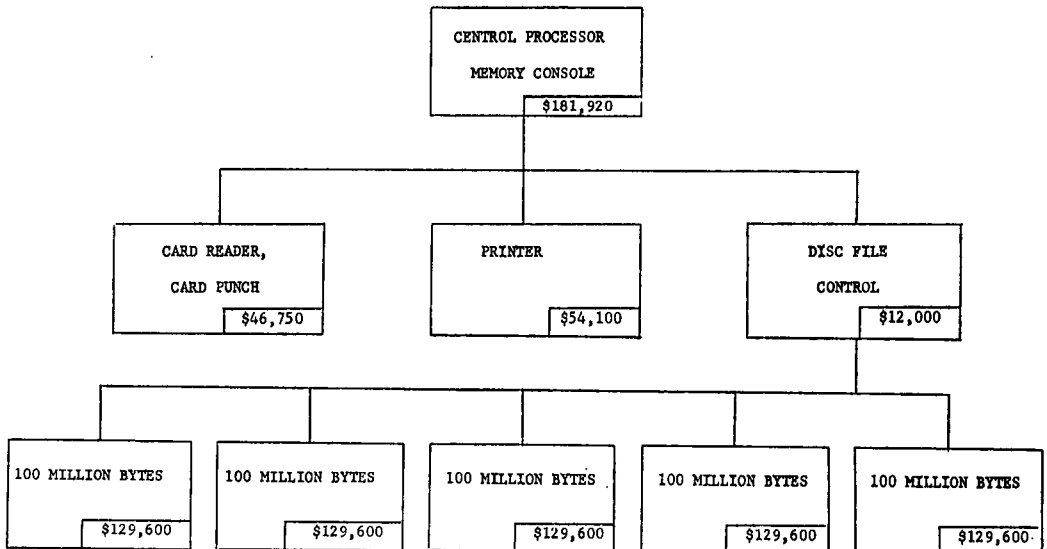
The U.S. Government must become aware of the cost savings to the Government through increased competition in Government procurement of peripheral equipment for computer systems but this can never be accomplished unless all manufacturers, both independent peripheral manufacturers and computer manufacturers, are permitted to bid on any part of a large computer system required of the Federal Government.

The major computer firms offer the Government complete computer systems involving main frames, peripheries, software and maintenance for many different sizes, types, and ranges of applications. They sell equipment that is GSA listed, or at least in their announced product line; and, generally, peripherals or other types of input/output equipment manufactured by independents are very seldom made available to the Government by the computer manufacturer unless under severe duress or under threat of losing a major order or unless a particular input/output device, periphery or feature that is nonstandard, is added to their otherwise published line of equipment for a particular procurement or due to the competition in the market.

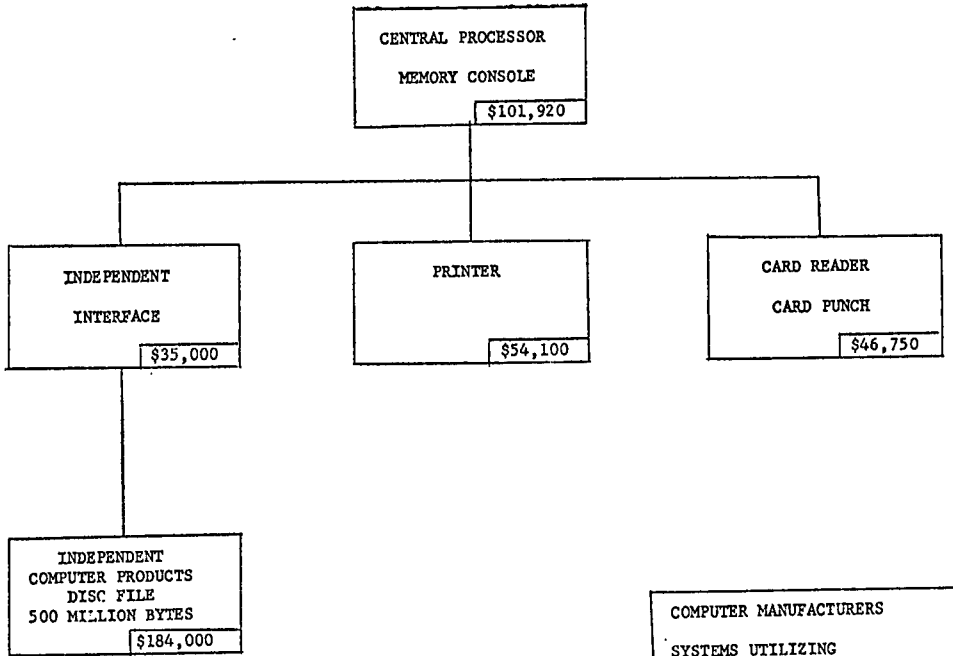
This practice raises the cost of procurement to the Government, provides less than an ideal solution to many problems for which the EDP system is intended to alleviate, since non-product-line peripherals are often not made available to the Government for many excuses, such as the difficulty of interfacing, maintenance and providing software for the nonproprietary periphery or nonstandard input/output device not carried in the computer manufacturer's price book, and tends to stifle competition which can be provided by the independent input/output and periphery manufacturer who often has superior equipment designed to do a specific job with such equipment readily available.

For example, Mr. Chairman, to illustrate this cost factor, I have prepared two illustrations, marked pages 6 and 7, which indicate the difference that could be saved if an independent had been allowed to bid and had won, from this illustration, the contract to furnish the memory and memory controller for the total computer system required of the Federal Government.

(The charts referred to follow:)



COMPUTER MANUFACTURERS
SYSTEM UTILIZING THEIR OWN
DISC SYSTEMS $942,770


CENTRAL PROCESSOR
MEMORY CONSOLE
$101,920
INDEPENDENT
INTERFACE
$35,000
PRINTER
$54,100
CARD READER
CARD PUNCH
$46,750
INDEPENDENT
COMPUTER PRODUCTS
DISC FILE
500 MILLION BYTES
$184,000
COMPUTER MANUFACTURERS
SYSTEMS UTILIZING
INDEPENDENT DISC
FILE STORAGE $501,770

Mr. CAVENEY. It must be noted the five memory units of the computer manufacturer equal only one unit of the independent, and both meeting the specifications assigned with the only difference being price. GAO, I am certain, can substantiate the prices stated in the illustration and the fact it takes five memory devices at a unit price of $129,600 plus another $12,000 for a controller, with these being manufactured by a computer manufacturer, whereas one independent firm's memory would equal these same five units, but at a price of $184,000 and $35,000 for the controller, with the savings being $441,000, if the Government had purchased the memory equipments individually and had not purchased a total computer system from the computer manufacturer. These figures are just initial cost savings.

Further, if five memories take about 400 square feet of space and the one memory takes only about 64 square feet it can be readily seen another dollar savings in floorspace is achieved. I have been informed by GSA officials this runs well over $100 per square foot.

Further, you take the five equipments, and count individual parts, it is easily understandable that to support these five units with spare parts and maintenance personnel, the one unit requires about 75 percent less, and again, a savings is accomplished.

Further, operating manpower increases with the five units and thus the overall cost savings for this example is well over half a million dollars and if you multiply this by just 100 such cases you are at a savings of $50 million. These figures do not include downtime—that time equipments are down due to failure, and this cost runs extremely high at a rate per hour. A total breakdown of each peripheral, plus the other variables including, but not limited to, spare parts, maintenance, floorspace, and manpower involved in a total computer system, the savings would be astronomical just for one—repeat, one—total computer system.

The GAO can clearly substantiate the fact that the Government, in a considerable amount of procurements, procures peripheral equipment, manufactured by independents, unknowingly, but via a computer manufacturer with such peripheral equipment being purchased at a price higher than if the Government had purchased each of the equipments required of the total computer system directly from independent peripheral manufacturers and computer manufacturers, and the Government plugging the system together.

Regarding the need of the technology put forth and available from independent peripheral manufacturers is exemplified by the article taken from the Electronic News, November 13, 1967, issue, under the title "Computer Trend, 1967," with the pertinent data quoted verbatim.

"Marriage counseling will soon become big business in the computer industry."

"But the computer industry 'marriage counselor' will not be called on to solve difficulties of estranged men and women. Instead he will work on the problems of wedding noncompatible peripheral equipment to the main frame system."

To capitalize on this potential business, Datametrics Corp., North Hollywood, Calif., is changing from a general customhouse to a specialist in marrying noncompatible pieces of hardware for computer application.

Dr. Melvin P. Peisakoff, group director of computing systems, planning and operations at North American Rockwell Corp.'s Space & Systems group, observed, "I think this would be a good business to get into." He feels the emergence of the marriage counselor will increase competition and give the user a better cost performance from his peripheral equipment.

When the main frame manufacturer knows that the user can turn to another supplier of peripherals for hardware which will be used with his main system he will price and engineer things better," Dr. Poisakoff said.

It was indicated the marriage counselor will also offer an avenue to the outside supplier of peripherals which might otherwise be blocked by the difficulty of engineering a unit to meet the various specifics of the many main frames.

One factor encouraging the counselor is the reluctance of the major systems manufacturer to expend time and money on wedding non-compatible hardware to this computer.

The major systems manufacturer would prefer to unite his peripherals with his main frame, saving lots of time and effort and adding dollars to corporate coffers.

The big hangup comes when the user says, "But your peripheral does not answer my needs and so I'd rather have what's-his-name's peripheral."

MARKET CREATED

Since the main frame producer would rather expend his money on getting his own hardware out the door, a market has been created for such people as Datametrics, Philip A. Ingalls, manager of applications, said.

Mr. Ingalls said the biggest interface area is in communications—remote computers and remote terminal sites. He said this market has been created by the non-compatibility of common carriers' data links with computer hardware.

While major computer manufacturers are reluctant to talk about the problem, Mr. Ingalls contends they have problems marrying some systems to peripherals.

In particular, Datametrics is aiming at a market of possibly 10-of-a-kind marriages. This might include a user who wants an extra-large desk file which the producer of the main frame does not have.

INTERFACE PACKAGES

The Data Products Sales group has developed interface packages to meet the problem of uniting one of the company's perpiherals with any standard computing system.

Mr. Drake feels the need for counseling will continue to increase because "the user is becoming more sophisticated about his peripheral needs."

He contends that a few years ago the user might accept what the main frame producer might say completely, but now the user is prepared to look around and decide for himself.

The major main frame producers don't like to talk about this aspect of the peripheral story.

Chairman PROXMIRE. Marriage counseling is going to become big business in the computer industry.

Mr. CAVENEY. Yes, sir; it is. Since you made that statement——

Chairman PROXMIRE. I do not want to get into that now.

Mr. CAVENEY. It should be noted that the group director of Computing Systems at North American Rockwell Standard Corp.'s space and systems group, who is not in the commercial computer business, made comments that are enlightening to both the Government and, of course, the peripheral manufacturers.

The individuals I have talked with in the executive branch of Government maintain the computer system know-how is lacking in the executive branch of Government and, therefore, they must go to industry for expertness in this field which is the same old outdated excuse they have been using for over 5 years for placing total EDP procurement with just computer manufacturers. Mr. Chairman, this was a true statement years ago but the executive branch of Government is considered by industry to have the best caliber personnel available who are knowledgeable and understand the total computer disciplines, and, therefore, the weak excuses offered appear to be offered by stagnant individuals reluctant to shift into an area requiring change.

The laxity by certain Government procurement facilities to write their own specifications stimulate the lockout of independents as the Government calls on a major computer manufacturer to write the specifications for the Government and naturally the specifications are written to the manufacturer's equipment. The Government places these specifications in a request for quote and then invokes that portion of Armed Services Procurement Regulations (ASPR) which will not allow any deviations and the manufacturer who wrote the specification is assured that he will receive the award because all the other bidders cannot meet the specification without deviation.

If the Government would pull key personnel under one group and cease the overlapping of functions not only would proper specifications be written but the budget could be reduced and such funds and personnel transferred to those functions of Government which handle the internal problems of the United States, such as poverty.

The eight major computer equipment manufacturers in this country cannot and do not provide in every proprietary periphery or input-output device the best device to do the job that is available on the market in their product line in most cases. This would be the same as saying this or that manufacturer is batting out a score of 100 percent.

Experience shows this does not happen; but there are many healthy independent periphery manufacturers who often offer superior equipment, but unless this equipment is made standard product line with the OEM (original equipment manufacturer) supplying the Government, the Government generally cannot purchase this equipment from them unless considerable time and expense is expended by outright insistence of the procurement authority to have a specific nonstandard component included in his system.

The U.S. Navy, specifically, the U.S. Navy Weather Facility, at Monterey, Calif., has recognized the fact that it isn't true that the best total computer system can be procured from any specific computer manufacturer. They realize they will not receive the best peripherals to do the best job for the application required at the lowest possible cost. The U.S. Navy procurement method resulted in savings which the GAO can substantiate which clearly points to a significant savings to the U.S. Navy when the equipment required of the total computer system was procured from independent and computer manufacturers.

This type of procurement made by the U.S. Navy I have defined as procurement of a total computer system by the "black box concept" and/or "modular concept" which is giving the independents and the computer manufacturers the right to bid on any part of an EDP system required of the Government of the United States. The Government's practice of freezing out the small independent peripheral maker from selling directly to the Government as part of large EDP systems is not new and as the practice is continued to be maintained by the Government the cost to the taxpayer is increasing year by year at an accelerated pace, since the number of available peripheral devices is increasing at a rapid rate and is expected to continue to do so through the 1970's.

The types of devices manufactured by independent peripheral people are modems, line printers, magnetic tape machines, magnetic drums, disk files, plotters, displays, tape punches and readers, et cetera. Over

50 companies are involved in the specialization in research, design, development, and manufacture of peripheral devices for computer systems that are compatible to almost any digital computer system in the Government operation. Some of these companies have achieved product line status with the major computer manufacturers. However, a great majority do not enjoy this very special and privileged relationship and are threatened with loss of their business in the future unless a change is made to Government procurement practices involving procurement of complete computer systems and equipment from only the computer manufacturer.

This freeze by the Federal Government is stimulated by the lack of control over appropriated funds received from Congress. Some elements of the Department of Defense and the U.S. Office of Education receive appropriated funds and in turn give them out to major universities for special computer requirements and little if any control over the funds are maintained. As an example, one element of the Department of Defense granted funds to a major State university and an independent was asked to assist on the memory application which he did for some 8 to 9 months and all communications indicated he would receive the memory contract and then silence from the university. After pressure was applied, it was learned the computer manufacturer who received the computer contract knew he would not receive the memory contract so he literally gave a new memory device to the program professor and the comment received from those in the university who were solely responsible for the program stated that they did not bother to ask the independent to requote in that they felt he could not compete with such an offer from the computer manufacturer. What is felt and what is proper procurement ethics are two entirely different practices and too many times the term "felt" and not adhering to any procurement ethics is the rule rather than the exception in today's Government procurement philosophy.

The Department of Defense element involved when confronted became very antagonistic and the procurement method by the university was condoned until the independent confronted them with the possibility of taking the incident to Congress and letting Congress decide if the proper control of appropriated funds had been adhered to and if proper procurement policies were being maintained. They very rapidly changed their "holier than thou" attitude. The element within the U.S. Department of Education grants funds piecemeal in a majority of cases and does not communicate funding information properly and certain universities with computer programs which are to be paid by appropriated funds cannot procure from independents because all funds are not available nor is any specific PERT time scale made available when such funds will be allowed and therefore must turn to a major computer manufacturer who will permit little if nothing down in respect to funds for 12 to 24 months or until Government funds are actually available for such programs at that university to spend and independents just are not that rich nor are the majority of computer manufacturers.

Another stimulant to lockout of independents by the Federal Government is allowing free service to be accepted by the Federal Government from large computer manufacturers which even the computer

manufacturers themselves are making large overtones about as stated in the November 22, 1967, issue of the Wall Street Journal with the following statements quoted verbatim:

IBM's competitors don't want to comment publicly on the current Government investigation (neither does IBM, nor the Justice Department), but executives of three IBM rivals privately confess that they consider Government intervention to stimulate competition in the industry long overdue. At the very least, one rival would like to see the Government require IBM to charge customers for services it now provides free.

At least one IBM rival company, however, believes the computer business would become far more competitive if Federal trustbusters ordered IBM to quit providing certain free services to its customers—including preparation of computer programs and visits from IBM systems analysts who show customers how to adapt a computer system to their own needs. Competitors complain that they can't match the services that IBM provides for no charge beyond the lease or purchase price of its machines. If IBM had to charge extra for such services, one of its strongest selling points would be eliminated, some industry sources believe.

Further stimulants to the freeze of independents and even computer manufacturers by the Federal Government is expressed in procurement ethics of the U.S. Air Force as stated by the November 22, 1967, issue of the Wall Street Journal with the following statements quoted verbatim:

Some IBM competitors say that Government buying practices over the years also helped IBM gain dominance. The head of one rival computer maker claims that Federal "procurement specifications are written around IBM machines," a charge that Government purchasing men deny.

This computer executive also maintains that Air Force purchasing officers "want aerospace firms to stick to IBM machines" and, in some cases, have refused to allow aerospace companies to buy from other manufacturers on the ground that costly new computer programs would have to be prepared for non-IBM machines.

All the independent peripheral manufacturer is asking is to have an equal opportunity, on a competitive basis, to be considered for Government business on his own merits of price, delivery, maintenance, logistic support, reliability, reputation and performance.

Today this is no sure road to success since the major manufacturers are all dedicated to building their own peripheral equipment and, in effect, freezing out the independent manufacturer from this growing and important segment of the computer business which is right in the free enterprise system but to have the Federal Government literally lock out independents is not right. The main frame is becoming less and less the major cost item in the average computer system. The difference in performance between computer systems of the future may well rest in the efficiency and reliability of the input/output devices.

For the Government to obtain the most of its taxpayer's dollar in the electronic data processing field the Government must immediately recognize the fallacy in their current procurement methods involving the purchase of total computer systems from one manufacturer. The degree of sophistication of some Government users is increasing and today some scientific branches of the Government are actually purchasing computer systems and equipment, with hardware and software often coming from different sources, with even maintenance being supplied by a third party.

Some large industrial users are going this same route and the trend is definitely toward the acquisition in major computer user organiza-

tions of hardware-oriented people to make the purchasing decisions on the basis of merit of the individual equipment or service, whether it be manufactured by computer maker or from an independent supplier.

The Ford Motor Co. has also recognized this fallacy and has employed our former assistant manager of systems who has stated the prime objective of his position is to bring to Ford Motor Co. the hardware knowledge and understanding of computer systems and to assist in implementing the best peripherals and augment the many total computer systems they now have with better peripherals which will assist in decreasing computer systems leasing costs, initial computer system cost, maintenance cost, floor space, manpower, and new buildings which were forecasted for computer facilities which now can be used for more important functions with all this leading to a tremendous dollar savings.

Mr. Chairman, we are faced with a situation in which one minute the Government says it wants competition and the next it practices a lockout of manufacturers.

Yet, if Government would follow just competitive practices both the Government and the taxpayer would benefit. The Government would be able to obtain superior equipment at lower cost through increased competition, and could serve to advance technology in the computer industry by preventing the ultimate destruction of many peripheral makers that today cannot foresee competing with major computer firms if the current lockout situation is allowed to continue in Government procurement.

The ultimate solution to this problem is a Federal standardization in the industry of interfaces between peripheral equipment and the computer proper. This is not something that obviously can be done overnight and should be a main objective of the Government now for future procurement of fourth generation of computing equipment.

Strong indicators clearly indicate Federal standardization would help to direct these companies to establish common interface equipment to allow the Government a free choice of input/output and peripheral equipment with assured compatability between the devices and systems. This can and should be a subject for Government control of the computer interface, at least involving computer equipment furnished the U.S. Government.

At the present time, however, an immediate solution is available that will allow the Government to purchase virtually any peripheral device and yet be assured plug-in compatability can be achieved at reasonable cost without resorting to special negotiations between the Government, the independent peripheral supplier, and the manufacturer of the computer.

This solution rests in the creation by each computer manufacturer for machines offered to the Government, a general purpose peripheral adapter. This device is not a controller, but provides the required timing, controlled data, and interface circuit specifications necessary to connect the peripheral device to the computer manufacturer's line of computers. It is anticipated that there would probably be a general purpose adapter for each series or type of computers from a given manufacturer.

The object of the general purpose peripheral adapter would be that for each manufacturer this unit would be clearly specified and listed

by GSA, such as other computer equipment now listed. The Government and the independent peripheral manufacturer then is assured that the specifications, input/output data, and control requirements of the peripheral interface are frozen or standardized and not subject to change at the whim or design of the computer manufacurer to intentionally or not thwart attempts of end users, such as the Government, from buying from second sources often less expensive and superior performing peripheral equipment; and equipment not available from the computer manufacturer.

One company has done this. The Honeywell Corp. has designed, built, and is marketing such a peripheral adapter. This unit allows the 200 series Honeywell computers to transmit data to and receive data from a wide variety of peripheral equipment not included in the standard series 200 product line. It is not in itself a complete peripheral controller which would be supplied by the independent peripheral manufacturer, however, it does contain all the common features required to communicate with the 200 line computers without the peripheral manufacturer or the Government necessarily becoming involved in the internal bussing and control operations of the computer proper.

Availability of this type of device gives the Government freedom in purchasing computer peripheral devices not manufactured or sold by Honeywell. The general purpose peripheral adapter offered by Honeywell appears to be unique in the computer industry and is something that should be required, in our opinion, of all computer manufacturers doing business with the U.S. Government.

Bryant Computer Products is currently offering several large industrial organizations series 4000 Bryant disc file systems attaching to a Honeywell 200 through their adapter. The XLO–1000 Controller, manufactured by Bryant, is compatible with the Honeywell peripheral adapted with a minimum of effort, as it would to any similar general-purpose adapters made available by other computer manufacturers.

We feel strongly, in conclusion, that the Government is not and cannot efficiently, at lowest cost, purchase complete computer systems for all types and classifications of applications as complete systems from any of the major computer manufacturers. This is due to the diversification of requirements for performance, cost, and for input/output of peripheral equipment which is becoming more highly specialized and more important to the average computer installation every day than is the capability of the main frame itself.

Computer systems cost is increasingly going into the electromechanical peripheral equipment area, and the trend is expected to continue upward for many years. In order for the Government to be able to purchase the best of these peripheral devices and to assemble systems with a minimum of difficulty, at the lowest possible price, a common interface is essential in the fourth generation computers now on the drawing boards. However, we feel there is no necessity to delay these benefits, nor to further tolerate the stifling of competition and the possible demise of very capable independent peripheral companies and their technology, by waiting for the advent of the fourth generation and a common Federal interface.

The general-purpose peripheral adapter is a device that can be designed and made available for any computer series by any manufac-

turer at this time. We need Government support by direction from the executive branch of Government to the General Services Administration to require computer manufacturers doing business with the Government to provide published information on standard peripheral adapters at this time.

Strong indicators exist which seem to substantiate the fact the executive branch condones, either knowingly or unknowingly, unethical practices of the Federal procurement elements to freeze independent peripheral manufacturers from submitting proposals to (1) commercial segments who have been given appropriated funding from the U.S. Government for computer system procurements and (2) directly from Federal procurement segments themselves.

Unless our words are heard the independent peripheral manufacturer will eventually decrease and become annihilated from the market which will decrease employment, stagnate technology, decrease competition, and increase cost to the taxpayer. Action must be taken to correct this problem as time is something the independent peripheral manufacturers just do not have.

I thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mr. Caveney. That is a very impressive statement.

Mr. Caveney, what experience have you had in Government procurement?

Mr. CAVENEY. Mr. Chairman, I was a former Marine Corps officer. I graduated from the Marine Corps Supply School, fourth out of a class of 33. And I spent my last 4 years with the Armed Forces special weapons project of AEC in the repair and manufacturing of nuclear weaponry.

I left the service and acquired a degree, majored in accounting, and contract law, and I have since been with my current company, where I am not only assistant to the vice president, but manager of all contracting and foreign licensing. So I am well versed in procurements of the Federal Government on both sides of the fence.

Chairman PROXMIRE. You acted in your capacity as a military officer as a procurement official—you bought for the Federal Government?

Mr. CAVENEY. I bought for the Government from commercial sources.

Chairman PROXMIRE. What did you buy? What was your area?

Mr. CAVENEY. Handtools—anything from toothpicks on up through minor computer periphery.

Chairman PROXMIRE. You did buy computer——

Mr. CAVENEY. Yes. But it was done by higher authority, I was a junior officer, and we would sit down in concert with the colonel and we would take parts of the contract. He would make the ultimate decision.

Chairman PROXMIRE. Who were the 50 independent peripheral companies you are talking about?

Mr. CAVENEY. Just to name a few—a list can be passed to the committee members, which Mr. Ward has several copies of—it will show the 50 major ones with some being as large as Packard Hewlitt, a large corporation.

(See app. 6, p. 530.)

Chairman PROXMIRE. That is a peripheral manufacturer?

Mr. CAVENEY. Yes. One of their divisions makes peripherals.

Chairman PROXMIRE. How do you discriminate between a peripheral—and what do you call the other ones?

Mr. CAVENEY. They are computer manufacturers. Independent peripheral manufacturers do not make computers, nor do they make total computer systems.

Chairman PROXMIRE. But you make computer parts?

Mr. CAVENEY. No. Mr. Chairman, the word "parts" is the wrong word—excuse me.

Chairman PROXMIRE. That is all right. I am glad to get corrected.

Mr. CAVENEY. As the GSA brought up yesterday, which was not correct, you take a light bulb, and if you laid the brass base out, the filament, and the glass top, they have no purpose whatsoever until they are put together, and then and not until then do they have the intended purpose of being inserted into a socket, and you push the switch on and off, and the light comes on. Now, that is an assembly which has an end use, which can be sold as an identifiable item.

Now, I have heard this same type of statement, of assembly part, used to either distract people in Government from the fact that they are trying to maintain that a peripheral is in fact a part.

Chairman PROXMIRE. My question is to determine the difference—what superficially rational basis, if you do not say it is rational—I think you make a strong case—the Government has for not procuring from you and insisting on procuring from the computer manufacturers.

What do you do? What is it—what does the peripheral producer do, what does he provide?

Mr. CAVENEY. He makes a specialized unit that is required in a total computer system—the memory, the memory system, the printers, et cetera.

Chairman PROXMIRE. He makes all of these specialized, or some of these?

Mr. CAVENEY. He makes all of them, not just a few of them.

Chairman PROXMIRE. And the computer manufacturer would make them all, or would at least procure them all and put them together?

Mr. CAVENEY. Yes.

Chairman PROXMIRE. I raised this specific point yesterday, and I think we have raised it before; GSA, as I recall—and Mr. Knott confirmed this was their position—in contradistinction to what you say, the Government, they feel, does not have the qualified personnel to do the job of assembling the various components into an overall computer, and that to do this, and to assume this responsibility is something the Government is willing to pay for, because they feel private industry can do it better.

Mr. CAVENEY. The U.S. Navy has done it. It is not a very difficult thing. It is just like plugging your lamp into the wall—it is so simple today. We have an Ex-Cell-O 1,000 controller, and with minor insertions of the electronic cards, we can plug into just about any major computer system.

Chairman PROXMIRE. Well, don't these people in private industry who assume this management responsibility for getting the parts from

the so-called peripheral producers, and then assembling them—aren't they very well paid?

Mr. CAVENEY. They certainly are highly paid.

Chairman PROXMIRE. They are not?

Mr. CAVENEY. They are highly paid.

Chairman PROXMIRE. Well, can the Government meet this kind of competition for personnel? We have pretty strict limits on what we can pay?

Mr. CAVENEY. I have talked to several people at your Elite Command, such as the Naval Electronics Systems Command, the Army Command, Rome Air Development—and the people there, to me, are the finest caliber individuals that you could find, they are second to none in the United States in the computer industry. With this top talent, I do not see why the Government cannot plug computer systems together.

Chairman PROXMIRE. You say the Navy has already done it?

Mr. CAVENEY. The Navy has already done it.

Chairman PROXMIRE. And they have been successful in doing it, and made a saving in doing it?

Mr. CAVENEY. Yes; Mr. Chairman. In fact, they came back for the third, fourth, fifth, sixth, and seventh memory and memory systems, right now, from us.

Chairman PROXMIRE. You see no reason why the rest of the Government—space, Air Force, Army, and so forth—cannot do the same thing?

Mr. CAVENEY. No, sir.

Chairman PROXMIRE. Does the Navy do this comprehensively?

Mr. CAVENEY. No—this is the only time I have ever heard, in my experience with my company, that we have ever been a true prime to the Government. Normally when we are a prime, it is when a total computer system has been purchased by the Government, and then certain peripherals fail—memories. Then they come to us for high capacity, and then they put the memory that was in out, and they move ours in. The only other time is when we sell spare parts direct to the Government.

Chairman PROXMIRE. Secretary Morris said in his testimony when price competition is introduced there is a saving on the order of 25 percent. What would you estimate to be the saving to the Government if the peripheral manufacturers were permitted to bid on computer systems?

Mr. CAVENEY. Well over 25 percent, as exemplified by my illustration. There alone it was over half-million dollars. The highest price was $900,000, roughly, the lowest was $500,000, with a saving of $400,000 in that one incident.

Chairman PROXMIRE. How many computer manufacturers are there?

Mr. CAVENEY. There is IBM and 70 others.

Chairman PROXMIRE. IBM pretty much dominates the field?

Mr. CAVENEY. Yes.

Chairman PROXMIRE. What proportion of Government procurement would you say they get in the area of computers?

Mr. CAVENEY. Well, I really cannot answer that.

Chairman PROXMIRE. But you think it is enough so that they are the dominant force; is there a degree of price leadership?

Mr. CAVENEY. We really do not follow the computer industry—I mean the total computer industry—because we feel they have dominance in the field.

Chairman PROXMIRE. When the Government procures a computer, do they by and large do this on an advertised competitive bidding basis for the computer manufacturers, or do they do it on some negotiated basis?

Mr. CAVENEY. Well, there again——

Chairman PROXMIRE. I know it varies. But, what is the rule?

Mr. CAVENEY. We are normally subcontractors. We receive the proposal down on big programs from a prime, such as RCA, and then we have to convince him to put our equipment into the system. We do not know the method, because it is a rule—and I have never read it in the regulations—but the rule is that the Government cannot talk to the subcontractor, only the prime can. And I have always felt this has been wrong as the whole truth by the Government is not known.

Chairman PROXMIRE. You do not know, then, what the system procurement is?

Mr. CAVENEY. No, we do not.

Chairman PROXMIRE. Finally, you referred to the need for a kind of computer marriage counselor, and a knowledge that the function would be to bring the peripheral manufacturers together?

Mr. CAVENEY. Well, I brought that up because of the statements made indicating the end users today realize independent peripheral manufacturers can supply the equipment to do the application at a cost savings which no longer can be overlooked.

Chairman PROXMIRE. This is a wedding counselor rather than a marriage counselor. It is not having trouble among the peripheral manufacturers, it is just arranging the procurement.

Mr. CAVENEY. No. This is because the end user today—banks, industry, small businesses—have become more knowledgeable of computer systems, and they are saying now to the computer manufacturer "Look, we do not like some of your peripherals, we want Joe's over here, who makes a peripheral that meets our requirements better and it is cheaper." They will say "You can't have that, we don't sell that." They say "Well, I will get this marriage counselor, he will interface it." And this is what the market trend is right now.

Time sharing has brought this out.

Chairman PROXMIRE. Would the Government procurement official act as a marriage counselor in this sense? Would he bring the peripheral manufacturers together for the Government into a complete computer system?

Mr. CAVENEY. Yes, sir. The Navy is doing it.

Chairman PROXMIRE. OK.

Mrs. Griffiths?

Representative GRIFFITHS. Thank you very much. I am especially pleased to have you here, Mr. Caveney. As you are aware, the president of the parent company is my constituent. And I am delighted to welcome you here.

Particularly I am happy to see a former purchaser, too, for the Government.

I would like to ask you this:

Let us assume for all practical purposes IBM is drawing the specifications for the purpose of computer systems, and they know before they start that they are going to be the qualified bidder.

What real advantage would there be to them in buying a cheaper peripheral system than—for any purpose?

Mr. CAVENEY. You mean the Government buys a cheaper peripheral.

Representative GRIFFITHS. No; for IBM. If they know they are going to be the qualified bidder, there is no advantage to them to buy a cheaper peripheral system?

Mr. CAVENEY. No; because the specification including the engineering numbers, the technical numbers, are stated around their equipment, and then when the Government invokes the clause whereby no deviations can be taken to the spec, in my opinion it is sort of unknown collusion.

Representative GRIFFITHS. Of course, it is. The result of it is that IBM makes more money on a higher price periphery system than they would make if they had a cheaper, better one—or anybody else that is drawing the specifications and knows he is the qualified bidder to start with.

Mr. CAVENEY. That is right.

Representative GRIFFITHS. May I ask you this. What would you think would be the result in my bill, to ask that the contractor show the price he has paid to every sub, be invoked just in computer systems? Just the first tier of subcontractors. What do you think the result would be?

Mr. CAVENEY. Well, I don't know what the result would be. I know what it should be. The bill should go through.

Representative GRIFFITHS. Good. But what do you think it would be in the matter of savings for the Government?

Mr. CAVENEY. Well, I would estimate just roughly it should amount to—in inventory time alone—would run around a half a billion dollars.

Representative GRIFFITHS. We are just talking about one set of purchases—just IBM systems or just computer systems—and asking only for the first tier of subs to supply the information. And do you really think it would take much manpower to keep track of that?

Mr. CAVENEY. No, I do not.

Representative GRIFFITHS. In the first place, they are not making a sensible buy when they do not know the price—the cost of building up——

Mr. CAVENEY. As an example, just our small division—we have over roughly 90,000 items what we call smart parts, and we only have a staff of four people that do all the purchasing and maintain inventory control on data processing equipment.

Representative GRIFFITHS. I do hope, Mr. Chairman, you are hearing this and supporting my bill.

Chairman PROXMIRE. Yes, indeed.

Representative GRIFFITHS. I would like to ask you, also, if you are selling now any parts to a prime—I mean any periphery system to a prime contractor for the Government?

Mr. CAVENEY. Oh, yes, Mrs. Griffiths.

Representative GRIFFITHS. Do you know what markup they take on it?

Mr. CAVENEY. No, I do not. However, I do feel that GAO has access to this.

Representative GRIFFITHS. And they could give us that answer?

Mr. CAVENEY. I am 100-percent confident they could, because of the fact they have access to Government contracts.

Representative GRIFFITHS. Mr. Chairman, will you ask one member of the staff to find out from GAO the markup on a periphery system in a computer?

Chairman PROXMIRE. Yes, indeed.

Representative GRIFFITHS. And let's put it in the record at this point.

Chairman PROXMIRE. Is there a representative from GAO here today who might know offhand? If not, we will certainly find it out and put it in the record. We will do that, Mrs. Griffiths.

Representative GRIFFITHS. Thank you, Mr. Chairman.

(NOTE.—GAO is currently formulating an answer to the preceding question and at the time these hearings went to press had not completed the study.)

Representative GRIFFITHS. I have just come from the Ways and Means hearing on the tax bill, in which the Secretary of the Treasury is asking us to defend the dollar. I personally feel that if the Secretary of Defense were to look at the mission of defending the country, it would not really be necessary to ask the Secretary of the Treasury to defend the dollar. Here is the place to take the money. And the savings you have already shown us, and the savings that we have already shown in this hearing, if these are made, we are in no problem.

The real truth is that the Defense Department is overpaying on almost every item that they purchase, because they do not know the price of anything—they do not know the cost of making anything—at least that is my judgment—as one ex-purchaser to another.

Mr. Ward would like to know, is it possible for one control point to keep an inventory of 4 million items and match requirements against it?

Mr. CAVENEY. Is it possible to do this?

Representative GRIFFITHS. Yes.

Mr. CAVENEY. Yes; I would say that I could handle 4 million line items and control them, and have a positive inventory.

Representative GRIFFITHS. Thank you very much.

Chairman PROXMIRE. Thank you, Mrs. Griffiths.

I would like to ask, before Mr. Caveney leaves, whether GSA representatives wanted to make a statement clarifying their position on this problem. I may have phrased the question differently to them yesterday, and I want to be sure I am fair to them. Mr. Abersfeller, in this case, is there an opportunity for these particular manufacturers to sell to the Government directly?

Mr. ABERSFELLER. Mr. Chairman, I think that opportunity exists. I talked to Mr. Caveney last night. He is coming in to see me on Friday, to explore this further.

Chairman PROXMIRE. What I wanted to clarify particularly was the impression that I got yesterday that you felt that the Federal Government was not in a good position to buy component parts, or in this case component systems, perhaps, because of the lack of the capacity to put these together.

Mr. ABERSFELLER. Well, it depends so much on the component part. There is in my view at least a lack of capacity, when we are talking about the total Government. Some agencies may have the capability of doing it. At the moment I think there is a lack of capacity to put it together. But if as Mr. Caveney says it is a matter of plugging it in, it is not the kind of technical problem I understood it to be.

Chairman PROXMIRE. Do you want to follow that up, Mr. Abersfeller? Go right ahead.

Mr. ABERSFELLER. I was just going to say one of the first things we must do is that we must get the product on the Federal Supply Schedule. Mr. Caveney has referred to talking to a lot of people. But unfortunately we have not had the opportunity of discussing this matter with him to establish a contract with his company for the products which they make. We do have contracts with 40 accessorial and periphery manufacturers now. But we do not have any with his company, nor to my knowledge—I do not have the list of the 50 companies—but, certainly, that is the first effort we must make. We hope to do that Friday.

Chairman PROXMIRE. You say you are buying from 40 peripheral manufacturers similar to Mr. Caveney's and you feel that there is not any significant or serious obstacle in the way of procurement?

Mr. ABERSFELLER. Not at the moment. I feel there is no particular obstacle at the moment in putting this item on the schedule.

Chairman PROXMIRE. Mr. Caveney?

Mr. CAVENEY. Let's clarify one thing here now. GSA is not giving the total picture.

I am talking about the big procurements, like the Buick program, the Bull's Eye program, the Air Force phase II contract, which GSA has no control over whatsoever.

Chairman PROXMIRE. You are talking about defense?

Mr. CAVENEY. Yes. This is where the dollars are located.

Chairman PROXMIRE. Will you add to the Navy program—the GSA in their procurement——

Mr. CAVENEY. We hold the highest esteem for GSA. In fact, we like the Brooks bill, but we feel it does not have enough teeth. And we feel the GSA is doing a tremendous job for everybody, not just one side of the coin. We feel that the Brooks bill has not got the proper teeth in their area of procurement of EDP equipment.

Representative GRIFFITHS. Mr. Chairman, may I ask the GSA?

If you could buy a part, one of these peripheral systems, to update a system, a computer system, do you have the knowledge and the authority to do it—in place of tossing that out and buying a whole new system?

Mr. ABERSFELLER. We have the authority to do it. I do not know whether we have the knowledge. It would depend on the peripheral equipment. We would have to examine it in some depth. But I would like to clarify something Mr. Caveney has mentioned. Apparently he does not know that we do have to do with the procurement the Defense Department makes. We are now negotiating the Air Force phase II, and not the Defense Department. So I do want to clear it up. GSA, under the Brooks bill, and under a recent decision of the Comptroller General has the exclusive authority in the executive branch of the Government to buy general purpose ADP.

(See Comptroller General decision, app. 10, p. 556.)

Chairman PROXMIRE. GSA would have the authority to buy automatic data processing and computers generally for the Defense Department?

Mr. ABERSFELLER. That is correct.

Chairman PROXMIRE. So you do assume the responsibility for this difficulty that Mr. Caveney refers to?

Mr. ABERSFELLER. Indeed. And we do hope we will work this out and put it in schedule. In furtherance of Mrs. Griffiths' point—we would hope that by using the revolving fund, provided for by the Brooks bill, and by using the information provided under our management information system, be able, in the future, to identify those pieces of equipment which otherwise might not be used and update them as she suggested by the addition of more high speed peripheral equipment.

Representative GRIFFITHS. Why don't you call up the Navy and ask to borrow their people? They will lend them.

Mr. ABERSFELLER. I am not too sure at the moment any people are necessary. I simply do not know how complicated this matter is at the moment.

Mr. CAVENEY. Mr. Chairman——

Chairman PROXMIRE. Mr. Caveney.

Mr. CAVENEY. Now, the statement here—granted he might have the prerogative of these big systems. But then I have a question. If this is true, I would like to know why the Government then sends all the RFQ's to the computer manufacturer and why we must go through the computer manufacturer, not direct to the Government.

Chairman PROXMIRE. Why is that, Mr. Abersfeller?

Mr. ABERSFELLER. Only because Mr. Caveney's firm is not on the Federal Supply Schedule. Generally only those firms who are on the schedule are invited to bid.

Representative GRIFFITHS. Are those people on the schedule the people who make or assemble the total computer system? Are those the only people on the schedule?

Mr. ABERSFELLER. At the moment, other than the 40 accessoral and periphery manufacturers—the other people on the schedule are the original equipment manufacturers.

Mr. CAVENEY. Then I have a followup question. If this is true, how can we get requests for quotes from CDC, Defense, Lytton Industries, RCA——

Chairman PROXMIRE. You say you are on the schedule?

Mr. CAVENEY. We are not on their schedule. But we get RFQ's on the programs via the computer manufacturer.

Chairman PROXMIRE. It sounds to me—and again I do not want to be abrupt—it sounds to me, Mr. Caveney, as if you can get together with Mr. Abersfeller and solve the problem. I am sure you are not interested simply in yourself. You say you are testifying for other peripheral manufacturers, you want to see that justice is done generally, and that the Federal Government saves money.

Mr. CAVENEY. That is correct.

Chairman PROXMIRE. So I think this is a broader question than simply satisfying Mr. Caveney his particular company's problem.

What steps are taken, Mr. Abersfeller, to see that the Defense Department has as comprehensive and full a listing of qualified suppliers

in the computer area, peripheral computer area, as there is? Isn't there a responsibility to make sure that the Federal Government knows virtually all of the manufacturers? After all, if there are 50, this is not an infinite number.

Mr. ABERSFELLER. The steps that are taken generally start with the request that a firm be placed on the Federal Supply Schedule.

Chairman PROXMIRE. And that is initiated by the firm?

Mr. ABERSFELLER. Yes, sir. Or sometimes on our part. In this particular case, I talked to Mr. Caveney last night—he did not call me. I asked him to come down to see whether or not we could not negotiate on the schedule—because after it came up yesterday, I checked with my staff and found that the firm had been in some time ago to discuss it, but we had not completed a negotiation, nor had an application been sent in. As soon as he comes in, I am fully convinced—presuming we can arrive at price—and from what he says, we sure can, because it is less costly—that we will be able to place his products on the schedule. It does not seem to be any problem.

I have looked at the list of the 50 manufacturers, and if my recollection serves me properly, Mr. Chairman, some of these people are on contract now with us. But certainly his firm is not.

Chairman PROXMIRE. Why would it not be a good idea to get in touch—write each one of these firms?

Mr. ABERSFELLER. It is an excellent idea, and we shall do so.

Mr. CAVENEY. Mr. Chairman——

Chairman PROXMIRE. Mrs. Griffiths wanted to say something.

Representative GRIFFITHS. Do you know the price that the total manufacturer of computer systems pays any of these peripheral people?

Mr. ABERSFELLER. I do not.

Representative GRIFFITHS. Why not?

Mr. ABERSFELLER. Well, this goes back to the Truth in Negotiations Act. If the product is sold commercially in substantial quantities there is no requirement—in fact there is an exception from the cost and pricing data requirements.

Representative GRIFFITHS. And the Defense Department, the GSA have fought getting it. That is why you have not got it.

Let me point out to you that what you are now doing in the Truth in Negotiation Act is after the purchase has been made, you are looking at a breakdown of costs that shows you labor and overhead and so forth and so on.

Supposing one of these peripheral manufacturers items is marked up 100 percent—and in my judgment, I think you are going to find it is pretty close to it. How can you justify that in a breakdown of costs? Where are they putting that cost?

Mr. ABERSFELLER. If the information were made available to you, then obviously it could not be justified. We are having some difficulty——

Representative GRIFFITHS. Why don't you demand it be available?

Mr. ABERSFELLER. To be very candid about it, there are occasions where we have demanded it and it has been refused.

Representative GRIFFITHS. If you support my bill, you will never be refused again. They are going to supply it.

Mr. ABERSFELLER. I am referring now to the current legislation that exists in the Truth in Negotiations Act where there is a requirement to provide cost and pricing data under certain circumstances and there have been recent occasions where companies have refused to provide the information.

Representative GRIFFITHS. I am sure they have. And they have also called up from the west coast, particularly the aircraft manufacturers, and objected seriously to supplying any such information, and the Defense Department has gone right along with them.

The best testimony we have ever had is that four people in a private industry can keep track of the price of 90,000 parts. The testimony of the Army yesterday, of the Defense Department yesterday, was that it would take 10,000 people to keep track of these things.

Now, anybody who knows anything knows that is silly.

Chairman PROXMIRE. Furthermore, isn't it true that to put the big computer manufacturers into the mood to reveal this information, you have to have more competition. As I understand it now, they have the whip hand, and they can refuse it, because they do not have to bid, and the Government may be in a position where they are pretty desperate. There are a few of them, and some of them are very big, and the competition is not as good as it ought to be.

On the other hand, if you can break the components out and provide more opportunity for the so-called peripherals, so that you can put these things together, you might be in a stronger position to insist that they give this information, or lose a very valuable sale to the Government.

Mr. ABERSFELLER. It certainly is a possibility. But unfortunately in some cases, as you point out, Mr. Chairman, these are first-of-a-kind types, but they are also in the commercial line of a particular company, and apparently the company has other commercial customers standing in line—yet the Government needs this particular computer desperately, and it is the only one that is known that can do the particular job. The companies do in fact have the whip hand and the Government then has no alternative but to procure the equipment.

Chairman PROXMIRE. Thank you very very much. I appreciate this. Mr. Caveney, you have been a most valuable witness.

Representative GRIFFITHS. I want to say one more thing.

I would like to point out that during these hearings—and I want to thank the chairman for holding them, because I think we have saved the country money—during these hearings the Defense Department has acted as if Congressman Pike, who reveals some astonishingly high prices on some shelf items, had found the only four or five such items that were overpriced that are purchased by the Defense Department. Now, today we hear that the GSA, after having heard the testimony yesterday, has decided it is possible they could buy some of this stuff differently and save some money. This committee ought to sit here all the time, going over these purchases. We would probably save more money for the Government than any other thing that could be done.

But the horrible thing is that—and any taxpayer must know—that it is like opening a catalog and just pushing your finger down like that, and you find out that the item you have is being overpriced—the Government is paying too much money. We are not going through this item by item.

Mr. CAVENEY. Mr. Chairman, in this regard—not speaking as a member of my company, but as a citizen of the United States—I am involved in what you call spare parts documentation. I sit and listen and advise the Government on what they should buy in the form of spare parts. Then they will turn around and buy it anyway, the ones I feel they should not buy, because they cannot do anything with it, except let it set on a shelf and acquire dust. And they are either procured because they are following some hidden regulation or the prime contractor wants to get as many spare parts on the list as he can, which is obvious, because of handling charges and a small profit. And this area of spare parts in itself is one of the largest wastes in Government.

Representative GRIFFITHS. Of course, it is.

Chairman PROXMIRE. Very good.

Once again, thank you so much, Mr. Caveney, for a very stimulating and useful, and, as Mrs. Griffiths has said so well, information that will help us save a substantial amount of money.

Our second witness is the Honorable Phillip S. Hughes, Deputy Director of the Bureau of the Budget. A letter of November 8 of this year which covers the subjects upon which we asked Mr. Hughes' testimony will be incorporated in the record at this point.

(The document to be furnished for the record follows:)

NOVEMBER 8, 1967.

HON. CHARLES L. SCHULTZE,
Director, Bureau of the Budget,
Washington, D.C.

DEAR CHARLIE: Your staff has been informally advised that the Subcommittee on Economy in Government of the Joint Economic Committee will hold follow-up or review hearings on the recommendations and conclusions contained in this report of July, 1967. This letter confirms that the hearings will be held from November 27–30, 1967, Room AE–1, The Capitol, Joint Atomic Energy Committee Hearing Room, and you and your associates are scheduled to appear on November 30, 10:00 A.M.

Please forward 100 copies of your prepared statement at least one day prior to the date of your appearance. If any additional information is desired please call Mr. Ray Ward, Staff Consultant, Code 173, Ext. 8169.

There are four main topics which we wish to cover in some detail during hearings:

1. Development in compliance with the "Truth-in-Negotiations Act" by the DoD and other agencies, including BoB participation.
2. Improvements in supply management in the U.S. and abroad. This will include procurement practices—Buy American, competitive versus negotiation, development of a National Supply System, procurement and management of Automatic Data Processing Equipment, etc.
3. Adequacy of management of Government-owned equipment furnished to contractors.
4. Progress in implementing Budget Bureau Circular No. A–76, revised, concerning the furnishing of material and services for Government use. An analysis of amendments included in A–76 revised would be helpful.

A status report on real property management under Circular A–2, revised is desirable. We also wish a statement on "the adequacy of the GSA's capability and efforts in behalf of the Government as a user of utilities," as recommended on page 16 of the July, 1967 report.

Sincerely yours,

WILLIAM PROXMIRE,
U.S. Senator.

Chairman PROXMIRE. Your statement is quite short, Mr. Hughes, so we may wish to ask questions as you proceed. Please introduce your associates for the record.

STATEMENT OF HON. PHILLIP S. HUGHES, DEPUTY DIRECTOR OF THE BUREAU OF THE BUDGET; ACCOMPANIED BY TIM RUSSELL, OFFICE OF EXECUTIVE MANAGEMENT; JOE CUNNINGHAM, GOVERNMENT MANAGEMENT DIVISION

Mr. HUGHES. Mr. Chairman, with me, on my right, is Mr. Tim Russell, of our Office of Executive Management, who is concerned with Circular A–76, "Competition With Business." On my left, Mr. Joe Cunningham, Assistant Director of our Government Management Division, who is concerned with ADP matters.

Chairman PROXMIRE. All right.

Mr. HUGHES. Mr. Chairman and members of the committee, we welcome the opportunity afforded by your November 8, 1967, request to appear and discuss six areas in which the subcommittee expressed a particular interest and concern. They are:

1. Developments in compliance with the "Truth in Negotiations Act."
2. Improvements in supply management.
3. Adequacy of management of Government-owned equipment furnished to contractors.
4. Budget Bureau Circular No. A–76, Revised, concerning Government competition with business.
5. A status report on real property management under Budget Bureau Circular No. A–2, Revised.
6. The adequacy of the General Services Administration capability and efforts in behalf of the Government as a user of utilities.

Our general budget and management improvement interests make all of these areas of interest and concern to us, and in several we have very specific responsibilities. In this statement, which we hope will be of help to the committee, we have attempted to supplement rather than duplicate the testimony of other witnesses who have appeared earlier and discussed some of these subjects at length.

DEVELOPMENTS CONCERNING TRUTH IN NEGOTIATIONS ACT

During the hearings last May, the subcommittee requested that we give particular attention to a General Accounting Office report to the Congress critical of the way the Department of Defense was administering Public Law 87–653, the Truth in Negotiations Act.

The law, which is implemented in the Armed Services Procurement Regulations, requires contractors to certify to the accuracy, currency, and completeness of cost data which they furnish to the Government during the negotiation of a cost-reimbursable-type contract. In its report to the Congress, GAO cited a number of contracts in which, in its view, there was inadequate cost data to support compliance with the act.

Looking into the matter, we found and reported to the subcommittee by letter of July 19, 1967, that DOD had initiated actions to improve its management in this area of contracting, and that in these efforts a close working relationship had been established between the staffs of GAO and DOD. The committee has heard extensive testimony on this in the last 3 days.

The outcome of the DOD–GAO work has been the development of various changes in the Armed Serivces Procurement Regulations. Generally these new provisions are designed to revise current criteria for determining when adequate price competition exists, to clarify and strengthen the procedure for identification and retention of cost and pricing data in the contract files, and to broaden the scope of post-audit coverage of cost data. In addition, a comprehensive personnel training program has been developed for those involved with the administration of Public Law 87–653.

We believe this joint GAO–Defense effort is the approach most likely to assure well-conceived regulations and procedures, which are the basis for improvements in procurement operations. Ultimate success will necessarily depend upon the effectiveness of internal administration within DOD, requiring proper selection and training of personnel; competent supervision and leadership; maintaining a high capability among procurement people at the working level; and constant testing and refinement of regulations and practices as operational experience is gained. DOD has taken steps to improve internal administration in all these respects. We believe DOD's actions indicate that it is fully aware of the importance of administrative improvements in meeting the objective of obtaining adequate documentation of cost data to clarify the backup records in contract actions.

In summary, our investigation and our discussions with officials of GAO and the Department of Defense since the May hearings indicate that substantial progress has been made. A period of operational testing will be necessary to assure that desired results are being achieved. During this operational period, we are confident that continued cooperation and exchange of views between GAO and the Department of Defense will contribute to further improvements. The Bureau of the Budget will maintain its interest in the matter and be of whatever help it can in overcoming the problems cited by the GAO.

Chairman PROXMIRE. Do you have anything specific in mind in this regard?

What occurs to me is that today is precisely 5 years after the Truth in Negotiations Act was passed. It is 20 years after Public Law 413, the Armed Services Procurement Act, was enacted. We have spent some $370 billion by negotiation in procurement. The loopholes or the failure to administer effectively the Truth in Negotiations Act have been most conspicuous.

So I think this report is reassuring, very helpful.

I certainly do not blame you, Mr. Hughes. You have not been there for 20 years. At least I do not think you have—not in your present position of responsibility.

Mr. HUGHES. That is right.

Chairman PROXMIRE. But I do hope that you can demand regular and detailed reports, and have a system of followup, so you are sure that the Truth in Negotiations Act is being fully implemented, and there is a full awareness in every respect of the costs of the contractors in negotiations—because this is the only real safeguard for the Government and for the taxpayer.

Mr. HUGHES. Mr. Chairman, our handle in these matters is the budget process, quite obviously. We plan with respect to the 1969

budget, as well as future budgets, to use this tool, this handle, if you will, to follow closely the actions by Defense to carry out the act. And, we will, as I have indicated here, maintain our interest and concern with it, and do what we can to see it is carried out.

Chairman PROXMIRE. One of the things that interested me was to find out how fully trained the procurement officials are, whether or not they have been tested and comprehensively tested so they understand the provisions of the law which requires the Truth in Negotiations Act to be fulfilled, and whether the auditing has been fully executed which is provided by the Nitze order—that kind of thing. And, it seems to me, if the Budget Bureau does not do this on a systematic basis—you have the staff and responsibility—it is unlikely to be done at all by anyone.

This committee has so many responsibilities, and so do the Government Operations Committees of the House and Senate—that we may spasmodically and occasionally get into this. But we have to rely on your steady and constant surveillance.

Mr. HUGHES. We will certainly try and do our part, Mr. Chairman. I think the GAO has given ample evidence of its own interest and continuing concern and will also be very important in following through on this.

Chairman PROXMIRE. OK. Go ahead.

IMPROVEMENTS IN SUPPLY MANAGEMENT

Mr. HUGHES. As we noted in our statement last May, the creation of a national supply system has continued to progress even though the Nation's military requirements have placed increasing demands on supply operations. As scheduled on July 1, 1967, GSA assumed Government-wide support responsibility for 52 Federal supply classes, which brings to 65 the total supply classes for which GSA will provide primary management. GSA also is considering assumption of responsibility for additional classes.

The assumption by Defense Supply Agency of Government-wide support responsibility for fuel has been delayed because of staff limitation in connection with fiscal year 1968 appropriations. The initiation of the first phase of its Government-wide responsibility for fuel, which was scheduled for January 1968, is now scheduled for July 1, 1968. This is also the date scheduled for DSA to assume Government-wide support for electronics which will be phased in over a 12-month period. We will work with the agencies concerned to effect the transfer of resources as required to carry out these plans.

The utilization of long supply items was strengthened by new GSA regulations which include guidelines for determining when items in long supply should be made available for utilization by other agencies in lieu of new procurement.

Chairman PROXMIRE. What was the date of that? You can supply it for the record.

Mr. HUGHES. I will, Mr. Chairman. I am sorry I do not have it.

(The information to be furnished for the record follows:)

(Amendment E–38, September 1967)

SUBPART 101–27.3—MAXIMIZING USE OF INVENTORIES

§ 101–27.300 Scope.

This subpart prescribes policy and procedures to assure maximum use of inventories based upon recognized economic limitations.

§ 101–27.301 Definitions.

As used in this Subpart 101–27.3, the following terms have the meanings set forth below:

(a) "Long supply" means that increment of inventory which exceeds the stock level criteria established by the inventory manager, but excludes quantities to be declared excess.

(b) "Centrally managed item" means an item of supply or equipment which forms part of an inventory of an agency performing a mission of storage and distribution to other Government activities (e.g., GSA and DSA).

(c) "Agency managed item" means an item which is procured and forms a part of a controlled inventory of an agency and its activities for issue internally for its own use and is other than a centrally managed item.

(d) "Economic retention limit" means the maximum stock quantity on hand of an item which may be held without incurring greater costs for carrying the stock than for the costs of its disposal and resulting loss of investment.

§ 101–27.302 Applicability.

The provisions of this subpart are applicable to all civil executive agencies.

§ 101–27.303 Reducing long supply.

Through effective interagency matching of material and requirements before the material becomes excess, unnecessary procurements and investment losses can be reduced. Timely action is required to reduce inventories to their normal stock levels by curtailing procurement and by utilizing and redistributing long supply. In this connection, requirements for agency managed items should be obtained, from long supply inventories offered by agencies in lieu of procurement from commercial sources. Since supply requirements usually fluctuate over a period of time, a long supply quantity which is 10 percent or less of the total stock of the item is considered marginal and need not be reduced.

§ 101–27.303–1 Cancellation or transfer.

When the long supply of an item, including quantities due in from procurement, is greater than 10 percent of the total stock of that item, the inventory manager, or other appropriate official, shall cancel or curtail any outstanding requisitions or procurements on which award has not been made for such items, and may also cancel contracts for such items (if penalty charges would not be incurred) or transfer the long supply, if economical, to other offices within the agency in accordance with agency utilization procedures. In such cases, acquisition of long supply items shall not be made from other sources such as requirements contracts.

§ 101–27.303–2 Redistribution.

If the long supply is still greater than 10 percent of the total stock of an item despite efforts to cancel or transfer the long supply as provided in § 101–27.303–1, the inventory manager shall:

(a) Offer centrally managed items to the agency managing the item for return and credit in accordance with the procedures established by that agency; and

(b) Offer agency managed items to other agencies which manage the same item. Reimbursement shall be arranged by the agencies effecting the inventory transfer. The responsibility of locating agencies or activities requiring these items shall rest with the agency holding the long supply. However, agencies may receive a list of Government activities using particular Federal stock numbers by writing to:

General Services Administration, Federal Supply Service, Standardization Division—FMS, Washington, D.C. 20406.

§ 101–27.304 Criteria for economic retention limits.

If, after taking action as provided in § 101–27.303–2, the quantity of an item in long supply is still greater than 10 percent of the total stock for the item, the inventory manager shall establish an economic retention limit for the item in accordance with the provisions of this § 101–27.304. The economic retention limit shall be used to determine which portion of the inventory may be economically retained and which portion should be disposed of as excess.

§ 101–27.304–1 Establishment of economic retention limit.

An economic retention limit must be established for inventories so that the Government will not incur any more than the minimum necessary costs to provide stock of an item at the time it is required. Generally, it would be more economical to dispose of stock in excess of the limit and procure stock again at a future time when the need is more proximate rather than incur the cumulative carrying costs.

(a) The agency managing a centrally managed or agency managed item shall establish an economic retention limit so that the total cumulative cost of carrying a stock of the item (including interest on the capital that is tied up in the accumulated carrying costs) will be no greater than the reacquisition cost of the stock (including the procurement or order cost). Consideration should be given to any significant net return that might be realized from present disposal of the stock. Where no information has been issued, the net return from disposal is assumed to be zero. Guidelines for setting stock retention limits are provided in the following table and explanatory remarks that follow:

Annual carrying costs as a percentage of item reacquisition costs	Economic retention limit in years of supply		
	Net return on disposal as a percentage of item reacquisition costs		
	0	10	20
10	8½	7½	6½
15	6	5¼	4¾
20	4¾	4¼	3¾
25	3¾	3½	3

NOTE: The entries in the tables were calculated by determining how long an item must be carried in inventory before the total cumulative carrying costs (including interest on the additional funds that would be tied up in the accumulated annual carrying costs) would exceed the acquisition costs of the stock at that time (reacquisition costs). For example, assuming no net return from disposal, the accumulated carrying costs computed at the rate of 15 percent per year on the reacquisition cost of the stock and compounded annually at 4½ percent (GSA's recommended rate of interest on Government investments) would be:

Years	Compounded carrying cost as a percentage of reacquisition costs	Accumulated costs as a percentage of reacquisition costs
1	15.7	15.7
2	16.4	32.1
3	17.1	49.2
4	17.9	67.1
5	18.7	85.8
6	19.5	105.3

At 15 percent a year, accumulated carrying costs would be equivalent to the reacquisition costs after 6 years. Six years is, therefore, the economic retention limit for items with a 15 percent annual carrying cost rate. Where an activity has not yet established an estimate of its carrying cost, an annual rate of 10 percent may be used as an interim rate thereby resulting in an economic retention limit of 8½ years when the net return on disposal is zero. The elements

of carrying (holding) cost are given in the GSA Handbook, The Economic Order Quantity Principle and Applications. The handbook is identified under Federal Stock Number 7610–543–6765 in the GSA Stock Catalog, Part I, and may be ordered in the same manner as other items in the catalog.

(b) The economic retention limit at a user stocking activity can best be determined by the item manager (for centrally managed or agency managed items) on the basis of overall Government requirements and planned procurement. Since stocks in long supply at a user stocking activity are less likely to find utilization outlets, the retention limit at these activities should be relatively small. Generaly the economic retention limit at a user stocking activity should be computed in the same manner as in paragraph (a) of this section and then reduced by 70 percent.

§ *101–27.304–2 Factor affecting the economic retention limit.*

(a) The economic retention limit may be increased where:

(1) The item is of special manufacture and relates to an end item of equipment which is expected to be in use beyond the economic retention time limit; or

(2) Costs incident to holding an additional quantity are insignificant and obsolescence and deterioration of an item are unlikely.

(b) The economic retention limit should be reduced under the following conditions:

(1) The related end item of equipment is being phased out or an interchangeable item is available; or

(2) The item has limited storage life, is likely to become obsolete, or the age and condition of the item does not justify the full retention limit.

§ *101–27.305 Disposition of long supply.*

Where efforts to reduce the inventory below the economic retention limit have been unsuccessful, appropriate disposition should be effected in accordance with Subpart 101–43.3 of this chapter. Any remaining inventory which is within the economic retention limit shall be retained. However, the item shall be reviewed at least annually and efforts made to reduce the long supply inventory in accordance with § 101–27.303.

Mr. HUGHES. This will enable civilian agencies to effect savings like those the Department of Defense has achieved through its facility at Battle Creek, Mich. However, a fully coordinated system will not develop as rapidly as we had hoped because of different procedures and different degrees of mechanization of supply records among the civilian agencies.

Chairman PROXMIRE. I understand the GAO has told us they do not think full use has been made of the DLSC at Battle Creek in this respect. (See app. 1, p. 397.)

Mr. HUGHES. I am not familiar with the comment. I thought that there was general agreement between GAO and the Department of Defense on the progress that was being made. I am not familiar with the comment you mentioned.

Chairman PROXMIRE. You go ahead. We will come back to that.

Mr. HUGHES. All right, sir.

With respect to short-shelf-life items of supply, we have responded favorably to the requests for our views on S. 1717 and H.R. 645 which were introduced by Chairman Proxmire and Mrs. Griffiths to insure utilization of medical materials and supplies before they reach the end of their useful life. We believe this legislation, together with the actions which the GSA and the Department of Defense have reported to you, should provide the means to reduce to a minimum losses from the deterioration of stocks which have limited shelf life. (See p. 270.)

MANAGEMENT AND ACQUISITION OF AUTOMATIC DATA PROCESSING EQUIPMENT

In June of this year, the House Government Operations Subcommittee held extensive hearings on the management of automatic data processing equipment. At that time, we reported on the progress being made in the implementation of Public Law 89-306 which provided for a coordinated, Government-wide approach toward improving the procurement and utilization of this equipment.

A basic requirement for strengthening this program has been the need for more comprehensive and current information which would enable us to manage our inventory more effectively.

COMPLETE INVENTORY OF ADPE NEEDED

Chairman PROXMIRE. Does this mean we do not have an inventory of this valuable equipment?

Mr. HUGHES. We have not to date had a complete inventory of equipment in the Government. This is a massive problem, Mr. Chairman, which Mr. Cunningham can talk to more effectively than I, in simply defining what is a computer, what is automatic data processing equipment, and where the lines are drawn between various types of equipment.

Chairman PROXMIRE. So, we do not know what we have.

Mr. CUNNINGHAM. That is not correct, sir. We do have an inventory of computers in the Federal Government; but, it is an inventory of total computer systems. The new information system which has been set up—and the inputs to it are now being processed—is an inventory by component, for each computer. This new inventory is to be maintained on a perpetual basis. It will give us a basis for planning actions, et cetera. We have had, until now, an inventory of the total number of computers, and their total operating cost. We have not had the specifics of the ingredients which made up the various computer systems. We have not had it broken down into detail so you could tell how many various components there are.

It is a brandnew system and with its newness, we are having some difficulty. But, I would hope, within a month or so, we will be operating on a permanent basis.

INVENTORY TO BE COMPLETED IN A MONTH

Chairman PROXMIRE. So you will have an inventory in a month?

Mr. CUNNINGHAM. Oh, yes. As a matter of fact, we have portions of it now.

Mr. HUGHES. I think as somewhat of an aside, Mr. Chairman, some of the problems here, and some of the problems that Mr. Caveney and Mrs. Griffiths were talking about, relate to the question of what is a computer, what the components are, and how complex does the equipment have to get to be counted. And, for these reasons, a numerical count by itself, without the kinds of classifications to which Mr. Cunningham referred, is not real useful. This relates, I think, to Mr. Caveney's problem of which kinds of components can simply be plugged together and which have to be wired together in highly com-

plex and technical fashion in order for them to function as a part of a complete whole.

This information system will provide the basic information necessary in our efforts to improve our contracting and procurement processes, increase the utilization of existing equipment, and extend the redistribution of excess equipment. It will also enable us to evaluate more closely the impact of our Government-wide policies, including those relating to the purchase versus lease of equipment.

GOVERNMENT OWNS ABOUT 50 PERCENT OF INSTALLED COMPUTERS

In this latter connection, the Government now owns outright about 50 percent of the more than 3,000 computers currently installed, compared to only about 21 percent in 1963.

We have also revised our applicable circular, A–54, to improve Government-wide policies on the acquisition of computers. June 1967 amendments to the circular specifically require Federal agencies to give full consideration to the sharing of computers installed within the Federal Government as well as to the use of excess equipment before taking any action to procure additional computers on the open market.

Conversely, agencies are prohibited from retaining displaced equipment for other purposes unless properly justified. Also, we have specified that the cost of money will be taken into account when considering the question of whether computers should be purchased or leased. Finally, we have clarified and reaffirmed the application of these policies to Government cost-reimbursement-type contractors.

AUTHORITIES OF BOB AND GSA

Chairman PROXMIRE. Can you take a minute to indicate to us the distinction between the Bureau of the Budget authority and the GSA authority over computers?

Mr. HUGHES. Essentially, Mr. Chairman—and again I would like to ask Mr. Cunningham to comment further—essentially the Bureau of the Budget is concerned with the division of responsibility as between the agency, the General Services Administration, the Bureau of Standards, and the Bureau of the Budget, all of which have roles in this. The Bureau of the Budget, with a general policy guidance responsibility, the General Services Administration, with a procurement responsibility in the computer area—and the Bureau of Standards, with a technical responsibility in terms of standards, programing and software, and the engineering of computer systems as the Government is involved in them.

Chairman PROXMIRE. Thank you.

PROGRESS IN COMPUTER STANDARDIZATION

Mr. HUGHES. Steady progress continues in the effort to achieve a greater measure of standardization among computers and related software. We expect to announce very soon the adoption of Federal standards for a coded character set and for magnetic tape and punched paper tape. These standards, initially approved for voluntary use by the USA Standards Institute, represent a significant step toward

eliminating costly and inefficient conversion processes, and pave the way for action in other areas where standards are needed.

STANDARDS FOR DATA ELEMENTS AND CODES

Complementing the work to develop computer and software standards is the program just recently established by BOB Circular No. A–86, to develop standards for data elements and codes that are commonly used by Federal agencies. The differences that currently exist in these data prevent their reliable exchange and summarization without engaging in difficult and expensive translation procedures. Through a Government-wide cooperative effort, we hope to minimize these difficulties by bringing about a greater degree of consistency in the way common data is described and coded.

BUY AMERICAN PRACTICES

We have again reviewed the effects of procurement under the Buy American Act by the DOD and civilian agencies. Our review indicates that the balance-of-payments savings gained from using the 50-percent differential in civilian agencies instead of 6–12 percent, would almost surely be more than offset by retaliation from foreign governments.

While the procurement practices of some foreign governments leave much to be desired, foreign government procurement in the United States far exceeds U.S. Government procurement of foreign goods. Millions of dollars of goods now purchased from the United States could be purchased domestically or elsewhere by foreign governments if there were an escalation of restrictive Government procurement practice.

Furthermore, a movement now, toward a more restrictive buy American policy would tend to disrupt our efforts in the Organization for Economic Cooperation and Development to harmonize Government procurement procedure and limit unfair discrimination to the fullest extent possible, and generally to abandon any prospect of improving the conditions of Government procurement. Clearly, it is in the U.S. interest to continue this effort to open up, through more open competition, a potentially large foreign market for American manufacturers. On the other hand, we do not believe the position of the U.S. balance of payments which caused the DOD to introduce a temporary 50-percent differential in favor of U.S. products in its procurement yet permits a change in that policy.

Chairman PROXMIRE. Yesterday we had testimony by Senator Edward Brooke, very able testimony, in which he complained about the discrimination against handtools. He pointed out 90 percent of the handtools are used by the Defense Department, but because they are procured by GSA, the differential in favor of buying domestically, instead of from a foreign source, is only 6 percent, or, with small business, 12 percent; whereas, if you could recognize the procurement by the Defense Department, the differential would be 50 percent. And, it seemed to us a very, very logical argument. The questioning yesterday seemed to suggest that this was something that the Budget, Bu-

reau of the Budget, would be in the best position to help resolve. What would be your comment on that? (See app. 9, p. 550.)

Mr. HUGHES. Well, certainly, Mr. Chairman, first an initial comment should be an acknowledgment that the situation is difficult—with two different differentials. I don't see any use in trying to evade that rather fundamental point.

MESS DUE TO SEPARATE DOD POLICY

Chairman PROXMIRE. This is a mess that the administration created by enabling the Defense Department to issue this directive providing for a 50-percent differential, and with a very real concern about our balance of payments, and perhaps it was good judgment on the part of Secretary McNamara who initiated it.

Mr. HUGHES. Secretary McNamara's action was part of a general defense related effort to reduce the impact of our very extensive defense and particularly oversea defense activities on our balance-of-payments problem. The 50-percent action was taken in that context. It seems to me it makes sense in that context.

The fact that GSA procurement of handtools, for example, for defense purposes results in a different kind of Buy American standard being applied should be evaluated almost case by case, and perhaps industry by industry, in terms of the effect of that practice on the particular industry.

I have had some opportunity to see Senator Brooke's testimony, and I think I can understand his concern with the handtool industry particularly. But I think it is somewhat relevant to look at the figures for handtool procurement in total—I am speaking of GSA procurement—something of the magnitude of $107 million worth of handtools were procured by GSA, and of that total, under $5 million represented foreign procurement.

The point I am making here, Senator, is that——

INCREASE OF HANDTOOL IMPORTS FROM 1948–1966 FROM $169,000 TO $14 MILLION

Chairman PROXMIRE. Let me read what Senator Brooke said:

In 1948, the value of all mechanics hand service tools imported into the United States was $169,000. By 1966 the value increased to $14 million.

This indicates an enormous increase in import. And you are saying $5 million of this was the Defense Department procurement?

Mr. HUGHES. Was GSA procurement for Government-wide use?

Chairman PROXMIRE. So that it does represent a very large proportion of all of the import, and it does represent roughly—a little less than 5 percent of the handtool procurement; is that correct?

Mr. HUGHES. About 5 percent, roughly—somewhat less than 5 percent of the Government's handtool procurement.

I think the portion of the total handtool procurement may be somewhat less. The figures which we have indicate that total handtool imports for all purposes might be more in the magnitude of perhaps $50 million than the smaller figure which Senator Brooke cited, but I cannot certify to that figure. (See app. 9, p. 553.)

The significant points are:

First of all, the Federal Government's procurement of handtools from foreign sources is still a very small proportion of the total procurement. And second, I think we need to keep in mind the rather fundamental fact that the United States sells much more to foreign governments than this Government buys overseas. Therefore, we run a significant risk of losing more than we gain, although not necessarily in the handtool area.

Chairman PROXMIRE. I think we are more or less inclined to favor free trade. But we have to look at the very grim short-term problem, especially in terms of the British devaluation, and the persistent adverse balance of payments. We have had this 50-percent differential for a long time.

How much actual retaliation have we suffered during this period?

Mr. HUGHES. I do not know, Mr. Chairman. Certainly, the volume of foreign procurement here remains high, both in terms of foreign government procurement and as reflected in the fact that our exports far exceed our imports——

Chairman PROXMIRE. We have had it several years.

Mr. HUGHES. Oh, yes; several years. It was introduced and so labeled in the Armed Services Procurement Regulation as a temporary measure in recognition of a balance-of-payments problem.

Chairman PROXMIRE. Which is as bad now as it has been.

Mr. HUGHES. That is correct.

Chairman PROXMIRE. And, more critical this month than it probably has been at any time.

Mr. HUGHES. It certainly is a difficult period. And, it seemed to us, certainly no time to back away from the 50 percent on the defense side. On the other hand——

Chairman PROXMIRE. Under these circumstances, you see, a handtool industry, which does seem to suffer this discrimination—what criteria or standard can you apply if you do not permit them to have the 50-percent differential, when the overwhelming amount of the procurement is by or for defense?

Mr. HUGHES. The criterion is applicable to the procuring agency which in this instance is GSA. I think, again, in appraising the impact of the differential, it is important to look at the figures I have cited, to look at the figures reflecting the growth of the handtool industry in general, and to look at the continued small portion of imports in relation to total domestic use of handtools.

I think it is fair to estimate, also, that of the $4.8 million of foreign procurement by GSA out of this total of roughly $108 million, some substantial proportion would probably stay foreign, even with a 50-percent differential.

So that the margin here, that we are talking about, between these two differentials insofar as the handtool industry is affected, is something under the $4.8. I do not know what the figure is.

Chairman PROXMIRE. Under the $4.8 million.

Mr. HUGHES. $4.8 million is procured foreign under the 6 to 12 differential. Even if that differential were increased to 50 percent, there would continue to be significant foreign procurement.

Chairman PROXMIRE. Could you do this—as a courtesy to the committee—could you get all the data that you can get on the handtool industry for us?

Mr. HUGHES. Surely.

Chairman PROXMIRE. And, could you then perhaps talk with Senator Brooke about this situation, because he has this very, very deep concern. And indicate to us the basis for this particular treatment of handtools as compared with other industries, which must have a similar problem, and which must be in a position of taking advantage of the situation.

Mr. HUGHES. Yes, sir. I think the dictaphone industry is another similar situation. We will do that, Mr. Chairman. And we will reflect in the data and the comments we give to you the results of our conversations with the Senator.

Chairman PROXMIRE. Very good.

(The information subsequently furnished is in app. 9, p. 550.)

THE MANAGEMENT OF GOVERNMENT EQUIPMENT FURNISHED TO CONTRACTORS

Mr. HUGHES. Another matter on which the subcommittee requested our comments is controls over Government property in the possession of Defense contractors. This relates to a request in the subcommittee report of May 1966 that GAO cooperate with DOD to develop an adequate contractor inventory accounting system and to review any unauthorized use of such property by contractors. Comptroller General Staats testified last May that a study had not been concluded and there was still further work to be done in cooperation with DOD. The final report on the study has now been published and GAO and DOD have both testified at length on the findings. (See app. 4 (a) and (b), pp. 411, 463.)

As you have learned, the cooperative study has produced a number of revisions in the Armed Services Procurement Regulations which are planned to be made effective in the very near future and which should tighten up existing controls considerably. These new measures will be tried out in actual working application for long enough to test whether further refinements will be needed. In any event, there seems to be no disagreement either as to legislative intent, or as to the feasibility of maintaining adequate physical and financial control of Government property, whether under contract or Federal custody. (See app. 4(a), pp. 231, 455, for DOD comments on GAO recommendations.)

Chairman PROXMIRE. This concerned the committee very greatly, as you know, from the testimony of the GAO, and from the questioning of all members of the committee.

INDIVIDUAL USE RECORDS FOR CONTRACTOR-HELD MACHINES

Do you feel that individual use records should be kept on contractor-held machines, so the Government can be fairly reimbursed?

Mr. HUGHES. It seems to me, Mr. Chairman, as a generalization; yes. It seems to me so. (See DMO 8555.1, p. 212.)

BASIS FOR EQUIPMENT CHARGES TO CONTRACTORS

Chairman PROXMIRE. The other alternative is, instead of this, you might charge the contractor for the time the machines are in his custody, the notion being there might be a tendency for the contractor to hoard these machines. After all, if he has them and is not using them, and he is charged, he might be more willing to make them available for disposal.

Mr. HUGHES. It seems to me, Mr. Chairman, that there should be selectively kept use records of equipment which is in the hands of contractors. We have not discussed this directly with Defense, or with GAO, but there is a point—and I think this is the essence of the remaining disagreement if that is the right term, between GAO and DOD—there is a point at which it ceases to pay to keep track of use, either on a use basis, or to charge, as the case might be, for the equipment.

Chairman PROXMIRE. That would be a pretty inexpensive piece of equipment.

Mr. HUGHES. Yes; an inexpenisve item, or perhaps, in some instances a one-shot piece of equipment—one shot in terms of Government purpose.

Chairman PROXMIRE. But, certainly, most of the Government's $11 billion—whatever it is—$11 billion investment should be covered. That is, 95 percent of it should be covered.

Mr. HUGHES. It seems to us that the Government should know what the contractor is doing with its equipment.

NEED FOR GOVERNMENT TO SUPPLY EQUIPMENT

Representative GRIFFITHS. May I ask this? What real excuse is there now for the Government supplying equipment to many of these manufacturers?

Now, I would like to point out that I feel in a situation where the Government is the sole purchaser from a plant, then the Government should own the equipment, and the plant. It is nonsense to do anything else. Although the Defense Department records are replete with situations where they have permitted a sole producer for the Government to buy the plant, buy the equipment, and charge them for it.

Now, to me this is too silly to talk about. But why should we continue to be in the business of purchasing equipment, or supplying equipment to manufacturers at this point?

DOD NOT ALONE IN FURNISHING EQUIPMENT

Mr. HUGHES. Well, it seems to me there are some instances, Mrs. Griffiths, in which we might wish to do that.

Defense is, incidentally, not the only one in the business. An instance which occurs to me relates to AEC, where there are Government-owned, contractor-operated establishments.

THOMPSON RAMO WOOLDRIDGE

Representative GRIFFITHS. In those you just have to, in my opinion. The worst abuse of this that ever occurred, in my opinion, was when

General Schriever let Thompson Ramo Wooldridge build a great big office and testing lab. I think they had $160,000 of their own money in it. The Government was the only purchaser. The total cost was $19 million, And, after the Government had paid for it, Thompson-Ramo-Wooldridge kindly sold it back to them for $26 million.

Now, it is possible that the Air Force does not understand money. But I think almost anybody would be smarter than that.

NEED FOR EQUITABLE CONCERN FOR COMPETITORS

However, I have talked about this before. But it seems to me that if you are going to have the equipment, and you are going to let the contractor use it on the Government property, then you are absolutely bound to keep track of it—because you are in reality subsidizing that man against his competitors. It is not only that the Government is losing money. It simply is not fair to his competitors, for the Government to be supplying the equipment.

Mr. HUGHES. If he is in a competitive enterprise, then, I think, we get away from the use and into the charge business.

LACK OF ADEQUATE USE RECORDS

Representative GRIFFITHS. But you see we have not been doing that. Nobody even knew there was any Government property around, until I asked that question about 2 or 3 years ago, and then we became quite interested. And there are billions of dollars' worth that is being used, and nobody is paying for it at all.

Mr. HUGHES. From the GAO reports, some are used for essentially private purposes.

Representative GRIFFITHS. Of course.

COMMERCIAL USE OF GOVERNMENT EQUIPMENT

Chairman PROXMIRE. It also indicates that the records are so inadequate, or so inadequately watched and observed that there is an enormous amount of private use for which no rent is ever paid. And even repeated instances of warnings—and each year they use it more and more for private use. These examples, according to Mr. Staats, were not exceptional, they were not picked to demonstrate the worst situations—they were typical. Firms would buy—get millions of dollars worth of equipment free from the Government, and use them most of the time on private commercial work.

IMPACT ON STATE AND LOCAL TAXES

Mr. Curtis raised a very appropriate if somewhat secondary problem of what does this do to the local and State governments, which rely on a property tax, and cannot tax this property. After all, $11 billion is not just a small amount—it is an enormous amount. But it can result in great penalty for them.

Congressman Rumsfeld?

FAVORABLE POSITION OF CONTRACTOR WITH GOVERNMENT EQUIPMENT

Representative RUMSFELD. Mrs. Griffiths mentioned the problem of enabling one company in the private sector to compete favorably through a subsidy, against another company.

There is another aspect to this about which I have been concerned. I would be interested in your comment on it.

I serve on the Science and Astronautics Committee, also, and we have gotten into space program contracting over a period of years.

I worry not only that a company might be subsidized, but about this second aspect to it.

When a new contract is going to be let, the advantage of the company that has Government equipment in the submitting of a bid, of a response to a request for proposals, seems to me to be considerable, not only from the standpoint of the fact that they might be able to submit a lower price in their bid, but beyond that, there seems to be a tendency on the part of Government agencies in negotiating these contracts to say "Well, this company has the equipment, it is there physically, it does not have to be moved, it does not have to be repurchased, it does not have to be built from the bottom up for someone else, so give them the contract. And, this puts a tremendous advantage in the hands of the company that has the equipment that can be either used the way it is, or updated or changed slightly to help meet the request that is being let.

Frequently, the time element is important. The people who need whatever they are asking to be done may need it now. And so you can add a 2 or 3 or 4 or 8 or 10-month advantage sometimes, because the equipment is there.

Now, I am no procurement officer—and thank goodness—there is no job I would like less. But they have to have discretion, and they are human, and when they do have discretion, as they properly need some, they are going to be affected by all these items I have mentioned. And what happens is the executive branch of the Federal Government starts with a company, and then it builds, and it feeds on itself and its advantage. And I have seen it happen in NASA. I serve on the Government Operations Committee also, and I have been exposed to other instances there where I sense that it happens. I am not aware of a hearing held in the Congress on this subject. I have never seen a comprehensive review of it. I have never even had an opportunity to discuss it in any great depth with people, for example, in a position such as yourself, or in GAO, who are not on the firing line with respect to the letting of the contract. But I am convinced it is happening, that it is serious, and that it is creating some unfortunate imbalances in the private sector.

What are you doing about it, or do you even agree that there is a problem?

Mr. HUGHES. Certainly there is a problem, and I think there are several aspects of the problem that are somewhat separable. Some of them I think we are doing something about in a sense. Some of them are very difficult to do something about—once you get beyond the procurement, the contracting point.

First, there is the inherent advantage of the man who is on the

scene—whether he has any equipmnet or whatever—he is there, and he is in business, he has an advantage whether he is doing business with the Government or with private industry or what-have-you.

Mr. RUMSFELD. Yes. But, this is Government equipment we are talking about.

Mr. HUGHES. First, whether he has any Government equipment or not, if the man is on the scene and in business and known, and, so on, he is ahead. That is a very hard thing to deal with.

Now, with respect to the Government equipment—it seems to me the essential thing here is that the value of the equipment be properly factored into the bidding process. If one man has access to Government equipment and the other does not, the contracting officer has a responsibility to, in judgment terms, and in financial terms, appraise the situation. People are human, and I am sure it is not done accurately in all instances. However, I am sure, in most instances, at least an effort is made.

Mr. RUMSFELD. But there is no way you can factor in the time element. There is absolutely no way. If this procurement officer is told "We need this in a certain amount of time"——

Mr. HUGHES. This is an on-the-scene problem. The Government equipment is incidental. If the man is there with his own equipment on the scene, he is also way ahead.

Mr. RUMSFELD. That advantage is a part of the private enterprise system. I am not trying to conquer that mountain at the moment. I am talking about the one involving the taxpayer's equipment.

Mr. HUGHES. We struggle with this first problem. I would like to point out—and this is part of the small business problem, this is part of the problem Mr. Caveney was talking about this morning. IBM is on the scene. It will do it fast and—give or take reasonable margins—the end product will be pretty good. And the temptation is great, say I, as a nonprocurement officer—and I am glad I am not one, too—the temptation is great for the procurement officer to settle for IBM, and not to look further into the highways and byways of the particular procurement area.

I think it helped my understanding of Mr. Caveney's problem a little bit, in discussing it with my colleagues, to visualize the problem as somewhat similar to that of the homeowner who wants some hi-fi, and he has a choice to make as to whether he is going to buy a range of components, and either put them together himself, or get somebody to put them together, or whether he will buy a Fisher, or other final product, all fixed up in appropriate furniture fashion.

Chairman PROXMIRE. The Government ought to have more competence than the typical homeowner.

Mr. HUGHES. I think that is right. But, computers are vastly more complicated than hi-fi also. I think Mr. Abersfeller's point was that in some circumstances we can put these together ourselves, and some of these other separate components can be put together more efficiently under contract. And, in still other instances, perhaps, we must pay RCA or IBM to do it. But, the discrimination among these choices is difficult, and I make no case that we are doing it entirely right at the present time.

WHAT CRITERIA ON GOVERNMENT FURNISHING EQUIPMENT?

Chairman PROXMIRE. Could I ask—Mrs. Griffiths uncovered a very important and fundamental point we have not raised so far.

What criteria do you use when you approve the decision made in Government to provide equipment to a contractor? How do you determine that you should go out and buy a million dollar or $6 million piece of equipment?

Mr. HUGHES. Well, first of all the basic decision would be made in the administering agency.

Chairman PROXMIRE. Do you have review of it?

Mr. HUGHES. We would review it in a budgetary sense. GSA, if it is ADP equipment—GSA would review it as the central procurement agency, and we would be responsible for arbitrating——

Chairman PROXMIRE. As a matter of policy, what would be the basis to determine whether you would buy this or whether you would not?

Mr. HUGHES. It would be a combination of cost and performance.

Representative GRIFFITHS. When the contracting officer makes this determination, he is sold a bill of goods. This is the only time that this firm will ever use the equipment—"We have no use for a piece of equipment like this. Therefore, we would appreciate it if you would buy it."

Now, if you are already producing an item and you are asked to double the amount that you are producing, you can sell this bill, too. You can say, "We cannot get this very fast. Do you have some stored someplace?"

And they will say "Yes, we do."

"OK, if you just bring in your pieces of equipment, and we will do it."

GOVERNMENT PROCUREMENT POLICY

One of the things that is wrong with the Government procurement policy is that they date back to Valley Forge. They have not been changed much, either. You still do what you once did. And in World War I, I understand when they went to the toolmakers, and asked them to change the plants over and make guns, they were told "Well, we do not need that to make these items. Could you supply it?" And they received in that war the most beautiful facility clause that ever was—it was just great—and one large company in Detroit refused ever to change it in World War II, and they got away with it. They went on the World War I facility clause.

Now, the Government ought to have sense enough to know now these arguments are not true. There isn't really anything so tremendously different about a Cincinnati grinder or a lathe or a milling machine. You just put on different jigs and fixtures—that is all you really need to buy for it, if you are going to buy them something.

So that the whole thing should be reviewed on why you do this.

Now, one of the questions we have never raised here is how many times has the Government removed the equipment from a sub's plant at the request of the primes, and put the sub out of business. And I know that they do it. I live in a town where practically any kid could become a patternmaker or a tool and diemaker. They are competent. They are the most skilled labor in the world. A big eastern contractor

came to a plant in my district one time and said, "This item has never been made, we have tried and tried, we cannot make it. Will you try?" Two men ran that plant, with a very small number of employees. They knew that those men were some of the most skilled workmen in America. They made the item. But they put in $325,000 of their own money. When they had completed it, the big contractor came out, looked over the whole thing, said, "This is great, just wonderful." They sent out their engineers, watched it made, and then the contractor said, "However, we do not need you to make it now." And the Navy inspector picked up their machines, and sent them straight to storage. They broke them.

But I think somebody ought to look into this, too. Because I do not think this is any isolated case. The subs are taking a terrible beating; and the Government is taking a terrible beating, and some of the competitors of some of the primes are taking a terrible beating—because the Government is not looking over this stuff.

CRITERIA FOR FURNISHING EQUIPMENT

Chairman PROXMIRE. Now, your criteria, you say, are cost and performance. I presume that one very important factor would be the availability of the particular item that you want to procure. In other words, if you are having difficulty getting jet blades or getting some kind of equipment—well, jet blades is not a very good example—but some kind of exotic equipment that is new, perhaps, a refinement on a helicopter—and there are no sources around—under these circumstances I can understand why you would have to make all kinds of concessions perhaps to the only manufacturer available, and he might argue "We are not going to have any use for this kind of machine"—under those circumstances perhaps you would think it would be lower cost to buy the machine and so forth. But I should think that would be a very rare exception.

Under normal circumstance, with the vast productive resources we have, and the great versatility of American production, you would think that you would be in a position to procure without actually going into the market and setting the manufacturer up with plant and equipment.

Mr. HUGHES. I certainly agree with you, Senator. I am sure that most of the things that the Government procures in terms of volume and probably cost, are common items available from several sources at any given moment. Time may be a factor, however.

Chairman PROXMIRE. Even if they are only available from one source, I should think you would still be in a position to bargain for them to purchase their own equipment.

Mr. HUGHES. I would think so.

Chairman PROXMIRE. So that in view of the elements other than strict cost and performance, in view of the competitive element, in view of the inequity in terms of taxes and so forth, in view of the difficulty of keeping records and that kind of thing—apparent difficulty—I would think that you would very carefully reconsider this policy which seems to be so widespread, in view of the enormous amount committed—I think Mr. Morris said $14 billion—between $11 billion and

$14 billion—review this and consider, as Mrs. Griffiths suggests, that it would be the rare and really exceptional case where you would actually buy equipment.

Mr. HUGHES. Buy equipment for a Government contractor to use?

Chairman PROXMIRE. That is right.

Mr. HUGHES. It would seem to me that with the exception of an exotic situation like the AEC situation and some others—the need for Government purchase of equipment for contractor use should be diminishing. And, it seems to me, it is in the interest of the Government to diminish it.

Chairman PROXMIRE. If you have any records of that, that would be very helpful and useful to us. Could you get that for us? We would like to have that in the record—to find out how much the Government is buying in each of the last 5 or 6 years.

Mr. HUGHES. The trend in contractor-used Government equipment? I will see what we can do.

(For information requested, see app. 9, pp. 553, 554.)

Chairman PROXMIRE. Very good. Thank you.

COMPETITION WITH BUSINESS—CIRCULAR NO. A–76

Mr. HUGHES. During the May 1967 hearings of this subcommittee, we indicated that we were then working on a revision of A–76 to reflect a number of clarifying changes recommended by the agencies. On August 30, 1967, a revised circular was issued along wtih a brief analysis of the changes made. With your concurrence, we would like to insert these documents in the record, together with our memorandum transmitting the revised circular to the heads of the executive departments and establishments. (See app. 13, p. 611.)

In revising the circular we had the benefit of views and suggestions from the executive agencies, the Comptroller General, and the report of this subcommittee in July 1967. In general, the changes made in the circular are for the purpose of clarifying provisions of the earlier circular and lessening the burden of work by the agencies in implenting its provisions. For example, we clarified the requirements for cost comparisons; for computation of depreciation; and for the treatment of costs that would tend to be the same for both Government and industry.

POLICY STATEMENT

There are a number of points on which the subcommittee expressed a specific interest in its July 1967 report, and we would like to comment briefly upon each of these, starting with the policy statement contained in the circular in respect to Government procurement from commercial sources.

After a great deal of consideration, we decided not to change the basic policy statement in the earlier circular. Instead, we emphasized in the transmittal memorandum the continuity of basic policy with the following statement:

> There is no change in the Government's general policy of relying upon the private enterprise system to supply its needs, except where it is in the national interest for the Government to provide directly the products and services it uses.

After carefully considering the policy statements in the earlier issuances in 1955, 1957, 1959, and 1966, we believe the basic statement of policy on competition with private enterprise was, in fact has been, essentially the same through the years since the first bulletin was issued about 12 years ago.

STATE AND LOCAL TAXES

The subcommittee report also made reference to the possible inclusion in Government costs of estimated amounts for State and local taxes. The revised circular makes no change in respect to this item, but we are continuing our exploration of it. Large and growing grant-in-aid programs, and rising interest in the subject of Federal sharing of revenues with State and local governments, both indicate a need to study further the policy of excluding State and local taxes from cost comparisons. We know, however, that estimating these taxes will be difficult, and that in many, perhaps most instances, the effect of inclusion or exclusion will be small.

Mr. RUMSFELD. That last sentence bothers me.

You say it will be difficult to estimate, I cannot see, myself, why it is any more difficult than any number of other estimates which you are making. And I would be interested to know why you say the effect would be small. It is a rather substantial sum.

Mr. HUGHES. Let me try and comment—first on the difficulty of estimation. True, we can estimate anything—the question is the difficulty of estimating reasonably accurately.

The problem stems in part from the large number of local jurisdictions and consequent differences in tax practice, tax rates, and so on, and in part also from identifying through the contractor, subcontractor, and so on where the taxes actually are being paid or forgone, as the case may be.

Now, with respect to the effect of inclusion or exclusion, we are exploring this further. But except for utilities—and that is an important exception, obviously—the best data which we have seen and analyzed suggests that State and local taxes in general are less than 1 percent of costs in manufacturing, distribution or service industries.

Now, utilities are different, because of their generally large real estate holdings.

In the case of utilities, the data we have suggests that State and local taxes may approximate perhaps 5, 6 percent of total costs, in which event they may well be significant in a particular cost comparison.

Mr. RUMSFELD. Is this part of the 10 percent?

Mr. HUGHES. The 10 percent is a margin, sort of, and was, as originally contemplated, considered to include an allowance for this and other elements of potential error or oversight in the estimating process.

In addition, it was also intended to be an "edge" for private industry in making these sorts of decisions.

Let me add just one other point.

The 10 percent is not intended to be 10 percent and only 10 percent. It is rather a kind of ground rule or baseline.

Representative RUMSFELD. It came out of the air?

Mr. HUGHES. Yes, sir. It has no technical——

Representative RUMSFELD. There is no computation?

Mr. HUGHES. There is no economic basis for it. It is an order of magnitude figure to be used as a kind of rule of thumb or a baseline in appraising a particular situation.

Representative RUMSFELD. In Circular A–76 you exclude specifically the Federal taxes from individual stockholders. It says:

> Including all other Federal tax revenues except social security taxes received from corporations or other business entities, but not from individual stockholders from a product or services obtained through commercial charges.

That again weights it in favor of government—just like the exclusion of State and local taxes weights it in favor of government.

Here again you would have to estimate it. But, you have company records, you have national averages.

I worry that the items you are not estimating all seem to push it in favor of government, away from the private sector.

Mr. HUGHES. Certainly the ones you have mentioned do. The 10 percent or comparable allowance was intended to compensate, perhaps to overcompensate for that.

Representative RUMSFELD. You feel that way?

Mr. HUGHES. Yes.

Representative RUMSFELD. You feel the 10 percent overcompensates?

Mr. HUGHES. Yes—from what appraising we have done of the estimates, of the specific situations that we have been exposed to. It seems to me that 10 percent is not an unreasonable guideline.

Now, as I point out here later, there are some factors which weigh against the Government doing the work directly. And, these must be thrown in. They are not factors which you can measure as you would stock dividends, perhaps, in individual cases—but the question of risk, of obsolescence, of getting in and getting out of the enterprise, and, so on—are factors which in the NASA instance, as a case in point, have led NASA to contract for many things which in other agencies have been done in-house. And, one of the questions, as you are well aware, I am sure, on the NASA side is whether we have gone too far on the contracting side.

Representative RUMSFELD. I have had the feeling, as we go over the NASA authorizations year after year, and deal with personnel limitations, is that Congress tries to exercise some control over the items in the budget dealing with personnel, and the next thing we find, they are popping up through contractor services.

Mr. HUGHES. Well, we are involved in the personnel ceiling business. We administer personnel ceilings for the Government in the Bureau of the Budget. We do our best to keep the ceiling consistent with the personal services money that goes with the budget.

Representative RUMSFELD. We deal with it, not from numbers of people, but money, of course.

Mr. HUGHES. Yes. But, in those instances where the ceilings are tighter than the money would otherwise permit, there is a tendency to drive the agency to contract out. We have tried to avoid it. I think Mr. Webb, and others on his behalf, have testified that at least, generally speaking, the ceilings are not the problem—rather that contracting out—to use that as a kind of term of art—has been a policy

of NASA's to take advantage of the flexibility, the capability that we discussed earlier, that industry has in some situations.

Chairman PROXMIRE. Go ahead.

INTEREST RATES—COST OF MONEY, GOVERNMENT AND PRIVATE

Mr. HUGHES. Another question identified in the subcommittee's report relates to interest costs—Should interest rates for cost comparison purposes be those in the private sector or the rates paid by the Government? Under provisions of the revised circular, Government costs will continue to include interest for any new or additional capital to be invested based upon the average rate of yield for long-term Treasury bonds, as shown in the current Treasury bulletin.

We believe this to be appropriate since, if the Government made the investment, this would be the rate that would actually apply. While we recognize that long-term money costs in the private sector are higher, this seems to us a differential which logically should be recognized in implementing the provisions of the circular.

Representative RUMSFELD. Isn't that a third link in this chain I have been building?

Mr. HUGHES. The cost of money is cheaper to the Government and therefore the Government costs would be lower on that account. The answer to your question is "Yes." Cheaper money tilts the scale somewhat in the Government's favor.

Representative RUMSFELD. Somewhat? It tilts it—period.

Mr. HUGHES. Yes; but the question is, When we have added up all of the components, have we made a fair comparison? That is our objective.

Representative RUMSFELD. I have mentioned two others.

Now, what is the cost of money to the Government? Is it the interest rate we are going to pay?

Mr. HUGHES. The one we are using is current long-term yield.

Chairman PROXMIRE. It is lower than you are borrowing at now; isn't it?

Mr. HUGHES. Current long-term yield.

Chairman PROXMIRE. Long-term yield.

Mr. HUGHES. Yield on long-term bonds.

Chairman PROXMIRE. What is it precisely—the coupon on long-term bonds—3¼ percent?

Mr. HUGHES. Not the coupon. It is the average long-term yield—would be a composite of current rates and old rates and would be below current rates. I think the average yield would be above 4 percent, but not as high as the price of money today.

Mr. RUSSELL. Mr. Hughes, if we were making a cost comparison analysis today, we would use the rates shown in the current Treasury bulletin, and that rate would be 4.97 percent.

Chairman PROXMIRE. That is more like it.

Mr. RUMSFELD. I do not know. It just seems to me that—from a decisionmaking standpoint—the figure that would have to be paid in the private sector would be a more accurate reflection on that decisionmaking process than the figure you authorize to be used in your circular.

Mr. HUGHES. Certainly—

Mr. RUMSFELD. That is my view. You don't have to comment on it.

Mr. HUGHES. We have studied some of the arguments. I have seen Dr. Stockfish's paper.

Chairman PROXMIRE. I am glad you are familiar with that. I was very impressed by it. I think Congressman Rumsfeld was, too.

Mr. HUGHES. Again, if we are developing a cost comparison, item by item, it seems to us that we ought to reflect actual Government costs on the Government side of the ledger. In a broad economic sense, there is much to be said for the argument——

Mr. RUMSFELD. Which is the way I am putting it. Putting it in the context of our society, and the effect of these costs—well, go on. I am sorry to interrupt.

Mr. HUGHES. In considering these cost items—taxes, interest, and all the others which are outlined in detail in the circular—we are keenly aware of the fact that there can be many uncertainties and differences of opinion when one gets down to the practical problem of making comparative cost analyses in a specific case, and reaching a determination as to whether the Government should itself supply the product or service or obtain it from private enterprise. In this context, we direct particular attenion to the following statement on pages 3 and 4 of the circular (see also, app. 13, p. 611).

> However, disadvantages of starting or continuing Government activities must be carefully weighed. Government ownership and operation of facilities usually involve removal or witholding 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.

In revising the circular, we considered carefully the question of whether we should change the 10-percent differential in favor of private industry under the "new start" section. We concluded that we should not do so—that this is a subjective judgment that can best be made by the responsible administrators in light of all the facts in a particular case. We did, however, add a sentence to further emphasize that the 10-percent cost differential in favor of private enterprise is not intended to be a fixed figure—and that the differential may be more or less than 10 percent, depending upon the circumstances in each individual case.

We believe further changes in the circular will be desirable. I think the State and local taxes is the most likely of these. We are working with GAO and hope to work with the National Industrial Conference Board and see what we can evolve that will enable us to do this on a reasonable basis.

The transmittal memo to the heads of agencies dated August 30, 1967, said:

> We intend to keep the provisions of the Circular under continuing review. We anticipate that further changes will be desirable in light of experience gained from implementing the Circular's provisions, including the required reviews of existing Government commercial or industrial activities to be completed by

June 30, 1968. We intend to give special attention to the adequacy of the guidelines contained in the Circular for such matters as comparative cost analyses; the circumstances under which cost differentials in favor of private enterprise are appropriate; and the use of contracts involving support services that require minimal capital investment.

We welcome your suggestions.

PROGRESS REPORT ON A–76

Since issuance of A–76, revised, on March 3, 1966, we have required two reports from the agencies on the progress being made by them in implementing the provisions of the circular. Briefly, the situation is as follows: (*a*) Organizational and staffing arrangements for assuring that the policies and procedures are being effectively applied are complete; (*b*) the inventory of commercial and industrial activities has been completed; (*c*) the "new start" provisions of the circular are being implemented in all agencies; and (*d*) most agencies expect to finish their reviews of existing commercial- and industrial-type activities by the target date specified in the circular, June 30, 1968. On the last item mentioned, much work remains to be done, especially in the larger agencies, and until it is complete it is not possible to obtain a composite summary picture of the results achieved in terms of activities continued and discontinued.

DR. STOCKFISH'S ARGUMENT ON OPPORTUNITY COST

Chairman PROXMIRE. I am not sure if it is pertinent at this point, but it seems to me that the Stockfish argument, and the argument by the other very competent economists who were here, which they said represented the overwhelming view of the economics profession, is that what Government should do in determining whether to invest in a reclamation project, for example, which is something a little different from this, or for that matter in almost any other kind of investment, is the opportunity cost, which is not a 4.9-percent return, but at least a 10-percent return. And that is the average return for industry before taxes. And that seemed most logical to me. As I say, this is not a matter of conservative economics. This is a matter of the whole economics profession—Otto Eckstein, all these people—agreeing this is a fair basis. If this element comes in here, in this particular circular, it would seem to me that you might very seriously consider revising the circular on that basis, because the economic profession, as I say, is united, and their case is very logical.

Mr. HUGHES. We are sympathetic, Mr. Chairman. With respect to the general question of interest rates—you mentioned reclamation projects, public works projects in general—we know of your views on this. We think the interest rates applied in evaluating the benefits and costs of these projects are somewhat lower than desirable, in a true economic evaluation.

Chairman PROXMIRE. You have a gross misallocation of resources on the basis of—what is it now, 3¼ percent they use for reclamation projects?

Mr. HUGHES. Generally it is a coupon rate. We have a lot of bent and broken lances in working on this problem. One of the most recent ones was so-called section 7 of the Department of Transportation bill.

Chairman PROXMIRE. I was one of two Senators who voted against that bill, and that is the reason I voted against it. Of course, others did not pay attention to that particular thing. But it results in a perfectly enormous excess in Government spending that in my view just cannot be justified.

I do not want to delay you now on this.

But, I hope, if you are revising this, this can be brought up. After all, you are putting Government money to work, and when you put it to work, it would seem to me that the fair base—not only the fair basis, but the economical basis for the whole society is that you put it to work on an opportunity cost basis which would be close to 10 percent. At least this should be raised and carefully considered.

Representative RUMSFELD. If I may add to that. I think the significance of it is not only this question we are talking about, public and private—but the decision as to whether it should be done at all.

Mr. HUGHES. That is quite right. The same problem exists in the public works area.

Representative RUMSFELD. Particularly in the public works area.

Mr. HUGHES. I certainly want to make it clear that we agree with the desirability of——

Representative RUMSFELD. Getting a new lance?

Mr. HUGHES. We get new ones all the time, and break them all over again. We will be dealing with this by project. That is the way the issues are set up.

With respect to Mr. Stockfish's view, and those of the others—I think in broad economic terms there is great validity to the concept that they set forth.

They do assume a degree of fluidity with respect to interchange, Federal Government versus private, and as among Government programs, which I think is greater than in reality exists. But nonetheless, the appraisal of opportunity costs on this basis is worthwhile.

Representative RUMSFELD. What would you think about having the Congress pass a requirement that the Bureau of the Budget submit, with the budget, and with every request contained in the budget, a statement indicating what the computations are with respect to the recommendations that have been made by the witnesses before our committee. Just simply go ahead and don't make your decision on that basis if you do not want to, but print it. I would think that would be a nice discipline for the House of Representatives—of which I can speak for personally—and, I think, from my observation, the other body could use a little of that discipline.

Chairman PROXMIRE. Even more.

Mr. HUGHES. We would certainly have no objection. I think you are going to have trouble. But, we would have no objection.

Representative RUMSFELD. It sounds fairly innocuous on the face.

Mr. HUGHES. This was the section 7 problem, really. We dealt with it also in the context of so-called water compelled rates for navigation projects, in terms of getting what we regarded as economically sound cost comparison. And, there are difficult social as well as economic problems here.

Representative RUMSFELD. Spelled "political."

Mr. HUGHES. I would spell them social. I would make the point, even as a Budget Bureau representative, that sometimes we want to do things that are not economic for social reasons.

Chairman PROXMIRE. What gets me is——

Mr. HUGHES. But we ought to know what we are doing.

Chairman PROXMIRE (continuing). Everything I have seen lately indicates if we follow this rational basis, we are going to make some excellent humanitarian investments. I just read in the paper this morning the value of a college education has a return of around 14 percent, 14 to 18 percent. And the poverty programs, for example, many of them have a much greater rate of return than the reclamation projects have. Not all of them, certainly, but many of them do have. These human investments can be justified on this basis. And we are not saying that you apply that across the board relentlessly and always, and just use a computer. That would put Congress out of work, and we would not have a job. But, we are thinking of at least having this as a guide, so we know just what we are doing. And we recognize when we are using intuition or using a social preference instead of using a rational application. We are just fooling ourselves as to what we have now on reclamation projects.

Representative RUMSFELD. To point out my recommendation here is not as wild as it sounds. Mrs. Griffiths has proposed we get Bill Veeck to construct a scoreboard in the House and Senate, and possibly at the Budget Bureau to show the cost of everything, and the deficit. Every time a bill is passed, it would be rung up on a board. My proposal is a more subtle way of doing it, at least.

Mr. HUGHES. We welcome anything that the committee would wish to do to reflect more realistically the cost of money or other more realistic economic factors in appraising public works projects or considering competition with business. Other areas where these kinds of considerations are applicable.

Representative RUMSFELD. But you really do not have good cost accounting systems in the agencies referred to in the paragraph.

Mr. HUGHES. Well, I think our costs data varies somewhat, depending on the program, and depending on the agency involved. In the public works area, for instance, I think our data are relatively good. We do not always use it well. But we have, I think, relatively good basic information to work from. The problem lies in the use of those data and what standards and tests, and so on, we apply.

REAL PROPERTY MANAGEMENT

With respect to the management of the Federal Government's real property holdings, we advised the subcommittee last May that the Bureau of the Budget had issued a revised Circular A–2 which provided improved guidelines to agencies for the acquisition, utilization, and retention of real property. We believe now, as we did then, that these guidelines will aid the agencies in improving the management of Federal real property.

REPORT ON REAL PROPERTY HOLDINGS DUE JUNE 30, 1968

The revised circular provides for annual reporting beginning with fiscal year 1968, which will include data summarizing the results of

each agency's action in response to the circular. The report will be based on annual reviews required by the circular. It will indicate whether or not all properties under the custody of an agency are needed, the action which has been and is being taken to screen, report excess, or otherwise dispose of unneeded properties.

It will also indicate the number of properties returned to the public domain and properties made available to other agencies by permit. Copies of new and revised instructions or criteria developed and issued by the agency to implement Circular A–2 will also accompany the report. The Bureau of the Budget will critically review these reports and the agencies' criteria for implementation of Circular A–2.

We believe, generally speaking, that the agencies are doing an effective job in the management of their real property holdings. We as well as the agencies, however, are trying to find better ways of attaining our overall objectives of—

Effective and economic use of current property holdings in meeting program objectives;

Identification of unneeded property;

Reporting unneeded property as excess;

Disposing of surplus real property for its highest and best use; and

Limiting acquisitions to actual program requirements.

We believe the results attained during the last 5 years are significant. In the 5-year period, ending June 30, 1967, Federal agencies identified as unneeded and reported to GSA as excess, real property costing $4.4 billion. During this period, excess real property, costing $542.4 million, was transferred between agencies, thus avoiding the need to seek funds to purchase or construct new holdings for new or expanded Federal programs.

Disposals of surplus real property for the 5-year period ending June 30, 1967, amounted to $2.5 billion, in terms of acquisition cost. Of the total disposals, in terms of acquisition cost—

$1.9 billion or 74.9 percent was sold at fair market value;

$278.6 million was conveyed on favorable terms for health and educational purposes;

$187.6 million was donated for airport purposes;

$15.2 million was donated for wildlife and historic monument purposes;

$44.4 million was sold at 50 percent of current value for park and recreational purposes; and

$115.7 million was disposed of by special legislation, abandonment, destruction, and writeoff.

VALUE OF FEDERAL REAL PROPERTY STEADILY INCREASES IN DOD

Chairman PROXMIRE. In spite of all that, I am very much concerned that the amount owned by the Federal Government seems to be growing relentlessly, and very sharply.

For instance, in the DOD I note that in 1955 there was $21 billion, went to $23 billion the next, $25 billion the next, $27 billion, next, nearly $30 billion the next, $33 billion the next year, $34 billion, $35 billion, $37 billion, close to $38 billion—and, it is $38.3 billion in 1966. So that each

year this Defense Department holding increases. I wonder if we are being aggressive enough in our disposal activities.

Could you tell me—would much of this be accounted for by the rise in real property value in those 11 years, or would it be the fact that the Federal Government, in fact, is holding much more real property?

Mr. HUGHES. I believe those figures are acquisition cost figures, but I am not sure. If I am correct, then escalation in property values is not a factor, and the figures reflect increases in acreages held.

I think, as you suggested, they reflect Defense acquisitions to meet Defense needs.

Your question as to whether we are sufficiently aggressive in disposing of property—whether we are as aggressive in disposing of property as we are in acquiring it——

Chairman PROXMIRE. You have put it much better.

Mr. HUGHES (continuing). Is the basic question. And, I think, all I can answer is, that we are very aggressively attempting to both better utilize and to dispose of the property we have.

Chairman PROXMIRE. There are good budgetary reasons for disposition.

Mr. HUGHES. There certainly are. These are capital investments. We have every incentive, we in the Bureau of the Budget, and to an extent the agencies do also.

GOVERNMENT-WIDE INCREASE IN REAL PROPERTY HOLDINGS

Chairman PROXMIRE. In 1955, the overall figure was $38 billion. In 1966, it was just short of $70 billion. So that is almost—close to a doubling in a period of 11 years. Increase of 82 percent, to be precise.

So I hope we can redouble our aggressiveness in disposition.

PROGRAMS TO UTILIZE REAL PROPERTY

Mr. HUGHES. We have mentioned here some of the things that we are trying to do in addition, above and beyond the circular.

The President's Council on Recreation and National Beauty is exploring methods of meeting the country's needs for parks and recreational areas to the maximum extent possible by utilization of available, suitable surplus real property.

The Secretaries of Defense and Housing and Urban Development, the Attorney General, and the Administrator of General Services have been assigned the task of surveying unneeded Federal real property throughout the Nation to meet critical urban needs for housing.

Another group, chaired by the Secretary of Commerce, is striving to utilize unneeded Federal properties in their efforts to locate industry in or near hard-core disadvantaged communities to provide employment and training opportunities for the disadvantaged.

We are continually reviewing Federal policies and practices relating to the utilization of excess, and the disposal of, surplus real property, and believe significant results are being attained. We are not wholly satisfied with the results to date but believe a critical review of the reports prescribed by Circular A–2 coupled with action as dictated by this review will result in additional improvement in the management of Federal real property.

NEED FOR OBJECTIVE EVALUATION OF REAL PROPERTY HOLDINGS

Chairman PROXMIRE. Why wouldn't it be good to get a clear directive from Congress, or from the President, that the Budget Bureau or some objective group would apply pressure and force to the agencies to get rid of the property they do not need? It seems to me there is a perfectly natural and understandable tendency for these agencies to hold on to property—they do not want to get rid of it unless there is real pressure on them to do it. And absent this kind of declaration from the Congress or from the President, it is understandable.

I can see that once in a while you come along with some kind of a program—and I don't mean to be demeaning of the efforts you have made—but it would seem to me that an overall policy, that the Federal Government should dispose of these holdings—especially by sale—would be helpful.

Mr. HUGHES. I think policy is very clear as far as the executive branch is concerned. There are Budget Bureau issuances, besides Circular A–2, letters and so on, which make this clear.

Chairman PROXMIRE. Maybe there ought to be more of a policy on acquisitions—in other words, to slow down on the acquisition unless you can justify it.

Mr. HUGHES. The revision of Circular A–2 was intended to help.

Chairman PROXMIRE. One area we have discussed in great detail in these hearings is the Government going out and buying equipment for private contractors. This is an example of that. That would be right in here; would it not? Not real property, but it would be in addition to it—the same kind of thing.

Representative RUMSFELD. Is there any way you could force an evaluation of the extent to which a request for the power to acquire something could be coupled with a reevaluation as to what might be disposed of to compensate for it?

Mr. HUGHES. I think you will find that the provisions of Circular A–2 do that. You come back to the problems of judgment, of discrimination as between, for example, the suitability of an existing piece of property for a new purpose, and the disposability of a piece of property in offsetting a new acquisition—those kinds of tests.

I think you will find that the circular is intended and does in fact confront the agency with the kind of choices that you are suggesting should be made.

We look forward to the product of the review of property in the form of the report that we will get at the end of the fiscal year, as a tool to see how well the agencies are doing in exercising their judgment in acquisitions versus using existing property versus disposal.

PAYMENT OF TAXES AS A DISCIPLINE AND EQUITY

Chairman PROXMIRE. Congressman Curtis has suggested that one discipline that could be used to help on this, is to require these agencies to make some kind of payment, in lieu of taxes, to local and State governments that have personal property taxes, not only in terms of discipline, but, more particularly, in terms of equity to the State and local governments involved.

Mr. HUGHES. The equity argument I regard as a more meaningful one than the discipline.

There are some areas at the present time where payments, in lieu of taxes, are made—nothing very spectacular has happened there, with respect to disposal. The fact is, I think, that the payment, in lieu of taxes, tends to be built into the system in much the same fashion that some of the other things we have discussed get to be built into the system. And while first time around, there is some incentive value, as time passes, the tax becomes a part of the base. And, I think, personally, it is not particularly helpful, therefore, as a disposal incentive.

Representative RUMSFELD. Wouldn't it, however, act as a discipline—as a piece of property depreciates—I forget the name of the Army base in San Francisco.

Mr. HUGHES. Presidio.

Representative RUMSFELD. If you had a payment, in lieu of taxes, that would jar people, wouldn't it? Can anyone tell me that the work that is being done on the piece of property by the U.S. Army, could not be done at half the price someplace else?

Mr. HUGHES. I think some people will tell you that, not all of them in the executive branch, probably. The question has come up before as with the Navy's Annapolis dairy farm, where there is a similar kind of problem, similar emotions are aroused, and where we are kind of up against it.

Again, I simply point out to you that as far as the Bureau of the Budget is concerned, and to an extent as far as Defense is concerned, there are massive incentives, massive values to be achieved in disposing of some of these properties. Nonetheless, they are hard to move many times, particularly properties like the Presidio or Fort DeBussey, another difficult kind of situation. And there are many more.

Again, we undoubtedly will sally forth with a new lance from time to time. But, the going is hard in this area.

A congressional expression of intent, concern, and so on, it would seem to me, would be helpful in this area.

CONGRESSIONAL EXPRESSION OF INTENT WOULD HELP

There is substantial expression of executive branch policy on these matters, and it all leans in the direction of disposal for market value or otherwise for highest and best use of the property.

Chairman PROXMIRE. In our July 1967 report,[1] we had what, I think, is a good section on the use of real property holdings, real estate management. And, without objection, that page and a half will be printed in the record at this point. Beginning on page 29 it goes through the so-called general provisions, on page 30.

(The document referred to follows:)

III. REAL ESTATE MANAGEMENT

USE OF REAL PROPERTY HOLDINGS

Federal real property holdings worldwide have increased in value by $31.3 billion or 82 percent from fiscal 1955 to 1966. In millions of acres the increase has been 11.8, or 2 percent in that period.[68]

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[1] "Economy in Government," report of the Subcommittee on Economy in Government, July 1967.

[68] Staff materials, 1967, pp. 11–12.

The increase in cost of real property owned by the United States in the United States from fiscal 1956 to 1966 was: [59]

Land	$265,000,000
Buildings	1,160,000,000
Structures	1,111,000,000

Despite the fact that the DOD and GSA have done some notable work in disposing of real properties, accruing proceeds thereby, augmenting the tax base or placing the property to approved public use, the subcommittee is and has been of the belief that a more vigorous program of identifying and screening excess and surplus real property should be undertaken.

The subcommittee report of May 1966 recommended: [60]

Recommendation

There is a continuing need to screen the Government's real property holdings to determine if they are being put to the best and highest use from the national point of view. Since the holding agencies may not be entirely objective in the matter and have the sole authority to make the declarations of excess, it is recommended that a high level economic policy committee be assigned the task of reviewing agency real property holdings and making recommendations to the President as to their continued retention and highest use.

The strength of the recommendation lay in the idea of a high-level economic policy committee which would review agency holdings and make recommendations to the President concerning the retention of the property. This would put the spotlight on the agency heads who have the sole authority to make excess property declarations but often fail to do so.

In lieu of adopting the subcommittee's recommendation, the Budget Bureau on April 5, 1967, issued Circular No. A–2, revised,[61] to the heads of executive departments and establishments on the subject of utilization, retention, and acquisition of Federal real property.

Deputy Budget Director Hughes explained the purposes of the new circular: [62]

GENERAL PROVISIONS

Circular A–2, as now revised, requires Federal agencies to develop criteria to achieve effective and economical use of real property holdings consistent with program requirements. It also provides that agencies are to identify real property, or any separable unit thereof, as unneeded when—

It is not being used by the agency for program purposes, or

There are no approved current plans for future use of the property, or

Substantial net savings to the Government would result if properties used for essential purposes could be sold at their current market values and other suitable properties of substantially lower current values substituted for them, or

The costs of operation and maintenance are substantially higher than for other suitable properties of equal or less value which could be made available by transfer, permit, purchase, or lease.

RELATIONSHIP TO RELIANCE ON PRIVATE ENTERPRISE

In addition to the guidelines enumerated in Circular A–2, Circular A–76, on which I commented previously concerning the Government's general policy of relying on the private enterprise system, bears on the problem. Circular A–76 establishes guidance for agencies for reviewing industrial and commercial type activities which may result in real property becoming excess incident to discontinuance of such Government activities.

REPORTS OF EXCESS PROPERTY

Circular A–2 provides that all unneeded real property as defined in the Federal Property and Administrative Services Act is to be reported as excess

[59] Ibid., p. 15.
[60] Report, 1966, p. 12.
[61] Hearings, 1967, p. 234.
[62] Ibid., pp. 215, 237.

to GSA or, in the case of public domain which is no longer required for the program for which withdrawn, reported to the Bureau of Land Management, Department of the Interior, or, if covered by other statutes, disposed of as provided by applicable law.

Growth of Real Property Holdings

We share the committee's concern relative to the growth of Federal real property holdings which totaled $69.4 billion as of June 30, 1966. To assure that acquisitions are kept to an absolute minimum as to area, A-2 instructs Federal agencies to acquire only those amounts of real property necessary for effective program operation.

Control of New Procurements

Also, before an agency acquires new property the agency head must make a determination that the best economic use is being made of existing holdings and, in the first instance, attempt to fulfill the need by using property under the agency's jurisdiction. If the need cannot be met by using existing agency holdings, the possibility of utilizing other satisfactory existing Federal properties must be exhausted. Procedures are provided for notifying the General Services Administration and the Bureau of Land Management, Department of the Interior, as appropriate, to ascertain if excess, surplus, or unreserved public domain lands are available which might fill the need. When existing holdings are not available for transfer, agencies then are to consider the possibility of joint use of real property held by other agencies before action can be instituted to condemn, purchase, construct, or lease.

* * * * * * *

GSA's Responsibility and Capability Concerning Public Utility Services

Mr. Hughes. The last matter that you wish us to discuss, Mr. Chairman, was GSA's responsiblity and capability concerning public utility services.

GSA's authority and responsibility stems from section 201(a)(4) of the Federal Property and Administrative Services Act of 1949, as amended, and reads as follows:

> With respect to transportation and other public utility services for the use of executive agencies, represent such agencies in negotiations with carriers and other public utilities and in proceedings involving carriers or other public utilities before Federal and State regulatory bodies; * * *

GSA's authority is, of course, limited to representing the Federal agencies as users of utilities services. While the Government's use of utilities is substantial, GSA has taken the position in the past that its staff assigned to this work, plus its ability to utilize other professional staff to supplement the work of assigned staff, is adequate to assure effective representation of the Government as a user.

Also, I believe, Mr. Knott, the Administrator of General Services, has testified before your subcommittee this week as to cumulative savings attributable to GSA efforts as well as to savings made since the hearings last May. We also have been advised of a recent reorganization by the GSA of its Transportation and Communications Service which it believes will make for a more efficient and effective organization. With this recent reorganization in mind, we are exploring with GSA as a part of our budget review its ability to handle the workload involved in representing the Government as a consumer of utility services.

Mr. Chairman, this concludes my prepared statement.

NEED FOR LEGISLATION ON CONTRACTOR-HELD EQUIPMENT

Chairman PROXMIRE. Thank you very much. I wish for the record, Mr. Hughes, if you could provide for us the opinion of the Bureau of the Budget—it does not have to be formal or detailed—on the helpfulness or the constructive use of legislation on contractor-owned equipment—specifically, on inventory controls, including access, clear access, by——

Mr. HUGHES. You mean Government-owned in the hands of contractors?

Chairman PROXMIRE. Yes; Government-owned in the hands of contractors. Control of the total inventory of such equipment, including access to premises of the contractor—which, I understand, on some occasions have been denied—so that they can make physical check. Second, the use of records; that is, the time used for the Government work, time used for commercial work, the idle time. The practicality of having quarterly reports on such records made available, the liability of property if such property is misused, and also the possibility of in lieu provisions for local and data taxes when privately used. And, the provision for sale at reasonable prices of this property to the contractor who is using it.

Now, I would like to——

Representative RUMSFELD. I have a unanimous-consent request that the full text of the article by Mr. Gonzalez be included in the record.

Chairman PROXMIRE. Without objection, the full text of an article by Congressman Gonzalez in the *Progressive* will be printed in the hearings. (See p. 156.)

NEED FOR BETTER TOP MANAGEMENT

Mr. Hughes, for a number of years, this committee has been pointing to our economic dilemma which is also social and political; namely, that our budgets get higher, our indebtedness greater, our taxes higher, et cetera. While on the other hand, we should do much more to improve our democracy in many areas.

We have said, and still say, that much if not all that we genuinely need can be financed from what we waste.

This simply means that we must have better mangagement in the areas of our great expenditures, some of which we have been discussing here this week.

BOB VIEWS ON ANOTHER "HOOVER COMMISSION"

There is another wave of opinion that we should create another Hoover Commission. But the Congress has vested great authority in the Bureau of the Budget, the GAO, and the GSA. I believe that these hearings and those going on in the Ways and Means Committee today and many other evidences show that our top management has been deficient insofar as economy and efficiency—and effectiveness—are concerned. Will you give this some serious thought and give us your ideas in letter form. We are meeting again on December 8, 1967, this room, 10 a.m., to again hear the Comptroller General on some subjects which

time did not permit us to cover on November 27. We will be in recess until that date.

(The following was subsequently supplied:)

We do not see a need to propose additional legislation at this time. Our reasoning is that the Budget and Accounting Procedures Act of 1950, as amended, and the Federal Property and Administrative Services Act of 1949, as amended, provide specific statutory direction to agencies to develop adequate procedures and systems for the physical and financial control of Government property, regardless of where located. However, during the course of the current GAO and DOD cooperative study to tighten up existing controls over Government-owned property in contractor plants, additional legislative authority or direction might be found desirable. If that proves to be the case we will assist whenever needed in proposing such legislation for congressional consideration.

Chairman PROXMIRE. Thank you very much for an excellent job. You and your associates were very responsive and helpful.

Mr. HUGHES. Thank you, Mr. Chairman.

(Whereupon, at 12:50 p.m. the subcommittee was recessed, to reconvene at 10 a.m., Friday, December 8, 1967.)

ECONOMY IN GOVERMENT PROCUREMENT AND PROPERTY MANAGEMENT

FRIDAY, DECEMBER 8, 1967

U.S. SENATE,
SUBCOMMITTEE ON ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to call, in room S-407, the Capitol, Senator William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire and Symington; and Representative Rumsfeld.

Also present: Ray Ward, economic consultant.

Chairman PROXMIRE. The Subcommittee on Ecomony in Government of the Joint Economic Committee will come to order.

Before we hear from Mr. Staats, who has very kindly agreed to return, I want to insert in the record, with unanimous consent, a statement by Congressman Gonzalez, of Texas, who has a very deep and a very competent interest in these matters. Unfortunately, he had to be in Texas today, so he couldn't be here. His statement will be printed in full in the record. It is an excellent and thoughtful statement.

STATEMENT OF HON. HENRY B. GONZALEZ, A U.S. REPRESENTATIVE FROM THE 20TH CONGRESSIONAL DISTRICT OF TEXAS

Representative GONZALEZ. Mr. Chairman and members of the subcommittee, I consider it a high honor and a rare privilege to appear before you today. Your investigations into defense procurement practices are of the highest importance, and I wish to lend my small voice in commendation. I should add that I am very grateful to be addressing such a distiniguished body of legislators in the first committee forum accorded me relative to my interest in the activities of the Renegotiation Board and my concern about the unreasonably restricted role it now plays in returning excessive profits to the American taxpayer.

It was entirely through happenstance that I first became aware of the existence of the Renegotiation Board. This was a year and a half ago when Mr. Farris Bryant, Director of the Office of Emergency Planning appeared before the committee I serve on, Banking and Currency. Although the topic was stockpiling, I was interested in figures that prime defense contract awards were approaching a magnitude higher than the Korean war peak. I asked about possible disloca-

tions in the economy and whether special controls were being contemplated. I was not answered directly, but in the exchange the name of the Renegotiation Board was mentioned.

At the time I knew nothing about the Board. I have been pained to discover that the same is true with most of my colleagues. But the more I learned, the more hearty became my support of the Board, and the more strongly I have urged that it be strengthened. I introduced a bill, H.R. 6792, which would return the Renegotiation Board to its Korean war effectiveness. I have requested hearings on my bill. I have made 12 exhortations in the Congressional Record, covering 19 pages. I have written to the President several times. And often, I confess, I have gotten the impression that mine was a lone voice crying in the wilderness. So I am very pleased to have such a distinguished audience this morning.

I have also authored an article for the August 1967 issue of the Progressive magazine entitled "The War Profiteers." In the November 28 hearings of this subcommittee, a distinguished member, Congressman Donald Rumsfeld, questioned the Assistant Secretary of Defense for Installations and Logistics, Mr. Thomas D. Morris, about my article. Since my views in this article were injected into your hearings and my conclusions challenged, I requested the opportunity to reply. I am grateful to Chairman Proxmire for graciously scheduling my appearance. (See p. 156.)

Mr. Rumsfeld asked Mr. Morris whether my charges that war profiteering is increasing were correct. Mr. Morris replied: "I know of absolutely no evidence to support those statements."

I cannot come before this subcommittee with figures and statistics proving that the volume of war profiteering is increasing by this or that amount, any more than Mr. Morris can prove that it is not increasing. The reason for this is not complex: there is simply no comprehensive scrutiny of war profiteering. The Department of Defense certainly does not keep track—it took them 5 years to order audits of cost estimates in order to better comply with the Truth in Negotiations Act. The General Accounting Office is not interested in the profits a contractor may realize except as resulting from unreasonable cost and pricing data at the time the original contract was negotiated. And the Renegotiation Board does not have purview over enough of the defense spending. With its present list of exemptions, and with its present minimum floor, I estimate that the Renegotiation Board annually misses at least $6 billion in Government contracts and misses about 7,600 contractors. And also, while the preponderant majority of the contractors and subcontractors the Board reviews are defense related, the Board also reviews contracts with NASA, AEC, FAA, GSA, and the Maritime Administration. Therefore, its experience cannot be considered solely defense contracts.

The fact that there are such gaps in congressional or quasi-judicial scrutiny of war profiteering is precisely the matter which causes me concern.

Despite the absence of statistics, I am confident there is a clear inference that war profiteering is increasing. I do not retract one iota from my statement that "the facts make it clear that profiteering is taking place on a considerable scale" and that "there is evidence it is

on the upswing." I say this because the volume of defense contracts has risen sharply as a result of the Vietnam War. This year we are spending more in Vietnam, both in dollars and in percentage of total U.S. spending, than we did in the peak year of Korea, which was 1953. Specifically, Vietnam is costing $26 billion now, contrasted to $10 billion for Korea in 1953. I say profiteering is on the upswing because the jurisdiction of the Renegotiation Board has been cut back by Congress over the years. The successive exemptions to renegotiations allow more and more profiteering for two reasons. First, the number of contracts and the number of contractors within the Board's jurisdiction have declined. For example, in 1952 the Board reviewed the profits of 13,104 companies; but in 1966 the number of companies had dropped to 3,387, a cut of nearly 75 percent. And secondly, these exemptions increase profiteering because the deterrent effect of the Board has vanished in those exempted areas.

Like the policeman of the beat, the Board casts a long shadow. To illustrate, in 1966 the Board made determinations of $24.5 million in excessive profits, but corresponding to this figure was an additional $23.2 million in voluntary refunds by the contractors which were reported to the Board. I suspect that the effect of the Board is like an iceberg—a good deal of its weight is below the surface.

Also, despite the direct denial of Mr. Morris, I stand squarely behind my statement that the "annual reports of the Renegotiation Board reveal that profiteering is going on now, is increasing, and will continue to increase unless something more realistic is done to stop it." Mr. Morris said, "The Renegotiation Board reports of past years certainly do not bear it out."

I disagree. The Board's reports certainly do. The fact that the Board in its latest report could point to its recovery of $47.7 million in excessive profits determinations or voluntary refunds certainly does confirm my statement that war profiteering is going on now. If I might be excused in appropriating the same argument used by Mr. Morris, I would say that I know of absolutely no evidence to support the contention that war profiteering has somehow ceased.

Further, the following table of Renegotiation Board determinations of excessive profits from 1962 to 1966 certainly does confirm my statement that profiteering is increasing:

Fiscal year:	*Excessive profits*
1962	$7,840,000
1963	10,070,000
1964	24,160,000
1965	16,150,000
1966	24,510,000

And finally, the fact that the first rash of contracts awarded during the Vietnam buildup are now coming before the Board does indicate the validity of my statement that profiteering will continue to increase.

While I am on the Renegotiation Board's latest report, I might mention that the Board recovered this $47.7 million in excessive profits with a total of 178 employees. This amount of profiteering is even more amazing to me when I consider all the contractors and their contracts now exempt from renegotiation. Though not entirely fair, it is nevertheless suggestive to contrast these 178 employees of the Renegotiation Board with the 25,000 "procurement professional people" that Mr.

Morris said work for him. You might also be interested in my calculation that for every $1 spent on the renegotiation, the Board has recovered for the American taxpayer about $18 in excessive profits.

Perhaps Assistant Secretary Morris objects to my use of the term "war profiteering." I contend there is a war going on. I contend excessive profits are being made on defense contracts. I contend, therefore, that war profiteering exists. I refuse to mince words. At a time when we are engaging in the involuntary procurement of men for Vietnam through the draft—at a time when we are asking nearly half a million American troops in Vietnam to be prepared to make the ultimate sacrifice for their country—at a time when nearly 200 of our boys are dying each week, I say it is unconscionable that even one contractor should be allowed to make a killing on a defense contract.

The position of Mr. Morris on whether war profiteering exists amazes me. He tries to have his cake and eat it, too. For one thing, he said he knows of "no evidence" to support my statements there is war profiteering, and yet he admits there "may be * * * individual cases." But my credence is taxed to the utmost by his statement that "we have no valid information" of overcharging except that disclosed by Congressman Pike. "Nor," Mr. Morris states, "has GAO brought any to our attention that I am aware of."

Surely Mr. Morris is not unaware of the charges of excess profits against Colt's on the M–16? Surely Mr. Morris is not unaware of the 10 examples of questionable profits picked out by Senator Young from among "private letters" of the GAO to his Department? Surely Mr. Morris is not also unaware of the questionable practices by the companies picked at random by Congressman Charles Whalen from among the "private letters" of GAO to DOD? Surely Mr. Morris is not unaware of the 222 out of 242 contracts which the Comptroller General stated before this subcommittee lacked evidence to support the cost or pricing data submitted by contractors? Surely Mr. Morris is not unaware of the 33 out of 101 cases of overpricing that the Assistant Comptroller General spoke of before the House Subcommittee on Military Procurement?

Surely Mr. Morris is not unaware of the Comptroller General's recent report to Congress charging improper use of Government-owned industrial plant equipment? In this connection, surely Mr. Morris is not unaware of the situation described by Jack Anderson in last week's Parade magazine under the title "How Uncle Sam Is Cheated: The Multi-Billion Dollar Machinery Giveaway"?

Mr. Chairman, I would like to call attention to attachment No. 1 of my remarks, which contains a short bibliography of recent charges of what I call profiteering, as compiled by my staff. Clearly, the Defense Department and the contractors must be heard in the full on these charges. But how anyone can imply that the GAO and the Congress has not brought to light serious indictments of war profiteering is beyond my comprehension.

If not already a part of the record of this subcommittee's hearings, I would like permission to include the Parade magazine story after my remarks. It is a very revealing article, and it gives an excellent account of the efforts of Chairman Proxmire and Mrs. Griffiths of this subcommittee in behalf of the national interest.

(The article referred to begins on p. 347.)

Representative GONZALEZ. You may have noticed that the examples of defense overcharging as listed in my attached bibliography were disclosed by persons interested in procurement practices. They are important to me because they confirm my conviction that if profiteering did not exist in this war, it would be the first time in our history. But I have not brought here similar, current examples from the renegotiation process. This is due to the nature of the Renegotiation Act itself. The Board does not deal in current contract awards. It does not review contracts until several years after they are negotiated. And the renegotiation process is not constituted on a contract-by-contract basis, but lumps all renegotiable business of one firm together.

Another reason the Renegotiation Board does not make news is because the records submitted to them are held in strict confidence. This is because the records required by the Board are based on a contractor's income tax records, and are covered by the same nondisclosure laws as income tax returns. Not unless a contractor appeals an excessive profits determination to the Tax Court do the details of his case become public. And since more than 90 percent of the Board's determinations of excessive profits are agreed to by the contractor, few cases are disclosed. Those cases that do reach the Tax Court are older still.

I realize my presentation so far has not been a model of orderliness. I hope I can be excused for my interest in demonstrating that my facts on the Renegotiation Board and my charges of war profiteering were based on all the evidence I could locate. I know that the Renegotiation Board is not the first order of interest of this subcommittee, and I appreciate your patience. This is not the place to go into the whys and wherefores of my bill to strengthen the Board, although I would like to repeat that it would bring at least $6 billion more renegotiable business under the Board's scrutiny, and cover about 7,600 more defense Government contractors. However, I believe it would be of some value to this subcommittee if I briefly compared my understanding of the renegotiation process with the truth-in-negotiations procedures.

I firmly believe there is no substitute for sound, tight procurement practices in the Government. I heartily endorse the investigations by this subcommittee into defense contracts. But I suggest that there is another way to help halt war profiteering than by fully implementing the Truth-In-Negotiations Act. I wish to suggest here that the statutory renegotiation process, developed during World War II and practiced by the Renegotiation Board, is an essential complement to the audit process of truth-in-negotiations.

I am also in agreement with the opinion advanced by Adm. Hyman Rickover this year during the House appropriations hearings on DOD that "the Government cannot rely on the Renegotiation Board to insure fair prices for defense equipment. The Board is not adequate for this purpose."

"First of all," Admiral Rickover said, "under renegotiation profits are averaged over all defense work so that high profits on individual contracts tend to have only slight effect on overall profit levels." This is correct, but I will argue later that there are advantages in this overall view.

He said, "Second, much Department of Defense procurement is exempt from renegotiation." Hence the need for my bill, H.R. 6792.

He said, "But most important, the Board cannot really determine how much profit a supplier makes since, as I have said before, there are no real accounting standards which industry must follow in accounting for work under Government contracts." Here, I defer to the admiral.

My knowledge of the DOD procurement process is not extensive but I do see several difficulties in present DOD practices which the Renegotiation Board can partially compensate for.

First, it is my conviction that the procurement process is not weighted as it should be, in favor of the American taxpayer. Admiral Rickover said, "I think the Defense Department is influenced too much by people who have an industry viewpoint." An article in the National Observer for November 6, 1967, and an AP wire story which appeared about October 16, 1967, both pointed to disturbing connections between defense procurement officers and the "military-industrial complex." I do not believe the Department of Defense can be expected to adequately police its own procurement work. It took 5 years and heavy prodding from Congress before DOD this year issued regulations implementing the audit provisions of the Truth In Negotiations Act. It can be documented that the history of the Department of Defense in complying with its own regulations is not a glorious one. I believe Senator Proxmire and Congressman Minshall are correct in continuing to push for their legislation to strengthen the Truth In Negotiations Act.

The Renegotiation Board, in contrast, is independent, judicious and nonpolitical. Its only job is to police excessive profits. The Board is not arbitrary. Nine out of 10 contractors reach agreement with the Board on its excessive profits determinations, and more than one-third of every 10th contractor eventually concedes the Board's position. Apparently, the Board is so fairminded and nonpolitical that few members of this Congress have had the occasion to learn about its functions.

A second difficulty with the procurement process is that the so-called competitively bid contracts cannot always be called competitive by any stretch of the imagination. Congressman Pike uncovered several such cases. For example, the DOD had contracted to pay $312.50 apiece for a small-sized plastic adjusting knob for field generators. It turned out that the supplier was paying only $1.62 apiece for them from the manufacturer. But the irony is this: since the contract was formally advertised, it was considered competitive and DOD therefore chalked it up as a saving for the U.S. taxpayer of 25 percent on the $33,000 contract. And the Armed Services Procurement Regulations that describe contract awards as competitive when one response is received just so two or more proposals were solicited is perpetrating a definition of competition that is beyond me. The ASPR that permits purchases of $2,500 and under to be considered competitive also escapes me.

Although the Truth in Negotiations Act is not applicable to so-called competitive contracts, there is no limitation on the type of contract the Renegotiation Board can review. They review competitive contracts and negotiated contracts, whether cost-plus, firm fixed-price or incentive. I should say all types of contracts are reviewed by the

Board as long as the contractor of his contracts do not escape under one of the numerous exemptions to renegotiation.

Thirdly, the Renegotiation Board has the advantage of taking a much broader view. It has jurisdiction over all contracts of subcontractors as well as prime contractors. A contractor is subject to renegotiation if he was awarded a total of $1 million of nonexempt business within a single fiscal year with either DOD, NASA, AEC, FAA, GSA, or the Maritime Administration.

The Board customarily looks at contracts several years after they are negotiated. It looks at the finished contract or at least the first year's experience with the contract. From this vantage point, the cost estimates as originally negotiated assume a different complexion. This is important when the Government has contracted for such innovative hardware as an Apollo booster or a new weapons system. Where new ground is being broken, cost estimates cannot be precise, and honest mistakes can occur. The Renegotiation Board is in a position in this respect to correct mistaken cost and profit estimates from the procurement process.

This broad view is advantageous in other situations. Take the hypothetical case of a company with an Air Force contract against which it must charge a certain amount of overhead. But further suppose that later in the same year this company gets a Navy contract that would rightfully relieve the Air Force of some degree of overhead costs. The Renegotiation Board can take this into account.

This overall view taken by the Board is also favorable to the contractor. A contractor is allowed to have a loss or a negligible profit on one contract balanced against profits on another contract that might otherwise be considered excessive. Further, the contractor gets a 5-year carry forward on his losses for renegotiation purposes.

The contractor also benefits from the flexible criteria of the Renegotiation Act. The Board must give due weight to a contractor's efficiency, to the character of his business, to the extent of risk assumed (i.e., whether the contract is fixed fee or cost plus, etc.), to his contribution to the defense effort, to his capital employed, and to the reasonableness of costs and profits. On this latter point, the Board allows costs and profits on the basis of the tax code definitions, which are more liberal to a businessman than costs as allowed by the procurement regulations.

Undoubtedly there are legitimate gripes from businessmen on some aspects of the Renegotiation Act or the Board's activities. But the basic act has always been so well-balanced that I cannot conceive of any reputable firm complaining that renegotiation is onerous or repugnant.

To summarize, the renegotiation has a threefold value as I see it (1) It strengthens the procurement process. I can imagine an alert procurement officer saying to a contractor's representative, "Don't get cagey; you know the Renegotiation Board will look at these costs on this contract we want to award you. Let's have some realistic cost estimates." (2) The Board's very presence is responsible for a large amount of voluntary profit refunds and generally acts as a restraint upon profiteering. Only finally (3) do I point to the actual determinations and recoveries of excess profits by the Renegotiation Board.

I am very grateful for your kind attention. Thank you.

(The attachment referred to by Representative Gonzalez follows:)

What War Profiteering?—I'm Glad You Asked

1. *Excessive Profits by Colt's*

"A 10-percent profit rate was negotiated on all production contracts. The records and information made available by Colt's indicate that profits before taxes were 19.6 percent for calendar year 1965; 16.8 percent for calendar year 1966; and 13.4 percent for the first 4 months of 1967, for an average of 16.8."

Quotation from the Report of the Special Subcommittee on the M–16 rifle program of the Committee on Armed Services, October 19, 1967, p. 5342.

2. *Ten Examples of Excess Profits from "Private Letters" from GAO to DOD*

Senator Stephen Young picked ten examples from the "private letters" of the General Accounting Office calling the attention of the Defense Department to excessive profits and profiteering on defense contracts. Sen. Young gave details and the amounts of the excess profits alleged by GAO, but withheld the company names. The cases include "a giant Ohio corporation that has a record for veracity in its dealings with the Government that leaves much to be desired"—$143,681, "a Minnesota corporation, also a frequent violator"—$1.5 million, "one of the largest aircraft manufacturers"—$1.6 million, "a leading radar manufacturer"—nearly a half million dollars, "a Texas corporation"—$921,000, "a missile manufacturer"—$150,000, "an electronics company"—$108,000, "an Ohio missile supplier"—$134,000, "yet another aircraft manufacturer"—$435,000, "another well-known New York company." These are from Senator Young's remarks in the July 21, 1967 *Congressional Record*, pages S9937 to S9939.

3. *More "Private Letters from GAO on DOD being Overcharged*

Rep. Charles Whalen (R., Ohio) has also reported on several of the "private letters" from GAO to DOD. Randomly selecting from these letters, Rep. Whalen pointed to Company A which overstated its proposed costs for electrical equipment by more than $50,000. Company B won a contract for reconnaissance equipment for a price about $16,400 higher than it should have been. Company C was awarded an aircraft procurement contract at a level, GAO concluded, "about $17,500 higher than indicated by information available at the time of negotiation." Company D estimated its costs for a new weapon $700,000 higher than the situation warranted, with an overstatement of the company's fee of $88.000. Company E, providing a navigation system, made two errors resulting in an overcharge of more than $250,000, and another error of $55,000 in overcharge. Company F should have used data on its aircraft accessory contract which would have reduced the cost by $52.900. Company G overcharged for construction and operation of a storage facility, based on cost figures 42% more than the only available estimate. Rep. Whalen detailed these cases in the *Congressional Record* of August 23, 1967, pages H11049 to 11051.

4. *Excessive Profits Made by Litton Industries, Inc. on the LN–3 Navigational System of the F–104 Fighter*

"I believe that Litton has made very substantial excess profits on this system. . . . Yesterday the General Accounting Office advised me that Litton had declined to provide them with certain essential data as to their profits on these multi-million dollar procurements."

Congressional Record insert by Congressman Otis G. Pike (D–NY), September 27, 1967, H12554.

5. *Overcharges Incident to Negotiated Contract Awards*

"(1) Despite the clearly expressed intention of the Congress, and the continual urgings of this subcommittee, it is clear that insufficient use has been made of competitive bidding, particularly in our military procurement.

(2) Moreover, the overcharges to the Government incident to excessive reliance on negotiated contract awards have been accentuated by the serious lack of compliance with the so-called Truth-in-Negotiation Act. The Comptroller General of the United States had made repeated reports on the insufficient enforcement of the provisions of this act."

From the Report entitled *Economy in Government* of the Subcommittee on Economy in Government of the Joint Economic Committee, "Procurement Policies," July 1967, p. 1.

6. *Overpriced Cleveland Pneumatic Tool Co. Contracts*

"In three contracts (1963 & 1964) with the Cleveland Pneumatic Tool Co., totaling nearly $2 million, the Army allegedly was charged $239,000 more than

was justified. This civil finding was made by the U.S. General Accounting Office. . . ."

Part of an article from the *Cleveland Plain Dealer*, April 10, 1967 as included in the *Congressional Record* in the remarks by Senator Stephen Young (D-Ohio), April 20, 1967, S5622.

7. *DOD Being Sold Down the River on 222 of 242 Procurements?*

"Mr. Staats. . . . we took 242 cases of either prime or first-tier subjects.

. . . in 1965 of these awards we found that the agency officials and prime contractors had no records identifying the cost of pricing data submitted and certified. . . .

. . . of the remaining 57 of the 242 procurements examined . . . there was not a record showing the basis for the contracting officer's determination."

Testimony of the Honorable Elmer B. Staats, Comptroller General, in Hearings before the Joint Economic Committee, part 1 entitled *Economy in Government*, May 1967, pp. 62–63.

8. *GAO Reports to Congress*

"This report we sent over in draft from (sic) to the Department of Defense will come to Congress when we get their comments. It covers, I think, 101 contracts and finds overpricing in 33 of those contracts."

Extracted from the remarks of Mr. Frank H. Weitzel, Assistant Comptroller General in Hearings before a Subcommitte of the Committe on Government Operations, entitled *Defense Contract Audit Agency*, July 28, 1967, p. 20.

9. *Improper Use of Government-Owned Industrial Plant Equipment*

"During the 3 years ended December 31, 1965, the 8,000 ton press was used 78 percent of actual production time for commercial work without advance OEP approval (i.e., illegally) . . . Also this contractor had used 10 machines, costing from $29,000 to $141,000 each, 100 percent of the time for commercial work during the first 6 months of 1966 without obtaining advance OEP approval. . . . In another case, during the 9-year period ended September 1966, an ammunition facility was used about 80 percent of the time for commercial work. . . .

Report to the Congress by the Comptroller General, "Need for Improvements on Controls Over Government-Owned Property In Contractors' Plants," Nov. 24, 1967, p. 19.

10. *Multi-Billion-Dollar Giveaway*

"But no one disputes that some contractors have misused and abused the free government machinery entrusted into their care . . . One company which had gotten a whopping $55 million of free special tooling 12 years ago, couldn't locate much of the stuff when GAO inspectors came around."

Article in the *Parade* magazine of the *Washington Post* by Jack Anderson entitled "How Uncle Sam Is Cheated: The Multi-Billion-Dollar Giveaway," December 3, 1967, pages 6–7.

[From Parade magazine, the Washington Post, Dec. 3, 1967]

How Uncle Sam Is Cheated: The Multi-Billion-Dollar Giveaway

By Jack Anderson

The Pentagon is pumping billions into American industry to provide businessmen with sophisticated machinery to help them produce essential military hardware. Instead, many of the machines are also being used to produce commercial items—and big profits for the manufacturers.

No one knows the exact extent of the Great Machinery Giveaway. Neither the Pentagon nor the recipients have kept adequate records of the equipment, and a substantial number of machines can no longer be located. Other equipment, too large or too vital simply to disappear, has been diverted from defense to civilian production despite federal regulations and military needs. Still other equipment has been worn out producing commercial items, so that it can no longer be used for the purposes the government intended.

All told, machinery, facilities and materials turned over to defense contractors by the Pentagon has been valued by the Comptroller General at more than $11 billion. Pentagon officials claim this figure is far too high; some government auditors insist it is too low. But no one disputes that some contractors have

misused and abused the free government machinery entrusted into their care. Indeed, as a recent U.S. audit of 17 plants showed, this amazing charity program for big business has added up to an enormous swindle of the American taxpayers.

Ironically, the whole idea was to save the taxpayers money. Manufacturers who are given free machines for their production lines are expected to pass on the savings to the taxpayers. More often, they have passed on the dividends to their corporate stockholders.

Of course, most of the contractors working on defense items are honest. But the case of one aerospace contractor illustrates how the taxpayers are being taken. The company complained that the 4000-ton presses which it had received free to produce blades for jet engines weren't adequate to stamp out parts for the latest military engines and meet production schedules. The Pentagon obligingly delivered to the company a one-of-a-kind 8000-ton press. Three years later, investigators learned that the military jet blades were primarily being stamped out on the smaller presses, while the 8000-ton press was being used to service commercial contracts 78 percent of the time.

An ammunition contractor used government equipment worth $4.2 million to produce military rockets only 20 percent of the time between 1957 and 1966. During the same period, he made $24 million worth of commercial orders on the machinery. When the Navy ordered the plant to begin producing rockets for Vietnam, the contractor wailed that he couldn't meet the production schedule. Investigators detected no noticeable cutback in commercial production, but the contractor insisted that the machinery could no longer meet the tolerances needed for rocket work. Apparently, the commercial work had worn out the government machines, although there was no way for the government to prove it. Instead, the taxpayers had to pay for more equipment to produce the rockets.

Federal regulations demand that contractors get permission to use government equipment for non-defense work and that they pay rent for the time it turns out civilian production. If the commercial use exceeds 25 percent, special authority has to come from the President's Office of Emergency Planning.

These rules are seldom enforced, however, and manufacturers often laugh at them. During one eight-year period, an aircraft company used government equipment to produce $500 million worth of airplane engines for commercial customers without paying a dime of rent to the U.S. Treasury. Even after a U.S. estimate that $5 million in rent was due, the money was never collected. It is a story that is repeated every day by other defense contractors.

In several instances, government equipment and machinery was used for commercial production as much as 97 percent of the time. One company had ten machines costing up to $141,000 which were used full time for commercial production in the first half of 1966.

Despite its celebrated computer systems for cost accounting, the Pentagon has confessed that it cannot completely keep track of all the equipment it has distributed to manufacturers out of the taxpayers' great grabbag. Astonishingly, the Pentagon has left it up to the contractors to inventory all this machinery and to log the hours it is used on commercial production. This is equivalent to putting the geese in charge of the corn.

The General Accounting Office—an investigative arm of Congress—disclosed a number of inventory abuses during a routine spot check in the Dallas area. One plant, which had been given $21.8 million worth of special equipment, couldn't explain satisfactorily what had happened to it. At another plant, 5000 special items were missing. At a third, "special use" tools supplied by the Pentagon were intermingled with commercial equipment. The Defense Department's own records were found to be so botched that in four Dallas plants the probers located 88 government-owned machines which weren't even listed among the Pentagon's possessions.

One company which had gotten a whopping $55 million of free special tooling 12 years ago, couldn't locate much of the stuff when GAO inspectors came around. A company spokesman said it would take 20 men one full year to make such an inventory. It should be mentioned at this point that contractors are not required to report on or keep records of special tooling and special test equipment. Thus it is no surprise that the Pentagon was unable to tell PARADE how much of this stuff it had given away, or where it was.

The discoveries in Texas can be multiplied by hundreds of defense plants across the country. The Pentagon simply doesn't know how much machinery it owns nor where all of the stuff is located. "We're not talking about little sausage

grinder machines," one investigator told PARADE. "A lot of this equipment costs many thousands, even millions of dollars. Defense not only has no idea where all of it is but doesn't know how extensively it's being used by private corporations for their own commercial purposes."

Members of Congress who have become aware of the situation are horrified by the waste and inefficiency. "It's all a monstrous disgrace," Rep. Martha W. Griffiths (D., Mich.) told PARADE. "The contractors, in my opinion, are stealing, they're cheating. They do this because they see that nobody in the Pentagon cares about it. The Pentagon doesn't want to be bothered."

Mrs. Griffiths speaks with authority. Before her election to Congress, she spent nearly five years as an Army purchasing agent. "No one knows better than I how stupid these military people can be," she said. "This whole area of defense procurement and lack of controls over government-owned property is a mess. It's a real gyp not only to the taxpayers but to legitimate business. How can you possibly compete when your competitor gets his equipment absolutely free from the government?"

The great machinery giveaway began during World War I to speed production of war materials and to aid manufacturers who otherwise would have been stuck with specialized tools having no peactime use. This subsidy to contractors steadily gained momentum and, in 1956, the Pentagon began replacing the equipment that had grown old and tired through civilian use.

As the use of government machinery spread to 3500 of the nation's plants, the abuses multiplied. Manufacturers bid for military contracts even when they didn't have the necessary machinery, confident that they could easily obtain the machinery from the government, according to Rep. Griffiths.

Other manufacturers hoarded special tools long after their military contracts had run out. Government auditors found "many instances" of plant equipment that should have been given back to Uncle Sam being diverted from military to civilian production. All too often, the government was obliged to duplicate these expensive tools and machines for other manufacturers.

An analysis of the utilization of $15.9 million worth of government equipment, scattered among several manufacturers, revealed that most of it had been used exclusively for commercial production or at least hadn't been used for defense work for a long while. Not one of the 328 items involved, however, was reported to the Pentagon as no longer needed. Yet 81 of them were urgently needed at other defense plants.

One Midwestern radio manufacturer, given special tools to produce Army radios, kept the machinery going to meet its commercial commitments after its defense contract had expired. The government had to pay its new contractor an extra $418,000 to speed production on the needed radios. Another contractor, with a small production order from the military, wangled 30 special machines from the government and spread the work out so he could swear that he had used them all. The total machine use, however, was 40 hours a month. The work could have been done by one machine in one week.

Other contractors have wheedled multipurpose tools, good for commercial production, out of Uncle Sam by claiming they were specialized tools. In one plant alone, government auditors listed $36 million worth of multipurpose tools that had been classified by the contractor as non-reportable "special tooling".

Use of government machines is controlled by regulations, not law, and the government's only recourse is through negotiations and civil lawsuits, not prosecutions. Armed with this immunity, the Pentagon's indifference and their own skill at juggling records, manufacturers are free to do almost anything they wish with the billions of dollars worth of machinery owned by the taxpayers. Even the General Accounting Office, which can find the hidden figures in most bookkeeping, was confused by one contractor's ability to mask his activities. The contractor had $8,858,833 worth of taxpayer-paid machinery. "This manufacturer's volume of commercial business was significant," grumped the GAO auditor who checked the books, but the "lack of detailed utilization records and basic agreement documents," he confessed, made it impossible for him to determine "whether equitable rental fees were being paid." The message between the lines was that this manufacturer likely was doing a lot of "moonlighting" with government equipment.

Checks by government investigators are infrequent in the plants, and contractors confidently play the loopholes. As long as they are keeping the records, they realize that they can be compelled to pay rental on the machines only for

those days when government inspectors actually see the machines turning out commercial products.

"It's not really true that these tools, machines, presses and other equipment are useful only in making what the government orders," said Congresswoman Griffiths. "In the first place things like aircraft and electronic items are often identical to commercially used products. And much of the equipment the government hands out free is sophisticated enough to turn out all kinds of commercial items. There are exceptions, and I say the government should only supply equipment absolutely incapable of producing anything but government-needed items."

Sen. William Proxmire (D., Wis.), who has also interested himself in the great machinery giveaway, has summed up his feelings. "I cannot come to any other conclusion," he said angrily, "except that it seems incredibly sloppy, a clear dereliction of duty in the management of inventory, a cost to the taxpayers of hundreds of millions of dollars, maybe even billions and billions of dollars."

The Department of Defense, on the defensive against GAO and Congressional charges of inadequate control and management of "government-owned property in the hands of contractors," is forming "implementation teams" to ride herd on this vast supply of equipment and machinery. Improved auditing, mechanized record keeping, and improving the caliber of government inspectors are also in the mill.

But perhaps the question should also be raised, as some officials in government already have, as to whether the government should even be in the business of supplying billions of dollars of free equipment, machinery, material, buildings, real estate and even whole plants to industry. There is also the question of whether Uncle Sam should rent out equipment paid for by taxpayers, for commercial production sidelines by manufacturers already making a no-risk profit on government defense work.

At a time when President Johnson is demanding higher taxes to pay for the Vietnam war, he might also insist on greater care with the money the taxpayers have already shelled out.

This story of a multi-billion-dollar boondoggle—the Pentagon's blatant waste of machinery and the enormous profits industry reaps from this waste—is the result of weeks of dogged digging into the facts. Mountains of documents were examined, charts and tables scrutinized. When it came time to interview the responsible officials, however, they ran for cover. Even some members of Congress, while admitting that the situation was "bad," didn't want to discuss it. One acknowledged that some of the companies involved were located in his state and they were "quite good to me."

Pentagon officials ducked calls and, when cornered, said they couldn't talk without clearance. The clearances never came. One official admitted to Parade: "The individual from whom the information should be forthcoming was frankly hoping that you would go away. Now that he's convinced you won't go away, I'm hoping for an answer within the next 36 hours."

When it did come, the answer was an evasion of the facts, cloaked in "credibility gap" semantics. "The Defense Department has no knowledge," said the spokesman blandly, reading from a prepared statement, "of any illegal use of government industrial plant equipment by contractors. For that matter, the General Accounting Office has made no report that indicates such a problem exists. Period. End of statement."

In the broadest sense, the spokesman was telling the truth. The misuse of government machinery, though against regulations, strictly speaking is not "illegal" but merely "unauthorized." When challenged, however, the spokesman smiled weakly and responded: "Well, they didn't really believe you'd buy it."

On the question of the legalities, Rep. Martha W. Griffiths (D., Mich.) told Parade: "Whether or not this is illegal is within the control of the Defense Department, and if they haven't made it illegal, then in fact the Pentagon is teaming up with contractors to fleece the American public."

Chairman PROXMIRE. Mr. Staats, we are delighted to have you here again. We feel that your rebuttal testimony to the testimony of the Defense Department, GSA, the Budget Bureau and others who have appeared can be very, very helpful to us.

Maybe rebuttal isn't exactly the right word, but your comments on their observations will be very helpful because some of these things are in conflict.

I feel that you will enable us to go into more critical detail on some of the serious errors which I feel, and some of the rest of us feel, the Defense Department and others may have made in their procurement and inventory management policies.

STATEMENT OF ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES; ACCOMPANIED BY FRANK H. WEITZEL, ASSISTANT COMPTROLLER OF THE UNITED STATES; CHARLES M. BAILEY, DEPUTY DIRECTOR, DEFENSE DIVISION; J. EDWARD WELCH, DEPUTY GENERAL COUNSEL; STEPHEN P. HAYCOCK, ASSISTANT GENERAL COUNSEL; JEROLD K. FASICK, ASSOCIATE DIRECTOR, DEFENSE DIVISION; JAMES H. HAMMOND, ASSOCIATE DIRECTOR, DEFENSE DIVISION; AND CHARLES KIRBY, ASSOCIATE DIRECTOR, DEFENSE DIVISION

Mr. STAATS. Thank you very much, Mr. Chairman.

As you have indicated, we are appearing here again today to comment on and to follow up on some of the points which were raised both in our testimony and in the testimony of the other agencies on the general subject of Government procurement and supply management.

My statement today will cover three areas: Inventory management, agency audit rights and recovery from subcontractors, and, third, the Government property in possession of Defense contractors.

We are also prepared, Mr. Chairman, to respond to other questions which we know you have in mind, which are not included in our formal statement.

But I hope we will be able to add to the record on several points about which, we have been informally advised, the committee has an interest in our views.

INVENTORY MANAGEMENT

Turning first to the subject of inventory management:

The primary objective of inventory management in the military departments is to provide adequate material support to their organizations and to avoid the accumulation of excesses. If this objective is to be attained, no more money should be invested in inventories than is necessary for effective support.

Therefore, accurate and current records of quantities of specific items in the inventory must be available for use in determining whether user requisitions can be satisfied and whether, on the basis of requirements computations, procurement actions are necessary. This entails controlling and accounting for the massive volume of transactions which daily affect the status of the over 4 million items in the inventory.

As a part of inventory control and accounting, the Department of Defense has directed that all items held in stock be physically inventoried not less than once each year either by full count or by statistical sampling techniques; however, exceptions are permitted for slow-moving items and other items, provided that storage con-

ditions and lack of movement insure adequate physical protection and accuracy of records.

Also, the Department of Defense has directed that inventory records and reports be reconciled promptly on the basis of physical inventories.

Each of the three military departments and the Defense Supply Agency has published policies and procedures which implement the Department of Defense policy. In addition, the procedures of the military departments provide for special physical inventories which are one-time unscheduled physical counts of one or more line items (1) when the stock record shows a balance on hand but the warehouse indicates no stock physically available to fill a request for the material, (2) to correct a suspected discrepancy between the recorded stock record balance and the assets on hand, and (3) on request from the inventory manager or another appropriate official.

These special inventories are recognized by all the supply components of the Department of Defense to be emergency measures which are not meant to substitute for the scheduled physical inventory program.

Chairman PROXMIRE. Is there any substantial difference in the actual procedures which they purportedly follow? I know there are sharp differences you have highlighted in your analysis of the way they actually handle these things. But in the orders they provide, are there substantial differences between the Army, Navy, and Air Force?

Mr. STAATS. I believe this comes out a little bit further, Mr. Chairman; if not fully, we will amplify it.

Chairman PROXMIRE. Please proceed.

Mr. STAATS. Last May, before this subcommittee, we expressed some concern over the need for substantial improvements in inventory control within the Department of Defense. The inaccuracy of inventory records, and the consequent adverse effect on the efficiency and economy of inventory management within the Department of Defense has been the subject in the past of a number of reports by the General Accounting Office.

EFFECTIVENESS DEPENDENT UPON ACCURATE RECORDS

Chairman PROXMIRE. Isn't it true it is not only a matter of efficiency and economy but also a matter of having the records accurate and available so that you can give the maximum kind of support to the troops in the field, in Vietnam?

Mr. STAATS. This is probably under the present circumstances, a more important consideration than the dollar costs involved.

Chairman PROXMIRE. And you cannot do that with full efficiency unless you have an accurate and up-to-date inventory.

Mr. STAATS. That is correct.

TWELVE REPORTS ISSUED BY GAO ON INVENTORY CONTROL

We have done quite a number of reports on this subject. I believe, if I am not mistaken, there are around 12 fairly major reports in this area in the time since 1962. I believe they have all contributed to the objectives which you have indicated.

The internal audit organizations within each of the military services have also consistently pointed out a number of serious defects in this area. The problem area continues to be one which, in our opinion, needs considerable attention.

DOD HAS $37 BILLION STORES INVENTORY

Inventories in the Department of Defense are valued at about $37 billion, excluding aircraft, ships, and supplies and equipment in the hands of using units.

Chairman PROXMIRE. Do you have any overall figures including these aircraft and ships and so on?

Mr. STAATS. I do not have. We would be glad to see if that is available. If so, we will be glad to put it into the record.

SUMMARY OF DOLLAR VALUE OF WEAPONS AND OTHER MILITARY EQUIPMENT AND SUPPLY SYSTEMS INVENTORIES IN THE DEPARTMENT OF DEFENSE AS OF JUNE 30, 1964-66

[In billions of dollars]

	Army	Navy	Air Force	OSD and other Defense agencies	Total
June 30, 1964:					
Weapons and other military equipment in use	9.2	38.2	33.6	0.03	81.0
Supply system inventories	10.5	11.6	10.8	2.2	35.1
Total	19.7	49.8	44.4	2.2	116.1
June 30, 1965:					
Weapons and other military equipment in use	9.4	41.2	34.3	.03	84.9
Supply system inventories	11.2	12.8	11.0	2.0	37.0
Total	20.6	54.0	45.3	2.0	121.9
June 30, 1966:					
Weapons and other military equipment in use	9.6	42.9	35.1	----------	87.6
Supply system inventories	11.9	12.7	11.0	2.0	37.6
Total	21.5	55.6	46.1	2.0	125.2

Source: Real and personal property of the Department of Defense as of June 30, 1964, 1965, and 1966. Figures for 1967 not available as of Dec. 12, 1967. Totals have been rounded to nearest $100,000,000.

Representative RUMSFELD. As of what date is that?

Do you have comparative figures on inventory evaluation?

Mr. STAATS. This is a 1966 figure, Congressman Rumsfeld. I am sure we can give you comparative data. You are thinking, I assume, in terms of the buildup, what has happened, as to whether this is approximately level.

Representative RUMSFELD. We are talking about a problem which comparative figures for 1965, 1966, and 1967 would be useful in evaluating.

Mr. STAATS. We will be glad to provide that.

(NOTE.—See app. 14, p. 624, for fiscal 1967 date subsequently provided the subcommittee.)

On November 14th of this year, we issued a report to the Congress on the results of our review of inventory controls over that portion of this inventory which is held in depots in the United States. These inventories totaled $10.4 billion in spare parts, components, and supplies, exclusive of ammunition and vehicles. (See text of report in app. 5, p. 513.)

We found in our review that significant differences existed between stock record balances and the actual quantities of items in depot inventories throughout the supply systems. This was evidenced by frequent and voluminous adjustments being made to the stock records by the services. We found that the inventory records were adjusted up or down, that is, gross adjustment, an average of $2.4 billion annually in fiscal years 1965 and 1966.

Factors which we feel contributed to the significant amount of inventory adjustments were (1) inaccurate stock locator cards; (2) physical inventories frequently made without proper control of documentation for receipts and issues occurring during the period of the inventory; (3) lack of proper reconciliations between the physical inventory counts and the stock records at the completion of these inventories and determinations as to the causes of the imbalances; and (4) failure of supply personnel to follow inventory control procedures.

Following are examples of some of the conditions noted in our review and included in our report. A draft of this report was submitted to the Department of Defense for comments prior to its issuance to the Congress. These examples, we believe, demonstrate the extent and significance of inventory control problems and the impact that loss of inventory control has on the functioning of the military supply systems.

Significant differences between stock records and actual inventories:

One. The Navy Supply Center, Norfolk, had an average inventory of $442 million. Approximately 61 percent of the records for the 239,000 items physically inventoried during fiscal year 1965 and 1966 contained significant errors requiring gross inventory adjustments totaling $33 million.

Chairman PROXMIRE. Does this mean they are off by 8 or 9 percent?

Mr. STAATS. That is right. As to the dollar relationship to the total inventory, but it would be somewhat higher with respect to the value of the items actually inventoried.

Two. As a result of special physical inventories taken in fiscal year 1966, the Oklahoma City air materiel area found it had over $37 million worth of assets in store which were not reflected on either the stock records or the locator records.

Chairman PROXMIRE. Are these typical or how were they selected?

Mr. STAATS. These were selected on the basis of the different kinds of situations, Mr. Chairman. I think that was it, and to go into different services.

Chairman PROXMIRE. It wasn't because there was a complaint, that you thought perhaps this was a bad situation that ought to be investigated?

Mr. STAATS. No; I don't believe there was any background of that kind that was involved here. I think it was more an effort to try to get into different kinds of situations.

Chairman PROXMIRE. So there is no reason to suspect that this was atypical.

Mr. BAILEY. No. We tried to take representative areas, in each one of the services, depots or air materiel areas, where we felt we could get an indication of what the situation was with respect to inventory.

Representative RUMSFELD. Just so that I will understand exactly what No. 2 means, the Oklahoma City air materiel area has what volume that we are comparing the $37 million against?

Mr. BAILEY. About $600 million, I believe, would be a ballpark figure of their inventories, their assets.

Representative RUMSFELD. And this is part of the Air Force?

Mr. BAILEY. It is part of the Air Force.

Representative RUMSFELD. How many such air materiel areas are there?

Mr. BAILEY. There are six materiel areas.

Representative RUMSFELD. So this is one of the six?

Mr. BAILEY. Five; I beg your pardon.

Representative RUMSFELD. So this is one of the five, and we are talking about $37 million out of $600 million, which was not reflected on either stock records or locator records?

Mr. BAILEY. That is correct, sir.

Representative RUMSFELD. Thank you.

Mr. FASICK. May I clarify that a little bit?

This $37 million doesn't represent a wall-to-wall inventory as such. This just represents those adjustments they made as a result of special inventories they took during this period of time.

Chairman PROXMIRE. Do you have any notion of how big an inventory they took? What is a fair comparison? Did they take half of it?

Mr. FASICK. The Air Force does take complete inventories in addition to special inventories. A great bulk of the complete, or regular inventories are inventories taken on the basis of statistical sampling. Sensitive or high-valued items are supposed to be completely inventoried once a year, and the lower valued items are sampled. In that sense, you don't have a complete wall-to-wall depot inventory.

Chairman PROXMIRE. You say it is not complete. There was not an inventory, apparently, of the full $600 million of equipment; is that what you are saying?

Mr. FASICK. That is right.

Chairman PROXMIRE. What would the $37 million be compared with? It is in comparison to how much inventory?

Mr. FASICK. That would be very difficult, sir, to relate to another figure.

Chaiman PROXMIRE. It would be difficult for us to analyze its significance. If there was only an analysis of $100 million worth, this is a fantastic overage. If it is $600 million, it is bad but not quite as bad.

Mr. BAILEY. These were special physical inventories taken under the conditions mentioned earlier in Mr. Staats' statement. That is, when a stock record shows a balance on hand but the warehouse indicates they have no stock available to fill that item, or to correct a suspected discrepancy between the stock record and the assets on hand, or on request from an inventory manager or other official. In other words, these were special physical inventories.

Representative RUMSFELD. But the figure you would compare it against would be something between $37 and $600 million, and you would have to further define it down by saying that it was things that were keyed as special items to be looked at or special areas. These were problem areas.

Mr. STAATS. In either of these three circumstances which we have indicated, in order to be able to give you direct dollar comparisons, we would have to go back and price out those particular items.

But I think the overall point that we are making is that the system, itself, was not adequate to produce the kind of information which was needed under these particular circumstances.

Chairman PROXMIRE. That is right. You see, it is difficult for us to assess this. If you could, as you go along, and I know it is hard to do it, and don't do it unless you feel it is responsible and proper to do it, but when you indicate an error if you could put in perspective by indicating what would be a standard, either in private business or in Government, it would be helpful.

Mr. STAATS. That is quite right. It is something we need to do more of in all of our reporting and we will be doing more of it. You do need this kind of information to put it in perspective. I don't know whether we could give you an approximation as to what the $37 million represented out of the $600 million, but we will check to see if there is any way we can give you that kind of an estimate.

Senator SYMINGTON. May I ask a question, please?

Chairman PROXMIRE. Senator Symington.

Senator SYMINGTON. Mr. Comptroller General, I am sorry I was late. I have read your statement in part. In looking at item 1 on that page, 61 percent looks pretty high. That is an error in operation and not an error in system, is it not? I don't know how they do an inventory there. I don't know whether it is on a bin basis, bin maximum, whether it is an annual point of replenishment basis, past experience, or what it is. But if you are 61 percent off, that is simply poor operation, is it not?

Mr. STAATS. It would be 61 percent of the items inventoried on which the errors totaled out to the $33 million.

Senator SYMINGTON. Wouldn't that simply be improper handling?

Mr. STAATS. I think that would be correct.

Senator SYMINGTON. So that, in itself, wouldn't be a criticism of the system would it?

Mr. STAATS. We tried to identify the source of the error on the previous page. There were four different things involved in these errors, inaccurate stock locator records, physical inventories made without proper control of documentation and receipts, lack of proper reconciliation, and failure of supply personnel.

Senator SYMINGTON. I read those four, but I would think that in any business you would have the same problem, if you didn't have it operated properly. Having read those four, that was my point about the top of page 5. There doesn't seem to be anything wrong with the system, but as I read to this point, it seems to be the way the system is operating.

Mr. STAATS. I think this will be one of the things the Defense Department will be looking at, how much of this is the fault of the system and how much is the fault of the way it is being operated.

I might add here, as I think it is pertinent, we were advised informally as of yesterday that the Defense Department is going to set up a high-level task force to go into this whole problem of the inventory control and inventory management.

One of the purposes, I am sure, is to deal with the question of how much improvement they need in the system, and how much of it involves faulty administration of the present system.

Senator SYMINGTON. Thank you, Mr. Chairman.

ERRORS IN STOCK LOCATOR RECORDS

Mr. STAATS. The second category is "errors in stock locator records."

First. A systemwide error rate of about 13 percent was found to exist in Navy stock locator records as a result of location audits performed at 23 Navy stock points during fiscal years 1965 and 1966. The location audits revealed that 778,000 of the 6 million audited stock locations were discrepant. The discrepancies included (1) materiel in storage but not shown on stock locator records; and (2) actual storage location did not agree with recorded storage location.

Chairman PROXMIRE. How does this affect operations?

Mr. BAILEY. For example, you cut a materiel release order for a warehouse to deliver certain items to fill a user's requisition. You go out and look for that item in the warehouse and it isn't where it is stated to be. You don't fill that requisition until you either find the materiel where it happens to be or acquire some more materiel to fill the requisition. You simply can't find it.

Chairman PROXMIRE. Thank you.

Mr. STAATS. Second. An analysis of 3,475 materiel release denials processed by the Sharpe and Red River Army Depots during a 3-month period ending September 1966 disclosed that 1,232 or about 35 percent, of the denials were caused by a mislocation of stored stocks.

Chairman PROXMIRE. At this point, that means the stock was there but not so recorded.

Mr. STAATS. That is right.

Chairman PROXMIRE. How much work, cost, and delay was occasioned by this? This happened in 1965–66. I assume it was rectified. Have you had a chance to follow up to see if it was rectified?

Mr. STAATS. Mr. Fasick tells me that in cases of these situations they would take special inventories to try to correct it. These were all examples which were developed in the course of our reports and we gave them to the Defense Department for comment.

I do believe that the Defense Department has, in all of these cases where we have called it to their attention, taken corrective action. But what we were concerned with was the broader problem of whether the system as a whole was functioning in the way in which it should.

Mr. BAILEY. Mr. Chairman, it might be appropriate at this point to point out that if you don't find the item where it is supposed to be in the warehouse, you have to go looking for it. Consequently, there is an expenditure of time by the people that are involved; there is a delay in filling the customers' requests for the item, and these are expensive propositions when you have to go out on an individual line item basis and take an inventory and try to locate materiel that should be at a particular location.

Senator SYMINGTON. You either do that or you buy equipment on the basis that you haven't got it, don't you?

Mr. BAILEY. Yes, sir.

Senator SYMINGTON. If you had a warehouse superintendent in private business like that, you would give him his pay as he left that night, but in Government he has a rather entrenched position, does he not?

Mr. STAATS. You don't have the flexibility that you have in private industry, Senator Symington. Part of the difficulty, I believe, that we would identify all through this is the rotation of personnel and the turnover of personnel has undoubtedly contributed very substantially to the problem.

Chairman PROXMIRE. How about the training of personnel?

Mr. STAATS. This is another area that we think needs more attention.

Mr. WEITZEL. In addition to the fact mentioned by Mr. Staats, we have to give consideration to the deficiencies in the system, itself.

At these two Army depots that were mentioned, Sharpe and Red River, we felt that adequate controls didn't exist to provide reasonable assurance that assigned warehouse locations for storage of incoming material receipts were being recorded in the computerized locator records and that incoming stocks were being stored in designated warehouse locations.

The stock locator division was responsible for assigning warehouse storage locations. The data processing division was responsible for input of assigned stock locations into the computerized locator record, and the storage division was responsible for the storage of the stocks.

There wasn't any central control, so far as we could find, over the interrelated functions of these divisions to provide assurance that the materials were being stored in the designated locations and that the storage locations were being entered in the computerized locator records.

So it wouldn't be sufficient to follow up just on these particular 3,745 release denials and find out what happened. There would be further work to be done to devise some coordination or some control to imprve the system.

Representative RUMSFELD. In any of these instances has any individual who has been responsible been relieved.

Mr. STAATS. I could not answer that.

Mr. BAILEY. Not to our knowledge. I wouldn't be able to answer that.

Mr. STAATS. We can check.

Chairman PROXMIRE. Would you check that for us and let us know what has been done?

Mr. STAATS. Yes.

INFORMAL REPLY BY MR. PAUL H. RILEY, DEPUTY ASSISTANT SECRETARY OF DEFENSE (SUPPLY AND SERVICES)

In response to the subcommittee's question, we requested the Department of Defense to determine whether any individuals responsible for errors in the inventories of the military departments and the Defense Supply Agency had been relieved of their duties. Officials of the Department of Defense indicated to us that differences between the inventory records and physical quantities on hand generally result from an accumulation of errors in a number of transactions over varying time periods. When these differences are disclosed through the taking of physical inventory, because of the volume of transactions processed and the complexity of the data processing systems, it is impracticable to attempt to reconstruct a historical record that would identify the different individuals who had participated to some extent in the total processing of the transactions that contributed to the error.

Officials of the Department of Defense, the military departments and the Defense Supply Agency recognize the desirability of identifying the responsibilities of organizational elements and personnel with the functions performed. They also recognize the importance to measuring the effectiveness and efficiency with which these responsibilities are carried out. However, accumulating data by individual on the tremendous volume of transactions handled has not been considered to be practicable in the past.

Mr. STAATS. We found that the Navy Supply Centers, Norfolk and Oakland, did not have effective controls over receipts to insure that materiel was properly stored and entered on the records within the prescribed 5-day period.

At Norfolk, we tested the receipt processing time required for 54 receipts of materiel which were logged in at a central receiving warehouse during the period February 1966 to July 1966. We found that the processing time required for 38, or 70 percent, of these receipts ranged from 6 to 72 days. We also found that three materiel receipts, valued at about $34,000, had been in storage for varying periods up to 200 days but had not been entered on the records.

EXCESSIVELY LARGE NUMBER OF SPECIAL INVENTORIES

As a result of the extensive differences between stock records and actual inventories, DOD supply activities resort to a large number of special inventories to resolve the differences and to locate missing stocks. For example:

One. The data furnished to us by the Army Materiel Command indicate that its depots, which are responsible for 514,000 line items of depot stocks, conducted over 900,000 special inventories between January 1965 and June 1966.

Chairman PROXMIRE. Just that figure seems shocking.

What does this really mean? Is this prima facie evidence of something being wrong?

Mr. STAATS. We think so.

Chairman PROXMIRE. How can we assess this? What does a special inventory mean? Do they do this when they find there is a discrepancy, then they go and do a special inventory?

Mr. STAATS. That is correct.

Mr. BAILEY. This goes back to those same three factors that I mentioned earlier in connection with special inventories. They either couldn't find the stock when they went to look for it, they felt that there was some discrepancy that they wanted to resolve, or an inventory manager had asked for a special inventory to see what the actual situation was with respect to the item.

Chairman PROXMIRE. Is there anything in the history of this with regard to time that we can compare it with? Is this a big increase over what happened before or is it less? Is there any way of knowing?

Mr. STAATS. We don't have figures.

These refer to a summary of special inventories conducted over an 18-month period. The result indicates that the problem is there.

Chairman PROXMIRE. Does it indicate the problem is growing?

Mr. STAATS. I could not answer that question, whether it is worse or better.

Chairman PROXMIRE. Can any of your staff answer that question?

Mr. FASICK. I think it has grown in the last couple of years, primarily because of the workload placed by the Vietnam buildup. So the

problem I think is more acute in the last couple of years than it was before, although it has always been serious.

Senator SYMINGTON. Mr. Chairman?

Chairman PROXMIRE. Senator Symington.

Senator SYMINGTON. Based upon what Mr. Weitzel said, Mr. Comptroller General, does this mean that they had to search for the 92 items five times in 30 days?

Mr. BAILEY. Yes, sir; this is correct.

Senator SYMINGTON. What happens when that is done? He goes out and says, "I haven't got it," and they say, "Go back and look again," or does he say he does have it and they find out later he is wrong?

What is the chronological procedure of looking five times for one piece in a 30-day period? How can that happen? I just don't understand the way it works.

Mr. STAATS. The sequence of it?

Senator SYMINGTON. Yes.

Mr. BAILEY. Again, if they receive five requisitions for a particular item and went out and counted it and didn't make appropriate adjustments in the inventory records, the next time they receive a requisition they may have to go back and count again in order to find the materiel, or if the location is changed, something of this kind, and it doesn't get into the records with an appropriate indication——

Senator SYMINGTON. I don't want to belabor this, but if you were in private business the man in the shop would try to correct it himself. He wouldn't just say, "It isn't right. Let's go have lunch."

Isn't there some way?

It is hard to visualize missing the same piece five times in that period of time.

Mr. WEITZEL. They have told us for one thing they are trying to develop new overall systems, for another thing concentration of manpower on trying to fill the orders for the buildup in Vietnam has prevented proper attention in some cases to these errors.

It may result simply in their feeling that they can't depend on their inventory records so every time they get a requisition for the item they go out into the warehouse and start looking.

Senator SYMINGTON. That would seem to be the logical answer.

Chairman PROXMIRE. What they need is a dependable system and then they wouldn't have to conduct these special inventories. As long as they don't have it. they have to do it over and over again.

Mr. WEITZEL. It should greatly minimize the necessity for special inventories if regular inventories can be taken at regular times.

Chairman PROXMIRE. This must also be very wasteful in terms of personnel. Special inventories take time.

Mr. WEITZEL. In the long run, it can take more time, as Mr. Staats testified.

In these 900,000 special inventory cases, as an average every item was counted 1.7 times during the 18-month period.

Senator SYMINGTON. I jumped the gun on you a little bit. I read No. 3 on page 7. I believe that is the worst thing I have seen. They ought to give a prize to the fellow who missed the most.

Mr. STAATS. I think the general point Mr. Weitzel was referring to comes out a little bit more in the text.

From this it appeared that in addition to regularly scheduled physical inventories, it was necessary to count each item an average of 1.7 times during the 18-month period. However, some items were counted many times. For example, one depot conducted, within a 30-day period, five or more special inventories for each of 92 items.

Two. For fiscal year 1966, the Air Force Logistics Command indicated that its five active air material areas (AMA) had conducted special inventories of 277,254 line items. This number of special inventories are equal to about 30 percent of the total items in their inventories.

Three. At the two Navy supply centers included in our review, we found that, in fiscal years 1965 and 1966, approximately 90 percent of the inventory effort was concentrated on special inventories.

Chairman PROXMIRE. This is the horrible example that Senator Symington referred to.

Senator SYMINGTON. That means that 90 percent of your normal inventory effort was ineffectual.

Mr. STAATS. It means it did not solve the problem of being able to yield the information that you needed as of a given time, and, therefore, were exerting manpower and losing time doing something which, with the proper investment either could be eliminated or minimized.

Chairman PROXMIRE. Even though there was an understandably difficult situation with the Vietnam war escalation taking place just during this time, the Vietnam effort would have been aided substantially, it would seem to me, by accurate, up-to-date records where you wouldn't have to go through this special inventory.

Mr. STAATS. That is right. I think we indicated in the previous hearing, Mr. Chairman, we are making at the present time, a special review in Southeast Asia, in part trying to get at this problem of improving the supply lines into Vietnam. We are getting good cooperation from Defense on it.

I think you are quite right in saying that what we are after here is improvement of the way the system responds to the need, the need of the Defense Department.

Chairman PROXMIRE. What we need is the assurance that vigorous action is being taken by the Defense Department in this area, and progress reports so we can measure it with some objective criteria. After all, this took place 2 years ago, 1 and 2 years ago, 1965 and 1966, so we should know whether improvement is being made now and we ought to have, as soon as possible, a further audit so we have a comparative basis.

Mr. STAATS. What we could do here, as we do in many other special types of audit situations, where we go in and make this kind of review we go back in after a reasonable period of time to see what has been done to improve the system, to determine whether there has been action taken to deal with the problem which we identify and which they agree with.

PROGRAM REPORTS NEEDED

Chairman PROXMIRE. I know you have the ability and the experience to give an appropriate study to that, but we want the reports for this committee, if we can get them, on a progress basis.

Mr. STAATS. All right.

In our opinion, the widespread use of special inventories in lieu of improved inventory control practices is costly and ineffective. The extensive workload associated with taking these special inventories frequently restricts the taking of systematically scheduled physical inventories.

INADEQUATE INVESTIGATION OF DISCREPANCIES

We noted instances in which a series of offsetting adjustments to the records on individual items of supply were made without adequate investigation to determine the reasons for the discrepancies.

Chairman PROXMIRE. I remember when Mr. Morris testified, he said that the Defense Department wasn't much different than private industry. He said that the almost 25-percent error which you pointed out in their overall inventory, $10 billion, roughly, and $2.5 billion off, he said these balanced out and the actual discrepancy was only actually between 1 and 2 percent which compared favorably with Sears, Roebuck. Is this the appropriate time for you to deal with that?

GAO DISAGREES WITH DOD ON DISCREPANCIES

Mr. STAATS. We deal with that a little later.

The short answer is we don't agree with him for reasons which we spell out later. (See p. 220.)

I will repeat myself a little bit.

We noted instances in which a series of offsetting adjustments to the records on individual items of supply were made without adequate investigation to determine the reasons for the discrepancies. For example:

One. At one Defense Supply Agency center, we noted a series of six adjustments made in about a 1-year period to the records for water chlorination kits. These six adjustments ranged from a minus adjustment of 9,404 units to a plus adjustment of 11,829 units. The result of this series of adjustments was a net increase to the records of 1,225 units.

Personnel of the center concluded that no further investigation or corrective action was necessary on this item inasmuch as the series of adjustments appeared to be offsetting.

EXAMPLE OF INVENTORY ADJUSTMENTS

Senator SYMINGTON. Would you give the sequence of that? Over what period of time did you go from a minus 9,400 to a plus of 11,800?

Mr. BAILEY. Senator, I will give you the sequence in which these adjustments were made.

In May 1965, on the basis of a physical inventory of the item they increased the quantity by 11,829 units. In September, they made an additional plus adjustment; in other words, added to the number, 640 units. There is no reason given for that adjustment.

Then in 1966, in January, they took a physical inventory and they decreased the item by 8,341 units.

Senator SYMINGTON. They found 8,000 less than they thought were there?

Mr. BAILEY. Less than they thought were there; yes, sir.

Then in March they took another physical inventory, a special physical inventory, and added 5,201.

Senator SYMINGTON. Was that because they didn't find the 5,000?

Mr. BAILEY. They found 5,000 more than they thought they had.

Senator SYMINGTON. These were not additional purchases?

Mr. BAILEY. No, sir.

Chairman PROXMIRE. None of these represent purchases, I understand. These are all adjustments.

Mr. BAILEY. These are adjustments to the stock records; yes, sir.

Then in April, they added another 1,300 units. The reason for this adjustment was not stated.

Then in June, they took another special physical inventory, apparently because of some discrepancy or other, and reduced the inventory by 9,440 units.

Senator SYMINGTON. How could they do that? They probably put all identical items in one part of a shop. How could they have gone up and down and sideways that way, five, nine, 11?

Mr. BAILEY. All of these items are not necessarily in the same location in a warehouse. They may have them in separate locations in a warehouse.

Senator SYMINGTON. You are not speaking about any particular group of items?

Mr. BAILEY. This is one line item; a water chlorination kit.

Senator SYMINGTON. Then why wouldn't they put them all in one place or reasonably close to one place? Why would they spread them around?

Mr. BAILEY. Sometimes they may have all of a particular place filled with this item and may have to put it in another place.

Senator SYMINGTON. But you say this is at one Defense Supply Agency center—one place.

Mr. BAILEY. Yes; but the locations in the warehouse may be several locations.

Mr. WEITZEL. It may be the locations where these are supposed to be kept are filled up when another shipment comes in and they have to have a place to put it, so it goes somewhere else rather than reshuffle everything else.

Our problem there was that they didn't seem to follow up on why these adjustments were necessary and what should be done to prevent them.

Mr. STAATS. Two. As a result of physical inventories taken in four Army depots during 1966, inventory adjustments totaling about $197 million were made to the stock records without research and reconcilation of major stock variances. Our tests of some of these adjustments showed that the adjustments were in error. If reconciliations had been made of the discrepancies, it would have become clear that the differences could have been accounted for by transactions in process.

Senator SYMINGTON. Just to be sure I understand, what do you mean without reasearch and reconciliation of major stock variances?

Mr. BAILEY. In other words, attempting to find out why they have these differences between the physical inventory on hand and what the

stock records show is on hand. They make the adjustment without attempting to find out why this difference.

Senator SYMINGTON. Why do they make the adjustment?

Chairman PROXMIRE. They found there was an error.

Senator SYMINGTON. What kind of an error, an error in inventory or in figures?

Mr. BAILEY. They will determine they have so much stock on hand on the basis of physical inventory. They say, "Okay, we will change our records to show this much stock on hand." But they don't go back to find out why did the records show they had this other stock on hand.

Chairman PROXMIRE. Proceed.

PRESCRIBED PHYSICAL INVENTORIES NOT TAKEN

Mr. STAATS. One. Overall data for the period February 1965 to June 1966 submitted for the 20 Army depots show that none of the depots performed the number of regularly scheduled physical inventories or location audits required by Army regulations. In many instances, complete counts of items were omitted and, in some instances, required sample inventories were omitted.

Furthemore, five of the depots performed no location record audits. The reasons given for these failures to conduct scheduled physical inventories were (1) utilization of personnel resources for special inventories; (2) conversion to new or revised major logistical systems; and (3) the workload caused by the Southeast Asia buildup.

Chairman PROXMIRE. Mr. Morris testified this had been rectified. His testimony, or that of his assistants, was that this was during the Vietnam buildup period, that they deliberately suspended inventories, knowing they would have a tremendous demand for personnel and so on. But they have now begun taking these inventories.

Is this your understanding, also?

Mr. STAATS. I do know that on these specific cases, as I indicated earlier, when we called them to their attention, we have not had difficulty getting them to respond to them, to make corrections.

But I don't have, personally, information as to whether in this particular situation involving the 20 Army Depots, they have been corrected.

ARMY WILL NOT BE ON SCHEDULED INVENTORIES UNTIL 1969

Mr. BAILEY. We understand, Mr. Chairman, that it will take the Army until about 1969 to get back on schedule for taking physical inventories.

Chairman PROXMIRE. This should be a lesson to all of us, I take it. It is your conclusion, and certainly my conclusion, that this was a serious mistake, suspending this physical inventory. We would be much better off in supplying troops in Vietnam, not only in terms of economy, which is important at all times, but in terms of a more effective military effort, if they had the physical inventory and knew where the supplies were.

Mr. STAATS. That is right.

Chairman PROXMIRE. In terms of timing and getting what you need there at the right time, you are much better off if you know what you have and where it is.

Mr. STAATS. That is right.

Representative RUMSFELD. Mr. Staats, isn't it correct to say that the problems that come with the buildup are no great surprise to the U.S. Government, and that we have gone through previous buildups of a less substantial nature? Certainly with the Berlin situation there was a change in the activity level, and there were similar problems discovered during the Berlin buildup period. Isn't this correct?

SYSTEM NEEDS IMPROVEMENT

Mr. STAATS. Yes; I am sure this is true. Of course, in any of these emergencies, no one can be sure at the time they occur what period of time is to be involved, or, for that matter, what the size of the buildup will be. I think it is important to keep it in perspective to the total size of the problem.

Given the size of the problem undoubtedly there will be errors and mistakes made if you have an uncertain situation ahead of you. But we believe, and I don't believe we have basic disagreement in the Defense Department on the central point, that the system, itself, needs a lot of attention and a lot of improvement.

If these regulations had been followed and there had been the manpower allocated to conduct the physical inventories in these 20 locations, I think, looking at it hindsight-wise, they would agree it was a mistake for them to have not continued them.

SYSTEM SHOULD BE CAPABLE OF EXPANSION FOR BUILDUP

Representative RUMSFELD. What I am saying is that Mr. Morris, and, in fact, those of you who have testified from the GAO, state periodically that the problem has to be considered in perspective, that there was a buildup.

My point is we have had previous buildups since World War II. We know, I would think, by now what happens when there is a buildup. We know that there is a greater demand and stress put on the systems, plural.

It would seem to me that recognizing the nature of the world we live in, we would be well advised to see that the system is so developed and constructed that it can expand for a buildup. I am a little bit tired of hearing, "But there was a buildup." It didn't just happen. People knew it was going to happen.

The people involved in making the decisions for the buildup to take place were also the people who have the responsibility for seeing that the system is capable of handling a buildup. I don't think that is an unreasonable position.

Mr. STAATS. No; I wouldn't quarrel with your basic point that the system should be capable of responding to this kind of a buildup.

Representative RUMSFELD. If this were the first time it happened since World War II, one might say, "Well, surprise; we were caught with our hands in our pockets." But it wasn't.

Mr. WEITZEL. Paradoxically enough, Mr. Rumsfeld, some of the very things they have tried to do to improve the system, they report, and I think our people would confirm, have caused some of the problems.

For example, computerizing some of the systems. The Defense Department said that would introduce transitional difficulties due to trying to control the stocks from remote locations. In other words, they had to work out some of the problems that the new system had originally built into it.

USE OF COMPUTERS

Mr. STAATS. To get really effective control, you have to use computers very extensively. This is a mammoth job, as I think you will appreciate.

I am convinced, myself, that the Government is behind private industry in using computers in this area of supply management. The size of the job, to be sure, is larger. There is no private enterprise even close to the size of the Defense Department's inventory management problem.

But, nevertheless, without the use of the computer, I don't believe we are ever going to get on top of the situation.

Senator SYMINGTON. Mr. Chairman?

Chairman PROXMIRE. Senator Symington.

Senator SYMINGTON. You mentioned it would take the Army until 1969 to get its inventories straightened out.

Would you care to comment about the Navy and the Air Force?

Mr. BAILEY. In the Air Force, the Air Force has been making physical inventories pretty much on schedule.

The Navy is somewhere in between. I don't know that we have any time factors with respect to the Navy.

Senator SYMINGTON. Thank you.

NINETY PERCENT OF INVENTORY EFFORT ON SPECIALS

Mr. STAATS. No. 2. Another case we have is: The two Navy locations included in our review were required to perform scheduled inventories annually on approximately 920,000 line items in fiscal years 1965 and 1966. However, during these fiscal years, less than 6 percent of the scheduled inventories were taken. Special inventories accounted for 90 percent of the inventory effort.

Chairman PROXMIRE. Was this on a directive of the Secretary of Defense? Was there a formal order in which this was decided as a matter of policy? Where was this decision made that the inventories required would not be taken in 94 percent of the cases?

Mr. STAATS. At the local level, I am advised.

I am also advised that there was no general statement of policy to the effect that this would be done.

Chairman PROXMIRE. Isn't this a violation of orders?

Mr. STAATS. I think this would be correct.

Chairman PROXMIRE. It seems to me it would be subject to some pretty serious discipline.

One thing, if they missed a few, that would be one thing. But they only took less than 6 percent of the scheduled inventories.

Mr. STAATS. The question we would have to check into is whether or not they had been allocated the necessary personnel and funds to do this. If they had the funds and personnel to do the special inventories, it is a little hard to see why they wouldn't be able to do the regular inventories.

Chairman PROXMIRE. Would this be known by the Secretary of the Navy or the Secretary of Defense until you disclosed it on the basis of your studies?

Mr. STAATS. I could not answer that.

Mr. FASICK. Yes, sir; they would be known in the sense that there were quite a number of internal reports of the individual services, internal audits, where this was pointed out and should have come to the attention of the secretarial level in the services.

Senator SYMINGTON. I would like to ask this question: If there was no general statement of policy there would be no order. How could a man at the working level violate an order?

Mr. STAATS. What I was referring to was the general regulations to provide for the inventory and they were not taken. They were allowed to slide.

Senator SYMINGTON. Just for the record, what do you mean there was no general statement?

Mr. STAATS. There was no specific statement of policy or directive, as far as I know, to give them permission to abandon the general regulations.

Senator SYMINGTON. In other words, it was on the negative side. I understand you. Thank you.

Mr. STAATS. Yes.

Three. Available data showed that Defense Supply Agency activities had about 1.9 million active line items on hand. During fiscal years 1965 and 1966, approximately 40 and 9 percent , respectively, of the DSA active items were physically inventoried by complete or statistical sampling methods. In addition, the data indicated that the DSA supply activities made less than 50 percent of the required location audits.

DSA officials indicated that one of the reasons for the substantial decrease from 1965 to 1966 in the number of line items physically inventoried was the workload associated with increased support to Southeast Asia. They indicated also that the failure to make the majority of the location audits was due in large part to a new depot warehousing and shipping system.

GAO FINDINGS REPORTED TO SECRETARY OF DEFENSE

At the conclusion of our review, we brought our findings to the attention of the Secretary of Defense along with our proposal that the military departments and the Defense Supply Agency be directed to take the necessary steps to attain an acceptable degree of stock record accuracy for depot inventories.

GAO PROPOSED A HIGH-LEVEL STUDY GROUP TO STUDY PROBLEM

We proposed further that the Secretary of Defense establish a group, composed of representatives from the military department and the Defense Supply Agency, to study the problems of inventory control in depth with an objective of resolving the broad basic causes for these problems and to make recommendations that will correct the conditions uniformly throughout the Department of Defense.

This is the task force, Mr. Chairman, which I referred to a while ago. Defense advised us yesterday they had decided to establish it.

The Department of Defense, in commenting on our draft report, in July 1967, concurred, in general, with our findings.

Chairman PROXMIRE. You say "in general." What disagreements were there?

Mr. WEITZEL. With the need for high-level management attention to the inventories, the importance and concern to the Department.

Chairman PROXMIRE. Did they disagree with that?

Mr. WEITZEL. No; they agreed in general.

Chairman PROXMIRE. My question was, What disagreements?

Mr. WEITZEL. The only point they reserved for further study, as I recall, was whether there should be established the high-level management group of the representatives from the military departments and Defense Supply Agency. They indicated they wanted to make a further study of that point. That is the one Mr. Staats said they have now agreed with.

Mr. STAATS. We should strike out the words "in general" in view of the information we received yesterday.

We were advised that each of the military services and DSA had initiated specific programs to eliminate the types of inventory control problems discussed in our report and each was in the process of installing new procedures which were aimed at more accurate inventory control.

I think this point was the reason that they did question the need at that point in time for the overall task force, but which they have now agreed to.

We were advised that the installation of the new procedures had advanced to the point where fruitful results could be anticipated within a relatively short period of time. We were told that the need for establishment of a special inventory study group would be reconsidered and, if necessary, organized after an evaluation of the results was obtained from the new procedures.

In testimony before this subcommittee on November 28, 1967, the Defense representatives testified that the material included in our report dealt with discrepancies that show up in a 4 million item inventory. The Defense representatives went on to say that the net difference between gains and losses in dollars was only 1 percent in 1965 and 1.4 percent in 1966 and that the largest merchandising houses consider 2 percent net adjustment to be quite satisfactory. (See p. 220.)

We recognize that in private industry a net adjustment figure (gains offset by losses) can be used to measure the extend to which profit or loss has been affected during a particular accounting period or the extent to which capital investment in inventories has been affected by inventory adjustment. However, this figure does not give a satisfactory indication of the effectiveness of inventory controls or the reliability of the inventory records. For these purposes, gross adjustment (the total of gains and losses) is a more meaningful figure.

An excessive volume of gross inventory adjustments is a clear indication that, in a large number of instances, the inventory accounts for specific items were inaccurate in relation to actual stocks on hand and, therefore, represented potential management problems.

In those cases where records indicate more stock on hand than actually exists, there is a distinct danger that when stocks are depleted,

orders cannot be filled. On the other hand, when the inventory records do not reflect all of the stock that is actually available, unnecessary procurements may be made and potential excesses generated. Since either of these conditions represent an unsatisfactory condition requiring management attention, it seems more appropriate that gross inventory adjustments be used as a measure of the effectiveness of the stock control practices and records.

Since the purpose of maintaining inventory records is to have accurate information available as to the quantities and location of stock on hand, an excessively high ratio of gross adjustments to average inventory is a strong indication that such inventory records are not accomplishing the purpose for which they are maintained and that necessary controls over the inventories are absent or inadequate.

NEED FOR STANDARDS FOR EVALUATIONS

Chairman PROXMIRE. This makes a lot of sense to me and I think it is a very good response to the position taken by the Defense Department.

I wonder, again, if you can give us some standard. Is there any basis for determining whether or not a 25-percent gross error is bad? It sounds terrible, but how do we know?

Mr. STAATS. I have been raising the same question with members of our staff. I think the only answer we can give you here is that it would be difficult to establish an overall standard. We think it is quite clear that this rate of gross inventory adjustment is higher than necessary and higher than we ought to live with.

Chairman PROXMIRE. Can you do it on the basis of consultation with the biggest and most competitive enterpreneurs? Sears, Roebuck has been brought up here. How about their gross adjustment? Do you know what that is?

Mr. STAATS. I am advised we are making this check. This is something which I have been pushing quite a lot. I do think we need, in this area as in many others, standards against which we can make a judgment as to the adequacy of an agency's operations.

In an organization as big as the Defense Department, you also have the risk of overall figures, either overstating or understating the problem in a particular vital operation in the Defense Department. That is another factor.

Chairman PROXMIRE. Once again, we can't compare it with a standard. Can we get anywhere by considering whether or not this is a deterioration of perfomance or whether, as bad as it is, it is an improvement?

Mr. STAATS. We do not have that information.

Chairman PROXMIRE. I hope we develop this over time.

Mr. STAATS. It would be very useful to have this, and we certainly want to move in that direction. I don't know at this point of time whether we can commit ourselves as to the feasibility of doing it. But I agree with you that it is a desirable thing to do, if we can do it.

Senator SYMINGTON. Mr. Chairman, I have to leave. If I may, I would like to congratulate you on these very constructive hearings. and also congratulate Mr. Staats and Mr. Weitzel, and the staff. I have known Mr. Staats over a quarter of century now, and I think he

and his staff have saved the Government a good many millions of dollars.

As this committee continues to demonstrate, the Government could save a good deal more money in following the advice of experienced people. My staff and I intend to study this further.

Chairman PROXMIRE. Thank you very much.

There is no one who is more qualified, as everyone in this room knows, than Senator Symington, from his lengthy experience in both private business and in the executive branch of the Government.

Mr. STAATS. Thank you.

CONCLUSIONS AND ADDITIONAL ACTIONS REQUIRED

We believe that the increased emphasis which DOD has stated that the military services and DSA are placing on more positive enforcement of the existing policies and procedures for control of depot inventories should, if effectively pursued on a continuing basis, result in greater stock record accuracy and increased supply effectiveness.

However, on the basis of other studies we have made of inventory controls and supply system responsiveness, we believe that there are certain broad basic factors which have a significant bearing on the effectiveness of inventory controls in the Department of Defense.

For example, we believe that the organizational structure of the supply systems in some cases may contribute substantially to the difficulties encountered in control of inventories. The responsibility for physical receipt, storage, and issue of stocks of the same item is frequently decentralized to several storage activities.

The management and accounting responsibility for these same stocks is centralized at another supply activity which has no direct authority or control over the practices of the storage activities. Thus, it is difficult to establish responsibility for errors or loss of control because no single organization has the direct authority, responsibility, or perhaps motivation to reconcile differences and insure closer control.

Another important factor which we believe warrants considerable attention is the need for increased supply discipline throughout the supply systems. This is essential if the accuracy and completeness of inventory records and related supply management data is to be improved.

Frequently, we find that the services have devised adequate system and procedures, but the people upon whose actions the operation of the systems depends do not always do that which is required and when it is required. To the extent that people at all levels of the supply system are motivated to follow prescribed procedures and maintain a high degree of accuracy in their work, more accurate and complete management data and information will result.

We do not believe at this time that there is any need for specific legislation in connection with improvement of inventory controls. The basic responsibilities and authorities have been established. Rather, we believe that creative thinking needs to be applied to basic problems and causes such as organizational structure and supply discipline cited above.

It is to deal with basic factors such as these that we suggested a a special study group within the Department of Defense should be established.

We believe the interest and concern with inventory controls evidenced by this subcommittee, as well as others in the Congress, is especially important in assuring that a high degree of management attention is focused on this problem. In other words, we believe the Congress and its committees can be a strong motivating factor to the departments to further their efforts in developing solutions.

For the immediate future, we intend to concentrate our efforts on study of the organizational structures, alinement of responsibilities and authority, and numbers and types of personnel involved in inventory management.

We also intend to examine more closely the policies, procedures, and practices used by the military services and DSA relative to the receipt and storage of material, and the processing of related transaction documents affecting the inventory records. In connection with this work, we intend to consider the organizational structure and methods used in commercial enterprises to determine if there are any techniques that may have application to the solution of inventory control problems in the Department of Defense.

Chairman PROXMIRE. Your investigation was made in February of 1965 and June of 1966—18 months ago. The Department of Defense is just getting ready now to do something about it. Is that right?

Mr. STAATS. As indicated here, they had not established the kind of overall study which we felt was necessary until now. They did have a number of things that were in process by the individual services and by DSA. That was their argument for not setting up the overall group at the time we made our report.

Chairman PROXMIRE. Who has been in charge of this in the Secretary of Defense's office?

Mr. STAATS. Until recently, Paul Ignatius, who is now Secretary of the Navy, was in charge. But Assistant Secretary Tom Morris has been moved fairly recently into this responsibility.

Chairman PROXMIRE. I was very much impressed by Mr. Morris. He is a most thoughtful and I know a dedicated man. I know he works 12, 14, and 16 hours a day, 7 days a week. How much experience has he had in this area?

Mr. STAATS. He has had rather considerable experience, going back to the previous administration. He was responsible for working with the Deputy Secretary, Reuben Robertson, in this area, when they were establishing the Defense Supply Agency.

Subsequently, after about a year in the Budget Bureau, he was appointed by Secretary McNamara to the present post that he holds. He served in that post for, I believe, approximately 3 years or 3½ years, and became Assistant Secretary for Manpower.

After the appointment of Mr. Ignatius to the Secretary of the Navy post, Mr. Morris was returned to the present position which he now holds. So he has had rather considerable experience.

Chairman PROXMIRE. He has been in this position for how long?

Mr. STAATS. This is his second tour in this position.

Chairman PROXMIRE. And he has been in this position for how long? When did he take over?

Mr. STAATS. I don't know whether I can give you that.

Mr. WEITZEL. It must have been about August 1967.

With further respect to timing, Mr. Chairman, this review covered the period that was mentioned, but we did our fieldwork from May 1966 through March 1967 and, as a result of that, we sent a draft report to the Defense Department on May 3, 1967, with our findings and our recommendations, and in replying to this in July, on July 21, 1967, Mr. Riley, the Deputy Assistant Secretary of Defense for Supply and Services, in what is now Mr. Morris' area again, did call our attention to the fact that each of the military services and DSA had initiated specific programs to eliminate the deficiencies, many of which they had recognized, and Mr. Riley said, for example:

> The Army initiated a six-phase program in September 1966. Three of these phases were completed by the end of December 1966, but not in sufficient time to be reflected in the draft report prepared by the GAO staff.
>
> The major phases, which involve the establishment of new inventory procedures would be phased in between May and October 1967. Likewise, the Navy, Air Force and DSA are in the process—

he said—

> of installing new procedures which are aimed at more accurate inventory control.

As we have already testified, they did defer action on the constitution of this high-level task force and have just now determined that they will go forward also with that.

Chairman PROXMIRE. Our experience has been that they are very cooperative, friendly, and responsive and then not much gets done, so often, as you know. So, we hope that we have follow up reports at regular intervals, as comprehensive as possible, so we can stay right on top of the situation.

Mr. STAATS. I have the exact dates that you asked for, Mr. Chairman Mr. Morris was appointed to the post of Assistant Secretary of Defense for Installations and Logistics in January 1961 and served there until December 1964. He returned to this post in September 1967.

Chairman PROXMIRE. You may proceed.

Mr. STAATS. The second part of our testimony has to do with agency audit rights and recovery from subcontractors.

Chairman PROXMIRE. I am very interested in this.

Mr. STAATS. This is designed to elaborate and bring up to date the the information on this subject.

AGENCY AUDIT RIGHTS AND RECOVERY FROM SUBCONTRACTORS

AGENCY AUDIT RIGHTS

About 2 years ago, we recommended to the Secretary of Defense that a provision be included in all contracts, required to be negotiated on the basis of cost or pricing data, giving agency officials the right to examine all records related to the contract performance. This recommendation was made to provide agency officials a more effective means of implementing the Truth in Negotiations Act, Public Law 87–653.

We had found that significant cost information was often not disclosed to Government negotiators at the time of price negotiations. Such undisclosed information could be more readily detected in post-award reviews of the contract performance records.

Although an examination of such records provided the best means of verifying that the data submitted before negotiations was accurate,

current, and complete, agency officials did not have the right to do so under negotiated firm fixed-price contracts and subcontracts.

This matter was discussed in hearings before your committee in May 1967.

In June 1967 both you and Congressman Minshall introduced bills to provide agency representatives the right to examine all data related to the negotiation, pricing, or performance of contracts and subcontracts where cost or pricing data are required.

In commenting on the proposed legislation in July 1967 we stated that we were in favor of its passage.

Thereafter, in September 1967, the Deputy Secretary of Defense directed that action shall be taken to include in all noncompetitive firm fixed-price contracts a contractual right of access to the contractor's actual performance records. The directive was silent on the agency's right of access to the subcontractor's records.

We advised Defense officials of this apparent omission, and we were advised that this matter would be considered in drafting the regulations. The Armed Services Procurement Regulation was revised November 30, 1967, effective as soon as received, to provide for an appropriate clause to be included in all contracts and subcontracts, where cost or pricing data are required. (Pertinent excerpts from the regulation are attached. For full text, see p. 162.)

(The information follows:)

ATTACHMENT A

EXCERPTS FROM DEFENSE PROCUREMENT CIRCULAR NO. 57, NOVEMBER 30, 1967

Agency Audit Rights

"ITEM IV—REVISED AUDIT CLAUSES

"To provide adequate contractual coverage for access rights to contractor's records necessary to perform post-award reviews, when required under Public Law 87-653, changes have been made in the clauses in ASPR 7-104.41. Effective as soon as received, these revised clauses will be used in contracts as provided in 7-104.41 herein. * * *."

"7-104.41 *Audit and Records*

"(a) Insert the following clause only in firm fixed-price and fixed-price with escalation negotiated contracts which when entered into exceed $100,000 except where the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. * * *."

"AUDIT (NOVEMBER 1967)

"(a) For purposes of verifying that certified cost or pricing data submitted, in conjunction with the negotiation of this contract or any contract change or other modification involving an amount in excess of $100,000, were accurate, complete, and current, the Contracting Officer, or his authorized representatives, shall—until the expiration of three years from the date of final payment under this contract—have the right to examine those books, records, documents, papers and other supporting data which involve transactions related to this contract or which will permit adequate evaluation of the cost or pricing data submitted, along with the computations and projections used therein.

"(b) The Contractor agrees to insert this clause including this paragraph (b) in all subcontracts hereunder which when entered into exceed $100,000, unless the price is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. When so inserted, changes shall be made to designate the higher-tier subcontractor at the level involved as the contracting and certifying party; * * *."

Similar clauses have been provided for price adjustment to formal advertised contracts, and negotiated contracts that are not firm fixed price.

Mr. STAATS. We believe that the revised regulations will accomplish by administrative action what would be required by enactment by the legislation. We recognize that regulations are more easily changed or rescinded than an act of Congress and are perhaps more susceptible to misinterpretation or oversight.

While we have no reason to anticipate, in this case, that the regulations will be either later rescinded or not followed, we would, of course, have no objection if the Congress should decide to enact this provision into law. We intend to observe closely the contracting agencies' practices with regard to the regulations.

HISTORY OF NEGOTIATED PROCUREMENT SINCE 1947

Chairman PROXMIRE. I would like to ask about that.

The Armed Services Procurement Act was passed in 1947?

Mr. STAATS. That is right.

Chairman PROXMIRE. And the Government could have made contract provisions consistent with the Truth in Negotiations Act, Public Law 87-653 and in the proposed amendment, any time in the last 20 years?

Mr. STAATS. They could have; yes.

Chairman PROXMIRE. But they didn't see the need until you made numerous reports to the Congress.

Mr. STAATS. I think that is correct. I believe this particular issue came more sharply into focus after the Truth in Negotiations Act of 1962 was enacted.

Chairman PROXMIRE. The GAO finally persuaded the Congress, in our judgment, to enact the Truth in Negotiations Act?

Mr. STAATS. It was a result of many reports by the GAO to the Congress.

Chairman PROXMIRE. Until that there was no requirement that the contractors provide, even though the overwhelming part of procurements were by negotiations and this is the only discipline by which you can keep the costs where they should be, there was no requirement in law on regulation that the contractor provide accurate, up-to-date and comprehensive records.

Mr. STAATS. I believe that is correct. It is a matter of law.

Chairman PROXMIRE. Did the Defense Department favor the enactment of that legislation?

Mr. STAATS. Mr. Welch or Mr. Bailey are better able to answer that.

Mr. WELCH. As I recall, Mr. Chairman, DOD initially took the position that this legislation was not necessary because similar requirements were already contained in the ASPR. Also, I would like to point out that the General Accounting Office has the right to examine contractors' books and records and subcontractors' books and records under negotiated contracts which stems back to the examination of records law that was passed in 1951. We are talking here about the agency's representatives' rights to examine subcontractors' records.

Chairman PROXMIRE. We say that was enacted in 1962, the Truth in Negotiations Act.

On the basis of your subsequent reports since 1962, it was clear that it was honored more in the breach than in the observance. It wasn't followed up at all on the basis of very, very comprehensive reports that you made to us, the real indictment, until very recently. As far as we know, it is still not being enforced.

Mr. STAATS. They, of course, as you know, disagree in some respects with the conclusions we reached in that report. But, nevertheless, as we testified here at our previous hearing, they have taken a series of actions which respond to the points we made in our report and which, if carried through, we feel——

Chairman PROXMIRE. But in the 5 years from 1962 to 1967, that law was not enforced vigorously and you have replete examples of how the contractors didn't provide the records. You showed, I thought, a devastating case in this respect.

Mr. STAATS. We do feel this is a very significant report. I believe some 2 years was required to develop a more comprehensive regulation. Our work was initiated in 1965 and involved contracts signed after the revised, more comprehensive regulation was issued.

POSITION OF DOD IN MAY 1967

Chairman PROXMIRE. Did they—the Department of Defense—favor the enforcement, more vigorous enforcement, in our hearings of May 1967?

Mr. WEITZEL. Mr. Chairman, if you will recall, the Defense Department testified in May 1967, that in its opinion it was enforcing the Truth in Negotiations Act. The differences in opinion related to the area of the identification of documentation or the requirement for written documentation in support of the cost or pricing information so that the contracting officers and the other Government representatives would be able to know what was relied upon by the Government in making the contract.

We stated in your hearings in May that there hadn't been full compliance with the Truth in Negotiations Act. The basic purpose of that law was to give the Government negotiators a better basis for pricing a contract.

Chairman PROXMIRE. Not only that, but you had examples where in 90 percent of the cases there hadn't been full compliance with the Truth in Negotiations Act.

Mr. WEITZEL. I think we need to clarify what is meant by the question of compliance with the act.

Chairman PROXMIRE. There wasn't full compliance in those cases.

Mr. WEITZEL. The act, itself, requires the furnishing of cost or pricing data, the submission of cost or pricing data. On this, the Defense Department testified that they were complying with the act.

The act also requires a certification by the contractor that the cost or pricing information that he has submitted is the most accurate, current and complete, available up to a certain date, which is supposed to be as close to the date of negotiation as possible.

The Defense Department testified that it was also requiring that certification.

The act, itself, does not say exactly how there shall be implementation of the act. In other words, what administrative details will be promulgated and followed in seeing that this information is furnished and is used in an effective form so that in the event it is found by the Government as a result of an audit that the contract has been overpriced to the Government because of a failure of the contractor to comply with these other two points—in other words, the submission of the proper information or the certification—the Government will know how much to charge back to him.

This was where we found that in our opinion there wasn't sufficient identification of what was furnished; there wasn't a sufficient audit trail. We felt that to the extent the data submitted either weren't complete, weren't accurate, or weren't current, or when it wasn't clear what data the certificate covered, there had not been full compliance with the intended purpose of the law.

The law, itself, requires implementation by regulation. We believe the Defense Department has done a reasonably good job in the regulation it has issued. As to be expected in the regulatory implementation of any new law, the experience developed weaknesses. We discovered evidences of weaknesses in our survey and recommended corrective changes.

DOD PROCUREMENT CIRCULAR NO. 57 COMPLIES IN GENERAL WITH GAO RECOMMENDATIONS

The Defense Department has now agreed, in the issuance of Procurement Circular No. 57, with practically all of the changes that we recommended. The major thrust of this is to make it more clear that the requirement for submission of data is not satisfied simply by access to the data, that the data have to be submitted in writing or identified in writing to the contracting officer. Thus, it will be known what actually was submitted and there will be a record, as you said before, a standard against which later developments can be measured.

Chairman PROXMIRE. Let me read two short paragraphs from your testimony in May 1967, in which you said, speaking of the 242 cases which you had studied:

> In 165 of these awards, we found that the agency officials and prime contractors had no records identifying the cost or pricing data submitted and certified by offerors in support of significant cost estimates. We also found that of the remaining 77 of the 242 procurements examined, agency and contract records of negotiations indicated that cost or pricing data were not obtained, apparently because the prices were based on adequate pricing competition or on an established catalogue of commercial items sold in commercial quantities to the general public. But there was not a record showing the basis for the contracting officer's determination.

So, really what you are saying is that in the 165 cases, only 20 were in full compliance with the law, and I concluded about 10-percent compliance, really.

Mr. STAATS. I think the essential point has to do with the phrase, that without adequate documentation and without an adequate record, neither the Defense Department, nor we, nor anyone else, can be certain that the information had been supplied.

To that extent, I believe we disagree with Defense in their statement that they could be sure that this information was actually supplied.

In a great many of these cases they had a statement from the auditor to the effect that he had seen this information, but there is no way to go behind that statement.

There is no itemization; there is no listing. There is nothing which refers it back into anybody's files.

Chairman PROXMIRE. We agree wholeheartedly on the necessity for this. There just isn't any question.

Once again, I want to say that I really meant it when I said that I had the greatest respect and admiration for Mr. Morris and his dedication, but, after all, Mr. Morris has a long record of opposition to the enactment of this law, enactment of the kind of thing we are suggesting as a matter of law.

What has Mr. Malloy's position been on it?

Mr. WEITZEL. I am not prepared to say that the Defense Department vigorously opposed the enactment of Public Law 87–653, the reason being the Defense Department staffs and GAO staffs cooperated in drafting the provisions of 87–653.

Mr. Bannerman was the main Defense Department representative, as I recall, and several of us worked on the GAO side. It was true that they had provisions in the regulation before requiring the certification. We felt the regulations were not being adequately followed and it was for this reason that we felt a law was necessary.

I would have to reexamine the situation way back in 1962 to confirm whether they opposed or didn't oppose.

Mr. STAATS. This would be a matter of record.

Chairman PROXMIRE. As far as the so-called Minshall-Proxmire proposal is concerned, the proposal that we want to put this into law for the audit and also for what we feel and you seem to feel is the proper procedure and not leave it to regulation—we have a change in the Defense Department coming up now, knowing Mr. McNamara is going to leave—under these circumstances, it seems to us it would be very wise for a procedure which all of us agree is proper, appropriate, necessary, and efficient, not just in terms of economy but in terms of a better military effort, that we should provide a solid legal basis for it.

You have no objection, but without some positive force behind it, it is pretty hard to get anything through the House and Senate.

Mr. WEITZEL. As to that provision, it is certainly true that the feeling in the Defense Department for a considerable period of time was that it would not be proper for the Defense contract auditors to have access to performance cost records under negotiated fixed-price contracts.

As to the other types of negotiated contracts, such as cost-reimbursement contracts, they already had access. But as to this particular type of contract, which is a major portion of their total contracting——

Chairman PROXMIRE. It certainly is. It is hard to see how the procurement officials can really understand what the fair price should be if they don't have access to the records, comprehensive access and full access right along.

Mr. WEITZEL. We had recommended to the Congress as early as 1966 that the Defense auditors should have access to the performance records. There was some legislative history on this.

Another committee had recommended that if Defense auditors were to be given access to this, it ought to be by legislation rather than by

administrative action, which we felt could have been done even in 1966.

There was that aspect and also the rather strong feeling in the Defense Department that to have performance costs audited under a fixed-price contract would be, in effect, invalidating the integrity of the contract. In other words, they were trying to get the contractors to assume more risks of performance and the top people in the Defense Department, whose influence had prevailed up until recently, felt that this effort would be affected by going into a contract after it was made and, in effect, second-guessing the contractor on his costs.

This wasn't our objective at all. Our reason for suggesting access by Defense auditors to performance records was so that it could be determined whether fair prices had been gotten by the Government in the negotiation of the contract, not to affect the contractor's profit if he was able to adopt more efficient procedures or if he was able to go out and get the material more cheaply than he had originally estimated.

This is the tack that has been adopted by the Deputy Secretary of Defense in the new directive, that the performance records will be opened to the DSA auditors for the purpose of comparing the prices that were actually paid with those that were offered to the Government at the time of negotiation, to see whether the contractor had information, such as a lower subbid, for example, that he should have disclosed to the Government but did not.

Mr. STAATS. There is no question in our mind, as Mr. Weitzel is saying, that better pricing information is essential to any negotiated contract situation.

Chairman PROXMIRE. How much money has been involved since 1947? Do you have any estimate of what the procurement has been? It is billions and billions and billions of dollars.

Mr. STAATS. It is in the hundreds of billions of dollars.

Chairman PROXMIRE. And without this kind of information there is no question that the Government, in my view, has lost billions of dollars. We have spent billions of dollars we shouldn't have spent. We wasted it. We will continue to waste it unless we have the assurance, it seems to me, by law, that this information is being provided to Defense procurement officials.

NEW REGULATIONS RESULT OF GAO AND COMMITTEE ACTION

Mr. STAATS. The Truth in Negotiations law, in our opinion, is very fundamental to the situation where we have so much of our procurement done through negotiated contracts. I think it is a sound law, and I think it is also a fair conclusion, Mr. Chairman, that without our report and without the attention this matter has had in this committee and in the Congress, that these new regulations probably would not have been issued.

I believe the Defense Department is now of the view that these further steps are required. I don't know of any basic quarrel in the industry, itself.

Chairman PROXMIRE. As an arm of Congress, I do hope you will reconsider what seems to me to be a much too mild no "objection" position here. I think we have the same objective. We know this is certainly in the interest of the taxpayer.

TEST OF ENFORCEMENT OF NEW REGULATION

Let me ask you: How shall we test the enforcement of this regulation?

Mr. STAATS. We will do it by the same processes we went through in developing our initial report; namely, of making audits of individual contract situations.

Chairman PROXMIRE. And when shall we review the situation?

Mr. STAATS. We have it in our program to do this periodically—not periodically, but, rather, as a part of a regular audit program of Defense contracts.

Chairman PROXMIRE. What does that mean in terms of the next time we will have a review?

Mr. STAATS. It is a question, really, of what would be a reasonable period of time to give the regulations a chance to change the situation.

Chairman PROXMIRE. Six months?

Mr. STAATS. I would say more nearly a year, probably.

REVIEW IN FALL OF 1968

Chairman PROXMIRE. As late as next fall, then, I think we ought to have a comprehensive review. Meanwhile, I hope we can get this enacted into law.

Go right ahead.

Mr. WEITZEL. Our situation, Mr. Chairman, is that we are simply very happy that they have adopted this suggestion.

Chairman PROXMIRE. They have adopted suggestions so often in the past and as long as they are under regulation not a matter of law I just have a feeling that we are not going to get results. After all, so very much is at stake here, billions of dollars, and the contractors who are all fine, honest men, nevertheless have their own special interests and their own desires, understandable desires, in the drive for profits. They aren't going to volunteer information which is going to sharply reduce those profits unless the law makes it explicit and emphatic that they have to do so.

Go right ahead.

RECOVERY FROM SUBCONTRACTORS

Mr. STAATS. The next point has to do with recovery from subcontractors, closely related to the point we have been discussing.

Under the existing provisions of the ASPR, the Government's right to reduce the contract price extends to cases where the prime contract price was increased because a subcontractor furnished defective cost of pricing data. Problems have arisen with respect to the Government's right to a price adjustment where the subcontractor has submitted defective data after the prime contract price has been established. These problems are being studied by the Department of Defense and by our office.

Again, we attach pertinent excerpts from the regulation to our statement.

(The information follows:)

ATTACHMENT B

EXCERPTS FROM DEFENSE PROCUREMENT CIRCULAR NO. 57, NOVEMBER 30, 1967

Recovery from Subcontractors

"3–807.5 *Defective Cost or Pricing Data*

"(d) Under 10 U.S.C. 2306(f) and the 'Price Reduction for Defense Cost or Pricing Data' clauses set forth in 7–104.29, the Government's right to reduce the prime contract price extends to cases where the prime contract price was increased by any significant sums because a subcontractor furnished defective cost or pricing data in connection with a subcontract where a certificate of cost or pricing data was or should have been furnished. * * *."

"Paragraphs 3–807.5(d) and (e), which are concerned with the area of subcontractor coverage, are still under study and may be revised in the near future. In event of revision, the clause in 7–104.29 will likewise be revised."

GOVERNMENT PROPERTY IN THE POSSESSION OF DEFENSE CONTRACTORS

Mr. STAATS. The third and final subject which we are covering in our statement today has to do with Government property in the possession of Defense contractors.

It is the policy of the Department of Defense that contractors will furnish all facilities required for the performance of Government contracts, except that facilities may be provided by the Government when (1) contractors are either unwilling or unable to do so and no alternate means of obtaining contract performance is practical; or (2) furnishing existing Government-owned facilities is likely to result in substantially lower cost to the Government of the items produced, when all costs involved—such as costs of transporting, installing, maintaining, and reactivating such facilities—are compared with the cost to the Government of the contractor's use of privately owned facilities.

Also, it is the policy of the Department of Defense to have its contractors maintain the official records of Government-owned property in their possession.

The Government's inventory of property in the hands of contractors consists of property which the Government has furnished and property procured or otherwise provided by contractors for the account of the Government. Basic policies governing the control of this property are set forth in the Armed Services Procurement Regulation.

At your subcommittee hearings on November 28, 1967, representatives of the Department of Defense indicated that the total value of Government-owned property in the possession of contractors amounted to about $14.9 billion. This figure includes an estimate of $3 billion, representing the value of special tooling and special test equipment held by contractors.

Chairman PROXMIRE. Do you have a breakdown of what the rest is? Is any real property included?

Mr. STAATS. We have a breakdown of it. Mr. Bailey has it here. He can read the highlights of it. We have a detailed statement to insert into the record.

Mr. BAILEY. Government material, in other words, the raw materials, used by contractors, such as cloth, duck to make tents, maybe electronic gear, this type of thing that goes into the production of an end item—material in the hands of contractors——

Chairman PROXMIRE. Electronic gear?

Mr. BAILEY. Black boxes or subassemblies, something of this kind that they have purchased and acquired for production of an end item or which may have been furnished by the Government out of its procurement. This material amounts to about $4.7 billion. Active real property, industrial property in the hands of contractors——

Chairman PROXMIRE. This is land?

Mr. STAATS. Land and buildings.

INCREASE IN CONTRACTOR-HELD INVENTORY FROM 1965 TO 1966

Mr. BAILEY (continuing). $2.1 billion. Plant equipment—these are machines, metal working machines, lathes, milling machines—this type of thing, $4.1 billion. This totals $10.9 billion, or $11 billion, roughly, which, plus the $3 billion that they estimated for special tooling and special test equipment, makes up the total included in Mr. Staats' statement.

Mr. STAATS. I think the comparable figure to the $11 billion for fiscal year 1965 was $7.2 billion. So there has been a substantial increase from 1965 to 1966.

FINANCIAL ACCOUNTING ON SPECIAL ITEMS, ET CETERA

The Department of Defense does not collect financial data regarding the value of special tooling, special test equipment, and military property held by contractors.

Chairman PROXMIRE. Don't you think they should? This is Government-owned equipment. Shouldn't they have concise, full, and complete data of what the taxpayers own that private individuals are using?

Mr. BAILEY. Yes, sir. In our report, which we made this month, on Government property in the hands of contractors, we recommend that such an inventory be kept.

Mr. STAATS. I believe there is definitional problem of what you would include. I believe that has been the main consideration here, if I understood correctly. But we have recommended that it be done.

Department of Defense records show that as of June 30, 1966, the cost of facilities in the hands of contractors amounted to $6.2 billion. This amounted to an increase of $700 million over that reported at June 30, 1965. About $300 million of this increase is attributed to the inclusion in inventory records of several Government-owned plants that had been inactive. The remainder is primarily applicable to increases in the amount of industrial plant equipment provided to Army and Air Force contractors. Comparable data for the period ended June 30, 1967, is not yet available.

Chairman PROXMIRE. On the basis of any period for which you have data for comparison, this has been an increasing problem or at least an increasing policy of buying equipment for private contractors to use. It is not decreasing and is not stable. It is going up.

Mr. BAILEY. I think there is another factor that we have to consider here, too, Mr. Chairman. That is the point that Government procurement has been increasing because of the effort in Southeast Asia.

Chairman PROXMIRE. Except the records we have seen, the Defense indicators—perhaps during this period it is increasing—from about the middle of 1966 to date it has been stable.

Mr. STAATS. 1965–66 was the big buildup.

Chairman PROXMIRE. There was increasing procurement in that time.

Did you say another element of this has also been increasing, just before you started to read this paragraph?

Mr. STAATS. I don't think so.

Chairman PROXMIRE. At any rate, the only time comparison you have is 1965–66, when there was a substantial increase.

Mr. STAATS. Yes.

Chairman PROXMIRE. Will you be able to get us more detailed data on this? This is something that the Congress ought to be able to get immediately from the Defense Department. They ought to know how much they own. At least, they ought to have figures on how much they have, that the contractors have, and they ought to be able to tell us each year.

Mr. STAATS. For these two categories of material and real property, I understand the records are available for prior years. We could very readily supply that.

(The material follows:)

SUMMARY OF MATERIAL, ACTIVE REAL PROPERTY, AND PLANT EQUIPMENT IN HANDS OF CONTRACTORS

[In thousands of dollars]

	Fiscal year 1962	Fiscal year 1963	Fiscal year 1964	Fiscal year 1965	Fiscal year 1966
Material (procurement, source, GPM, in custody of contractor):					
Department of the Army	(1)	(1)	485,000	252,000	616,000
Department of the Navy	(1)	(1)	119,000	105,000	1,633,000
Department of the Air Force	2,461,000	2,729,000	1,114,000	1,276,000	1,422,000
Other	12,000	11,000	17,000	18,000	24,000
Total	2,473,000	2,740,000	1,735,000	1,651,000	4,695,000
Active real property (industrial), contractor operated:					
Department of the Army	685,768	662,704	631,712	660,931	1,061,080
Department of the Navy	489,615	425,869	396,502	399,154	378,994
Department of the Air Force	745,012	784,126	724,286	736,214	688,423
Total	1,920,395	1,872,699	1,752,500	1,796,299	2,128,497
Plant equipment (in custody of contractors) [2]:					
Department of the Army	966,461	859,980	838,339	894,996	1,042,851
Department of the Navy	835,077	513,692	765,130	678,995	680,791
Department of the Air Force	1,604,928	1,622,403	2,112,693	1,953,758	2,343,039
DSA	(1)	(1)	(1)	210,624	52,432
Total	3,406,466	2,996,075	3,716,162	3,738,373	4,119,113
Grand total	7,799,861	7,608,774	7,203,662	7,185,672	10,942,610

[1] Information not available.

[2] Plant equipment is personal property of a capital nature, including machinery, equipment, furniture, vehicles, machinery, tools, and accessory and auxiliary items for manufacturing or administrative use. Information obtained from Mr. Francis Jameson (OSD Comptroller), Directorate for Statistical Services.

Source: All data, except noted, obtained from report on real and personal property of the DOD for the fiscal years shown.

Chairman PROXMIRE. We would like to know whether this has been increasing or not, and the reasons for it. You give one reason, which is legitimate. But we want to know what other reasons there are.

Mr. BAILEY. One example would be the inventory in 1966 of inactive real property which went down $300 million. The active real property in the hands of contractors went up $300 million, but the inactive real property went down $300 million, roughly.

Chairman PROXMIRE. In 1965–66, the inactive property was down?
Mr. BAILEY. The inactive real property; yes, sir.

RISE IN VALUE DUE IN PART TO MODERNIZATION AND REPLACEMENT PROGRAM

Mr. STAATS. It is shifting between the active and the inactive status.
One of the factors contributing to the rise in the value of Government-owned property held by contractors is the Department's program for modernization and replacement of Government-owned machine tools. Annual expenditures for this program averaged about $27.4 million during the period 1958 through 1963. Fiscal year 1966 expenditures amounted to $51.5 million and expenditures of $65.8 million were forecast for the fiscal year 1967.

Chairman PROXMIRE. Once again we have a situation in which the Federal Government has purchased equipment for contractors and it is following a policy, apparently, and the tenor of your remarks suggests that maybe there is approval and maybe not, maybe I misconstrue it, of providing better equipment, more modern equipment for the contractors.

It would seem to me that every one of these purchases should be made with the greatest reluctance and only on a showing that it is absolutely necessary. When you have to buy more modern equipment, there should be a real effort to get the contractor to buy it himself.

ADHERENCE TO POLICY INVOLVED

Mr. STAATS. That would be a correct reading of the statement of policy on the part of the Department of Defense. What is suggested here at least is a question, and maybe it can only be a question absent more specific information on individual cases: Whether or not they have vigorously applied the policy which the Defense Department, itself, has enunciated in modernizing equipment at Government expencse.

Chairman PROXMIRE. Do you have anything in greater detail as to what kind of justification they require to enable the Defense Department to go ahead and make purchases for a private contractor?

Mr. STAATS. We do not have it here today, I understand, but we will be glad to see if there is anything we can obtain for the record.

Chairman PROXMIRE. We would like to know the justification, what they go through, what the criteria are.

(The justification follows:)

NATURE OF JUSTIFICATION REQUIRED AND THE CRITERIA USED BY THE DEPARTMENT OF DEFENSE FOR REPLACING GOVERNMENT-OWNED INDUSTRIAL EQUIPMENT IN THE POSSESSION OF PRIVATE CONTRACTORS

The Department of Defense's general policy on replacement of industrial equipment as stated in DOD Directive 4275.5 is that basically, the contractor will be encouraged to replace old, inefficient Government-owned equipment or manufacturing processes with modern, more efficient, privately owned equipment. The weighted guidelines for negotiation of profit or fee is cited as encouraging the contractor to provide equipment required on DOD contracts.

When the contractor cannot be persuaded to replace Government-owned equipment or improve manufacturing processes, the replacement may be effected if

such action is in the interest of the Government and can be justified on economic grounds.

The analysis required to justify the replacement of Government-owned equipment on economic grounds is prescribed in DOD Directive 4215.14. This involves a comparison of projected operating costs to be incurred on Government orders during the next immediate 12-month period using the present equipment with projected operating costs using the proposed replacement equipment. The operating costs considered, include such factors as direct labor, indirect labor, maintenance, power, scrap/rework, tooling, etc. The cost projections are based primarily on the projected machine load for the 12-month period. The projected machine load for the proposed replacement equipment reflects a productivity increase ratio for the new equipment as developed through engineering studies and estimated production potential from machine tool builders.

The annual operating costs savings, if any, resulting from the proposed equipment is then compared to the annual amortization costs of the equipment. DOD Directive 4275.5 states that replacement costs for equipment to be used by the aerospace industry will normally be amortized within 3½ years; in other industries new equipment should normally be amortized within 5 years. If the annual operating costs savings exceeds the annual amortization costs of the new equipment the analysis is considered as favoring replacement.

The economic justification is usually prepared by the Government contractor and is subject to review and approval at various management levels depending on the cost of the replacement equipment. For example, in the Air Force the Systems Command may approve projects up to $500,000. Projects costing more than $500,000 must be reviewed and approved by Headquarters USAF. All projects costing more than $1 million must be approved by the Office of the Assistant Secretary of Defense (Installations and Logistics).

As a result of our report to the Congress on the need for improvements in controls over Government-owned property in contractors plants (B-140389) issued November 24, 1967, the Deputy Assistant Secretary of Defense (Procurement) has indicated that current procedures would be modified to require the specific consideration of and a statement as to the contractor's inability or unwillingness to finance equipment modernization.

CONTRACTORS NOT ASKED TO INVEST IN MODERN TOOLING

Mr. HAMMOND. We found in some cases in review of the tooling modernization program that contractors were not asked to invest in the modern tooling. The Government furnished it without requesting a contractor to make their own investment and in some cases did not find out whether or not he was in a position to do it. Information on this is included in our report. (See app. 4(a), p. 411.)

Chairman PROXMIRE. You say in your report you show that in the past there has not been a policy of requiring or asking the contractor to buy the equipment?

Mr. HAMMOND. There is a policy that they will be required to furnish equipment, but in actual practice they did not, in many cases, ask contractors to furnish it.

Chairman PROXMIRE. Are you reassured that at the present time they do in all cases do everything they can to request the contractor to buy his own equipment?

Mr. HAMMOND. We have recommended that the Department of Defense do that. We do not have the final action that they have taken on it.

Chairman PROXMIRE. You do not have it? You don't know?

Mr. HAMMOND. That is right.

Mr. WEITZEL. Mr. Chairman, the Defense Department policy requires the contractors to submit justifications on the purchase of new equipment. They have a directive which is set out on page 39 of our

report on the "Need for Improvements in the Controls Over Government-Owned Property in the Contractor's Plants" that says basically the contractor will be encouraged to replace old, inefficient Government-owned equipment or manufacturing processes with modern, more efficient, privately-owned equipment. (See p. 433.)

We found, though, that in submitting justifications contractors generally weren't required to include statements as to their ability or willingness to finance the equipment. Most locations where we inquired into this we found that either the contractors had not been requested to acquire privately owned equipment or the files gave no indication that use of private funds had been considered in evaluating the proposals that we examined.

As to some of these cases, Government officials told us that contractors had been encouraged to use private capital. However, we did not find records of that. At two locations, we did find evidence that the possibility of contractor financing had been questioned in connection with certain submissions, in which cases Government financing was justified because of contractor investment in other equipment or facilities.

It appeared to us, and we so reported, that the Government's investment in this program is sufficiently great that the question of contractor financing should receive positive attention in all cases.

FAILURE TO COMPLY WITH POLICY

Chairman PROXMIRE. The policy apparently on the part of the Department has been that the Government would only procure this equipment for contractors under certain exceptional circumstances. This has been the policy. But the practice has been that they have in many cases, and you don't say how many, you don't say what the proportion is, but in many cases, the Government has not applied this policy, that the Government has gone ahead and purchased this equipment for the contractor.

Mr. WEITZEL. We feel that there should be stronger application of the policy and also of that other part of the policy which directs that replacement of machine tools be justified on economic grounds.

Chairman PROXMIRE. And you have no knowledge that the Defense Department is now pursuing a different policy?

Mr. STAATS. We do not.

Chairman PROXMIRE. Under these circumstances, if the Congress should decide that this is a policy that should be provided in law, a requirement in law, why wouldn't that be desirable and necessary?

Mr. WEITZEL. All we can say at this point is that the Deputy Assistant Secretary of Defense agreed with our proposals in this area, that he said that it was DOD's policy that the contractor be encouraged to replace these old, inefficient Government tools with privately owned ones. He said that current procedures would be modified to require the specific consideration of and a statement as to the contractor's inability or unwillingness to finance equipment modernization.

Also, he said that they would review the need to revise their guidelines as they apply to both new and existing major defense programs.

That is the latest we have.

COST STUDIES ON ADVANTAGE IN GOVERNMENT PROVIDING EQUIPMENT

Chairman PROXMIRE. Perhaps I should wait until you complete this statement because as far as I know you are going to recommend, I hope, that we enact a law on this. But let me ask on the part you have completed, your second exception is that these facilities can be purchased by the Government and should be when it is likely to result in substantially lower cost to the Government of the items produced.

Have you seen any cost studies to prove that there are any examples of this?

Mr. STAATS. I have not.

Chairman PROXMIRE. Wouldn't this be helpful? Wouldn't this be a good way to follow up to determine whether this exception is meaningful?

It is hard for me to, offhand, imagine that this would be very common. I can't conceive of a situation in which this would be likely to occur, given an accurate and proper cost accounting system.

Why would it be cheaper for the Government to own equipment? Certainly, all motivation is for an entrepreneur who buys his equipment to buy it more carefully, to maintain it more rigorously and to make sure that it is the equipment that can do the job in the most efficient way. If the Government buys it, there is far less incentive for him to exercise this kind of diligence.

REDUCED COSTS FOR GOVERNMENT-OWNED EQUIPMENT

Mr. BAILEY. Mr. Chairman, in our report which we referred to before, we do point out that in some cases where reduction in cost of production was one of the reasons for acquiring Government machinery, adjustments were not made in contract prices to reduce or reflect these revised production costs. That is, for existing contracts in the plant. Whether these reductions in cost would be reflected in new contracts would be a matter of negotiation of new contract prices.

Chairman PROXMIRE. What you are saying is that even though the Government owned the equipment and, therefore, the price of the product produced should be less inasmuch as the contractor did not have to amortize——

Mr. BAILEY. Where the equipment being used to produce Government property was modernized on the basis that it would cost less to produce the Government material.

Mr. STAATS. There was no flow through on the saving.

Mr. BAILEY. The contract price of the material was not reduced.

Chairman PROXMIRE. This is the point which has evaded me. I think it is a good point.

If you are going to modernize the equipment, you certainly ought to do it on the basis of renegotiating the price of the item being produced.

You say the record shows there has not been such a reflection?

Mr. BAILEY. In some of the instances.

Chairman PROXMIRE. You are helping the contractor to make a bigger profit, at the same price, with more efficient equipment, the efficiency provided by the Government, by the taxpayer. So he has a lower cost and his profits are bigger. That is the ultimate result.

Mr. BAILEY. Of course, in our report we recommended that we get these profits in the future, or this reduction in price.

Chairman PROXMIRE. Of course, if you don't enforce the Truth in Negotiations Act, and don't have accurate cost records, it is hard to know whether or not the price should be reduced on the basis of the actual cost, either.

Mr. STAATS. On the relative cost price you referred to, we will be glad to examine that.

But the general points that I think we have to keep in mind would be that a great deal would depend on whether it is general purpose equipment or specialized equipment.

I think you would find a great variance as to what your tradeoffs would be in terms of cost of providing it by the Government or by the contractor. We will be glad to look into it.

Chairman PROXMIRE. Fine.

OEP APPROVAL FOR COMMERCIAL USE

Mr. STAATS. The Department of Defense allows rent-free use of its facilities for military orders.

In June 1957, the Office of Emergency Planning established a requirement for contractors to obtain advance approval to use Government-owned machine tools on commercial work exceeding 25 percent of the total usage. The procedure for prior approval was established primarily to preclude contractors from obtaining a favored competitive position through rent-free use of Government-owned production equipment on commercial work. (See p. 213.)

OEP APPROVALS NOT OBTAINED

Generally, we found from our review of the records covering the years 1965 and 1966 that contracting officers were not requiring contractors to request and contractors were not requesting approval to use Government-owned industrial plant equipment for commercial work in excess of the 25-percent criteria.

Chairman PROXMIRE. That 25-percent criteria leaves a lot of leeway, it seems to me, for extracurricular use on Government-owned equipment that is unfair competition and also exploiting the taxpayer.

If you have a million dollars worth of equipment and you can use that equipment up to 25 percent of the time for your own private use, this is a big advantage. Of course, you could have tens of millions of dollars of equipment.

Mr. STAATS. We were not questioning this point so much in our report as we were the fact when it exceeded 25 percent it still wasn't getting approval. That was the point we were referring to the other day.

Chairman PROXMIRE. So it could be 50 and 60 percent and so on. The examples that you gave in your report were 57 percent and another was greater than that.

Mr. STAATS. That is correct. There were a number in excess of the 25-percent rule.

Chairman PROXMIRE. But the 25-percent rule doesn't satisfy you, does it?

Mr. STAATS. I don't really know what consideration went into the establishment of the 25-percent rule.

Chairman PROXMIRE. They don't even have to request approval to use Government-owned industrial plant equipment as long as they use it less than 25 percent of the time? Why shouldn't they be required to have some kind of approval? It can be routine, but there should be some kind of approval.

Mr. STAATS. It is a question of local approval versus approval by the Office of Emergency Planning. There is a procedure requiring local approval even in cases under 25 percent.

Mr. HAMMOND. Even under 25 percent they get the local approval and are required to pay rent for the commercial use.

Chairman PROXMIRE. Wasn't your conclusion that in some cases even with more than 25-percent use they may not have been required to pay rent?

Mr. STAATS. No; it was to get approval.

Chairman PROXMIRE. Wait a minute. How about on the rent part.

Mr. BAILEY. In some cases there was some rent, yes.

Mr. WEITZEL. Later in the statement we point out that the rent is inconsistent and in some cases inequitable.

Chairman PROXMIRE. In some cases nonexistent?

Mr. WEITZEL. The rent is not paid on a machine-by-machine basis. It is not computed that way now. We have some recommendations to that effect.

Mr. Hammond, would you care to comment?

Chairman PROXMIRE. The contractor keeps the records, too.

Mr. HAMMOND. In some cases the contractors did use the equipment without getting the approval and paying the rent. We have recommended a machine-by-machine utilization record so that the Government will know when the equipment is used and will collect the necessary rent.

ASPR NOT PRECISE AS TO "25 PERCENT USE"

Mr. STAATS. The further point we are making is that the armed services procurement regulation does not precisely define what constitutes "25-percent, non-Government use." It is not clear whether the criteria refers to total planned use or a portion of manufacturing hours available under one or more work shifts, or if it is to be administered on a total plant or an item-by-item basis. That is the point which has just been made.

Insofar as we can determine, the approval obtained from the Office of Emergency Planning places no restriction on the extent to which a contractor may use the facilities on commercial work provided rental payments are made.

LACK OF UNIFORMITY IN RENTAL RATES

Although uniform rates for the rental of Government-owned machines to contractors have been prescribed, as currently stated in Defense Mobilization Order 8555.1 of the Office of Emergency Planning and section 7–702.12 of the Armed Services Procurement Regulation, we found that the various bases upon which the rent payments were negotiated resulted in a lack of uniformity in the rates actually

charged, inequities between contractors, and in some cases, reduced rent payments to the Government. This occurs because the regulation allows the contractors to compute rent based on overall allocations of the workload between Government and non-Government work according to the relationship of various factors—such as sales, labor hours, or machine hours—rather than computing rent machine-by-machine according to the ratio of shared usage of the particular machine.

Chairman PROXMIRE. You say the regulation allows and the contractors to compute rents. Those are the allocations you are talking about?

Mr. STAATS. Yes.

Chairman PROXMIRE. Do they have discretion? Can they do it on a different basis and choose the one most favorable to them?

Mr. STAATS. I think the regulation permits them. I think our quarrel is with the regulation.

Mr. HAMMOND. Basically, the regulation provides for rental in accordance with the value of the equipment and on the basis of usage. But in some cases for ease of administration and ease of computation, rent is computed on the basis of sales, a certain percentage of sales. We found in those cases, as indicated in our report, sometimes there was a less recovery in terms of rent than would have been had it been computed on the value of the property.

Chairman PROXMIRE. Have you made any study at all, or has anybody made any study of what would happen if you just didn't let them use this equipment for anything except Government work, period—that is it?

After all, there might be some losses to the contractor if you did that, but certainly there is an inequity. It seems to me it is very hard to assess fair rentals. You would solve a problem if you did this. Why not consider that possibility? It might be a very efficient and quick way of reducing the amount of Government-supplied equipment.

The incentive on the part of the contractor to insist on this Government-supplied equipment would be sharply reduced.

Mr. BAILEY. It might generate some difficult problems, too, Mr. Chairman, in terms of contractors setting up a production line where he has to put a particular piece of equipment in this line to perform, let's say, a milling operation or a lathe operation, something of this kind. This becomes a part of his total work in this area.

Chairman PROXMIRE. If it is, under that circumstance certainly he ought to buy it himself. Sell it to him. I can understand if you have an exceptional situation where the Government needs some kind of exotic equipment for a Vietnam action or some new antimissile, or atomic kind of construction that is new and different, and may only be used once and then discarded, under these circumstances. But if you are going to buy something that fits right into his regular assembly line operation that he can use anyway, and use any significant amount of time for his own commercial production, this is just unfair competition as well as exploitation of the taxpayer.

Why don't you consider, at least, this fairly radical suggestion? Consider the possibility of what would happen and ask the Defense Department. We will ask the Defense Department to try and justify their position in permitting any use of Government-supplied equipment.

Mr. STAATS. I assume you would. And also to be considered is the different situation you have where a plant is wholly in Government production as against a mixed commercial and Government contract plant.

Chairman PROXMIRE. Yes, or particular equipment that is bought by the Government for a particular purpose which should be used for that purpose only. See what the limits are. It may be that my suggestion here is wrong. I don't know. I would like to see it studied out.

Mr. STAATS. Most of the problem we are pointing out has to do with the contractor who has both commercial as well as Government production. It might well be that you have a different situation with a contractor who is exclusively engaged in production for Government use. We will consider it.

Chairman PROXMIRE. Fine.

DISPOSITION OF GOVERNMENT-FURNISHED PROPERTY

Mr. STAATS. We turn finally to the subject of disposition of Government-furnished property.

To promote the maximum utilization within the Government, serviceable or usable property is required to be screened prior to disposition.

The armed services procurement regulation provides that Government-furnished property, return of which has not been required by the Government at the conclusion of Government work, may be disposed of either by competitive sales or by negotiation. With respect to the latter, sales are required to be made at prices which are fair and reasonable, and not less than the proceeds that could reasonably be expected to be obtained if the property were offered for competitive sale.

This concludes our formal statement, Mr. Chairman.

NEED FOR LEGISLATION REGARDING CONTRACTOR-HELD EQUIPMENT

Chairman PROXMIRE. How do you feel about legislation in this area?

Mr. STAATS. You asked us in our previous hearing to consider this. We have not reached any conclusion as to what type of legislation. We have discussed it briefly since our previous discussion on the subject. It may very well be that legislation would be desirable in this area.

Chairman PROXMIRE. I hope you can give us a response on that as soon as you can. Also, we haven't really gone into the basis on which the rentals are computed and whether or not they are fair, if there is a comparison with competitors. It seems to me that this is something GAO might be able to do and come forward with useful recommendations.

Mr. STAATS. I think this would be a specific matter particularly growing out of our report that we can offer suggestions on.

Chairman PROXMIRE. At the present time, the records on the use of this Government-owned equipment in the hands of private contractors are kept by the private contractors; right?

Mr. STAATS. On use, yes.

Chairman PROXMIRE. The amount of time used for the private work and for the Government work. What kind of reports are made by the contractors now? How frequent and how comprehensive?

Mr. HAMMOND. I think the reports would vary depending upon the rental arrangement, like, for example, when the equipment is used and

charged on the basis of sales. Then at the end of the month the contractor would look at the sales commercially and to the Government and then the rent would be charged to the two in relation to sales. But we did find in our review that greater attention should be given to machine-by-machine utilization records so that the Government would have more precise information as to what use was made of the equipment in order to appropriately collect rent.

Chairman PROXMIRE. If there are no sales, there is no reimbursement, even if they produce for a commercial account but don't sell?

Mr. HAMMOND. That could create a problem.

Chairman PROXMIRE. Is the basic method of computing the rent on the cost of the equipment and on amortizing that cost over a period of time? To give a simple example, if you buy a million dollars worth of equipment, used 50 percent of the time commercially and 50 percent of the time for the Government. The Government would get back over a period of time $500,000, with interest? Is that the way it is done?

Mr. HAMMOND. There is a rate set up in the armed services procurement regulations that considers the value of the equipment.

For example, for a piece of equipment that is 2 years old, it would be a monthly rental charge of 1¾ percent of the cost of the equipment, plus installation and transportation.

Chairman PROXMIRE. How is that computed?

Mr. HAMMOND. I don't have the basis for that at this moment, although we could furnish you that for the record.

Chairman PROXMIRE. So if this equipment was used 50 percent of the time for private purposes, you would take one-half of 1¾ percent per month?

Mr. HAMMOND. Yes. If the equipment were used 50 percent of the time commercial for 1 month, it would be half of 1¾ percent of the value.

Chairman PROXMIRE. How do they compute the time element? Do they figure a 160-hour week?

Mr. HAMMOND. There are various methods. Sometimes the total value is used for an 8-hour-shift operation and some cases a longer period.

Chairman PROXMIRE. Depending on what the system is in the plant.

Mr. HAMMOND. That is right. It would vary.

Chairman PROXMIRE. Did you have anything further, Mr. Staats?

Mr. STAATS. This concludes our formal statement but it was our understanding that you had other matters that you wanted us to comment on.

One item you were interested in was the question of identical bids on proposals.

Chairman PROXMIRE. Maybe identical bids is the wrong word, but some kind of collusion which may develop where you had a negotiated price competition.

As I understand it, we have made real progress in reducing identical bids on advertised competitive bidding, but it seems very logical that you would have much more of a problem where you have the Government selecting two or three suppliers, as they do with a great deal of their procurement, and asking for bids between them. In most cases they would select similar suppliers and the firms would know each

other, the effective heads of the firms would have worked together. There would be every reason to suspect that under these circumstances the Government would have to be very alert and watchful.

I wondered if there was any way you could get at this particular problem.

Mr. STAATS. It is a very difficult matter. There are two different aspects. One is the identical bid problem and the other one is the one you refer to of collusive sharing of Government business. There is a provision in the Armed Services Procurement Regulation which simply indicates that this is one of several practices designed to eliminate competition and restraint of trade. But the term itself is not fully defined. There is an item in the certificate of independent price determination which is required by the armed services procurement regulations, section 1–115, which says that no attempt has been made or will be made to induce any other person or firm to submit or not to submit a bid or proposal for the purpose of restricting competition.

That is simply a statement of purpose and intent. When the certificate is suspected of being false, or there is indication of collusion, then the matter goes to the Department of Justice. But ordinarily this will not happen except when somebody makes a report or an allegation that this has happened in a particular case.

Chairman PROXMIRE. It strikes me there is another way we can get at this. As I understand it, the Truth in Negotiations Act and the other legislation applies primarily on negotiated procurement with a sole source. This is the area of its most common application. This is the area where most of us think of it as being most essential.

Mr. WEITZEL. It applies to negotiated procurement.

Chairman PROXMIRE. Does it apply to negotiated procurement where you have price competition?

Mr. BAILEY. It does not apply where there is adequate price competition.

Chairman PROXMIRE. This is the area where maybe it should apply, too. This is one way of getting at this. You can have adequate price competition in terms of having two, three or four people provide competition with each other. But here is the situation where the collusion is most tempting and where one would logically anticipate that there might be collusion. You know the difficulty with the General Electric case and others. I am not nearly as concerned where there are very few big suppliers who can get together and save enormous amounts of money. We have advertised competitive bidding and any number of people can come in.

Mr. BAILEY. It is my recollection at the time Public Law 87–653 passed the House, it would have covered all negotiated contracts, whether competitively negotiated or otherwise. But in the Senate the provision was added excluding contracts that were let pursuant to adequate price competition, prices based on catalog or market prices of items sold in substantial quantities to the general public.

Chairman PROXMIRE. The additional cost would not be much if we got into that, would it?

Mr. BAILEY. Industry representatives will say that this is a very expensive proposition, to get together these cost estimates, I think. But it is really hard to quantify what you would actually lose because the ones that should result in the larger amount of accumulation of data to support prices are the ones that are negotiated for complex military items that are ordinarily not subject to price competition.

Chairman PROXMIRE. Where we have competitive negotiations it would seem logical to provide that if the procurement is over a certain amount, say $1 million, there you ought to apply the full rigors of insisting on getting accurate cost data.

Mr. WEITZEL. Without reference to the policy question, I think the law does leave some leeway because it says "the requirements of the subsection," with respect to the furnishing of a certification and so forth, "need not be applied to contracts or subcontracts where the price negotiated is based on adequate price competition," and so forth. It doesn't absolutely exempt them.

Mr. BAILEY. That is correct. It is permissive rather than mandatory.

FEES FROM ARCHITECTS AND ENGINEERS

Chairman PROXMIRE. Let me ask you this other question. This is a question which concerned me quite a bit on architects and engineers being picked on a competitive basis.

Business Week of November 25 has this item. It says:

> The drive within the government to introduce price competition into fees for the services of architects and engineers has been stopped cold in Congress by an uprising of engineering professional societies. Merit, not price, should be the sole criterion for picking engineers.

And it quotes a Congressman as saying that:

> As Chairman of a strategic subcommittee on Government activities, he is in a position to enforce his warning to the Comptroller General to quit trying to introduce the price issue. The General Accounting Office opposes the traditional flat 6 percent for most engineering services. New York engineer Richard S. Tatlow III took charge of the engineers' battle against the GAO. By last week his group had convinced, the Congressman, that the present provisions on the subject are "Taut, beautifully drafted statutes."

I stuck my neck out and introduced legislation along this line and, of course, it was received with great "joy" by the architects and engineers in Wisconsin who let me know how they felt. What can you say to resurrect my battered corpse?

Mr. STAATS. We have been involved in this subject for a considerable length of time. The issue is not as indicated in this article that you referred to, merit versus price. We think the Government is not getting all the merit that it needs under the present procedure, if we want to be blunt about it.

Chairman PROXMIRE. And as we look around at some of the architectural beauties of Washington, I think it is pretty easy to document that.

Mr. STAATS. The present procedure that is being followed, in brief, is that a single contractor will be selected based upon the knowledge of the contracting agency of this individual's background, experience, and perhaps his interest in that particular type of construction. Negotiations will be entered into, including price. If they cannot satisfactorily reach an agreement, then they select a second contractor, and so on. We became concerned with this problem as a result of a situation in a contract, I believe, with the National Aeronautics and Space Administration. The House committee concerned with NASA matters asked us to review the matter further, looking at this as a part of a broader problem because it was the committee's view that they could not deal with the situation in NASA except in the framework of the Government-wide policy. And they were correct. We made an extensive analysis of this problem and it was our conclusion

that the 6 percent provision had, in fact, been violated, that the costs in a number of cases had exceeded the statutory limit of 6 percent. It was also our conclusion that a flat, arbitrary limit of 6 percent was not realistic from two standpoints:

One, it tended to cause a contracting agency to perhaps be a little less stringent if the costs were under 6 percent and, second, that in a number of cases it was quite obvious that 6 percent was an unrealistically low limitation.

So on both of these counts we felt that the 6-percent limit should be removed. The provision which the architect and engineering organizations have quarreled with is that we believe the present statutes do, in fact, require that there be negotiation. This does not mean that there cannot be two-step negotiations. This is the argument that these groups, I think conveniently, do not want to report. This two-step negotiation process is one in which you could engage in negotiations and discussions with a number of organizations and then limit price discussion to those which do come in with good proposals.

What we are in effect saying is that we do not think that price needs to be determinative, and, in fact, our asumption would be that in a very large number of cases this would not happen. It would be on the basis of the proposal, the merits of that proposal, rather than on the basis of the price alone.

We are, frankly, having great difficulty understanding why they feel that price would automatically govern, except for the general assumption that perhaps our organization and the Congress would be quarreling with any contract let where there is a lower bid.

This is a fear which is not fully justified or founded. It may be that it is not well understood, what two-step negotiation would involve, although we have had extensive discussions before and after our report with these organizations on the subject.

Chairman PROXMIRE. That seems to be a moderate and a careful statement. I would agree wholeheartedly with it. At any rate, it seems clear that you could hardly affect the situation adversely if you had some element of price competition involved. You would certainly be able to rely on a selection based on merit, as you say. The present system relies on political preference to some extent. We all know that. It is a fact of life. It also relies, by and large, on getting the same people to do the same job over and over again. Very often this eliminates an opportunity for some of the finest architects in the country, and keeps some of the engineers who ought to have the opportunity from getting into this work.

Mr. STAATS. Management consulting organizations that deal with the Government, and there are many of them, have become used to this two-step negotiation process. It has worked very effectively.

Chairman PROXMIRE. Theirs is certainly a profession in which the quality of the professionalism is of the greatest importance. You say they have been brought in on the basis at least a price element and a price consideration?

Mr. STAATS. Yes.

Mr. WEITZEL. Mr. Chairman, our view, we feel, has solid statutory support in this same Truth in Negotiations Act and in another provision which has not received as much public attention as the re-

quirement for the cost and pricing data. The same act of 1962 requires in negotiated procurements over $2,500 generally that there will be competitive negotiation, price and other factors considered. These are the same factors as are required as a basis for award under the Armed Services Procurement Act. Price is not the only factor. The award is to be made to the bidder whose offer, price and other factors considered, is most advantageous to the Government. We feel that by zeroing in on the charge of price competition or price bidding that there is being overlooked our feeling that the law requires some competitive negotiation on the basis of all pertinent factors, including the design, the relative capability of the bidders, and so forth.

Chairman PROXMIRE. Thank you, gentlemen, very, very much.

Mr. Staats, as you know, Senator Dominick of Colorado raised some points about negotiated bidding in a statement to this committee on November 29. There are some technical questions involved and I wish you would review these cases and give us your judgment on them for the record.

Mr. STAATS. We are prepared to do that. (See app. 11, p. 590, et seq.; see also DOD comments, p. 586.)

Chairman PROXMIRE. Members will be given 3 days for questions to witnesses and relevant material to be put into the record. (See app. 12, p. 604, for special questions and answers.)

I want to once again commend you and your very fine staff on a very helpful and informative performance. Thank you so much.

We will stand in recess subject to call of the Chair.

(Whereupon, at 12:20 p.m., the committee was recessed subject to call.)

[APPENDIXES FOLLOW]

APPENDIX 1

U.S. General Accounting Office

SUMMARY OF THE STATUS OF MATTERS OF INTEREST TO THE SUBCOMMITTEE ON ECONOMY IN GOVERNMENT, JOINT ECONOMIC COMMITTEE, NOVEMBER 27, 1967

1. Inventory Management
2. Accounting and Reporting System for Disposal Activities
3. Unfilled Orders for Air Force Materiel
4. Requirements for Aircraft Ground Support Equipment
5. Military Housing Construction
6. Consolidation of Field Organizations and Facilities
7. Competition in Procurement
8. Reporting of Negotiated Procurement Actions as Competitive or Noncompetitive by the Department of Defense
9. Real Estate Management
10. Savings and Economies to the Government as a result of General Services Administration Operations
11. Methods of Financing Agency Programs

1. Inventory Management

In response to the recommendations made by the Subcommittee in its report of July 1967, we have continued to give emphasis to the area of inventory management and stock control at the depots of the military departments, Defense Supply Agency, and the General Services Administration.

STOCK CONTROL

In its reply to our report on the need for improvements in the control of depot inventories, the Department of Defense generally concurred with our conclusions that increased emphasis and attention were needed at all management levels in order to improve the reliability and usefulness of the inventory records. They informed us that each of the military departments and the Defense Supply Agency had initiated specific programs designed to eliminate the types of inventory control problems cited in our report. They advised us that the need for the establishment of a special inventory study group would be considered after an evaluation has been made of the results obtained from the new programs. The Department of Defense has, however, recently awarded a contract to the Logistics Management Institute for a study to be made of a wide range of stock control problems.

We plan to maintain continuing contact with the military departments and the Defense Supply Agency efforts to carry out these new programs and revised procedures for improved inventory control at the depot level. We also plan to coordinate our work with that to be accomplished by Logistics Management Institute in this area so as to avoid any unnecessary duplication of effort.

As a continuation of our efforts toward identifying opportunities for improvement in the control of depot inventories in the Department of Defense, we are presently examining in further depth into the receiving and initial storage procedures and practices at selected supply activities of the military departments and the Defense Supply Agency. We anticipate that a preliminary report on the results of this examination will be issued to the Department of Defense in April 1968.

In addition to our work in the area of stock control, we have been looking into the related areas of control over shelf-life items, stockage of inactive items, utilization of inventories in long supply, controls over reparable items, distribution and redistribution, Military Standard Requisitioning and Issuing Procedures (MILSTRIP), and nonexpendable equipment.

SHELF-LIFE ITEMS

In the report of the Subcommittee on Economy in Government dated July 1967, it was recommended that the General Accounting Office and responsible executive agencies continue to identify short-shelf-life inventories and develop procurement and management programs to insure their maximum use. As of November 1966 the Department of Defense obtained, on a one time basis, a complete inventory of shelf-life items which showed a total inventory value of approximately $990 million. However, approximately 70 percent or $686 million of this amount represented recoverable items which are identified as shelf-life because a component of the item, such as a gasket, hose, etc., has a limited shelf-life. Therefore the actual Department of Defense inventory of only shelf-life items and components is significantly less than the $990 million.

We recently inquired into the status of the new instructions issued by the Department of Defense in November 1966, and found that they will not be fully implemented before September 1968. The military departments and the Defense Supply Agency indicated to us that extensive revisions to existing directives and data systems were required.

We also found that an agreement between the Department of Defense and the General Services Administration for accomplishing an accelerated sequential screening that would make items available for utilization by other departments or agencies was not reached until October 26, 1967. It appears that 6 months to a year will elapse from the date of initial reporting of shelf-life items by the military departments and the Defense Supply Agency and their reported utilization by other agencies before sufficient data will be available to determine the effectiveness of the system.

We are currently evaluating the progress made by the General Services Administration since it established, in May 1966, procedures for the cataloging, procurement, inventory management, storage and distribution, and quality control surveillance of short-shelf-life stocks under its control. We are particularly interested in determining whether the Federal Stores Stock management system adequately reports the extent and significance of losses through deterioration of short-shelf-life stock. Indications thus far are that there may be opportunities for improvements.

We are also interested in the effectiveness of implementation of the May 1966 order at the warehouse level. We have noted some instances of noncompliance but have not yet formed any overall judgments on this matter.

INACTIVE ITEMS

We recently completed a review of low-cost items in the Department of the Navy and the Defense Supply Agency which revealed that 860,000 spare parts stocked by these two organizations had had no demand for appreciable periods of time. To the extent that these items do not warrant retention and are eliminated from the supply systems, significant savings in management and storage costs can be realized by the Government.

When we brought our findings to the attention of Department of Defense officials, they informed us that the program for the identification and review of inactive items had to be postponed because of a higher priority program governing the transfer of items from the military services to DSA management. However, they indicated the program would be reactivated early in 1968. We did find that some inactive items are currently being eliminated from the supply systems as items are screened for transfer to DSA.

We intend to maintain close surveillance over this area in order to observe the progress made by the Department of Defense in eliminating inactive items from their inventories.

We also completed recently a review and have submitted a draft report to the General Services Administration for comment, on the need for the Administration to improve its cost information system to provide information useful to determination as to the most advantageous method of supplying the requirements of Federal agencies for specific items, i.e., through the stores stock program, under a Schedule supply contract, or through decentralized purchasing, and to provide information useful in establishing optimum inventory levels and determining appropriate stock position patterns.

We have not yet received the General Services Administration's comments on our findings or on our proposals for improvement.

PROCEDURES FOR LONG SUPPLY ASSETS UTILIZATION SCREENING

In October 1967 we reported to the Secretary of Defense on the results of our examination into the effectiveness of the automated screening operation for matching material available at various locations in the Department of Defense with the needs at other locations.

Department of Defense officials generally agreed with our findings that the centralized screening system has not been fully effective because:

1. The inventory control points do not, in many instances, provide the Defense Logistics Services Center with the required information on needed or available material.
2. The information reported is not always accurate or current.
3. The lack of appropriate and timely decisions by the inventory control points has resulted in improper deletion of needed information in the screening process.

We have suggested that the Office of the Secretary of Defense look into the desirability of giving the Defense Supply Agency additional authority in order to facilitate improved management control over the materiel utilization program.

RETURN OF REPAIRABLE ITEMS FOR REPAIR AND REUSE

In our review of the Department of the Army procedures and practices for the return of unserviceable, repairable parts to the supply system we found that substantial quantities of these parts were not returned by the using installations. The two principal reasons for this were (1) improper recoverability coding in publications issued by the National Inventory Control Points, and (2) lack of adequate control and follow-up action by supply activities to assure the return of reparable items by the using oranizations.

We suggested that the Secretary of the Army (1) instruct the National Inventory Control Points to design proceudres which will insure the correctness of codings in their publications, and (2) direct a review, and strengthening as necessary, of procedures at Army installations to provide a more effective means of exercising control over the stockage and turn-in of unserviceable recoverable parts.

We are currently examining into the procedures and practices for the return of repairable items in the Departments of the Air Force and Navy.

DISTRIBUTION AND REDISTRIBUTION

In a recently completed review of the redistribution of base excess supply materials in the Department of the Air Force, we found that approximately 34 percent of the shipments of excess supply items from Air Force bases to depots were unnecessary or uneconomical. These items were either already Air Force-wide long supply or excess positions, or their value was less than the costs incurred for their return. We estimated that costs could be reduced by more than $5 million annually if these types of items were not returned to the three depots included in our review.

Air Force officials have substantially agreed with our findings and have informed us that they have instituted actions that should correct this condition.

We have initiated a review of the procedures and practices for the return of excess supply materials in the Department of the Army. Although our work is not conclusive at this time, we do have indications that similar conditions are present in the Army.

MILITARY STANDARD REQUISITIONING AND ISSUE PROCEDURES (MILSTRIP)

During the first half of calendar year 1967 we performed a limited examination at various installations of the Departments of the Army, Navy and Air Force of the processing of requisitions under the Military Standard Requisitioning and Issue Procedures system.

We found that large numbers of requisitions prepared by military using units in the Far East could not be processed on data processing equipment in a normal manner because they contained erroneous or noncurrent information. This was caused primarily by (1) carelessness in the preparation of the requisitions, (2) inadequate editing of the requisitions before forwarding them to the next higher supply level, and (3) noncurrent catalog data at all levels of supply.

We plan to forward a draft report on our findings to the Secretary of Defense

in the near future. We are proposing that certain steps be taken to ensure more timely distribution of catalog data to using units, and that commanders stress the importance of accurate preparation of requisitions.

NONEXPENDABLE EQUIPMENT

In November 1967 we issued a report to the Congress on our follow-up evaluation of the actions taken by the Air Force to correct deficiencies in its management of nonexpendable equipment. We had previously reported on this subject in June 1961 (B–133361). Although the Air Force has made significant improvements, we found that further improvements are needed to obtain accuracy in the reports of assets in use and validity of equipment requirements.

Our review showed that over $8 million of the computed requirements for fiscal year 1966 were not needed. In addition, about $20 million worth of procurement requirements were questionable. Approximately $3 million of planned procurements were cancelled as a result of our discussions with Air Force officials concerning these conditions.

We believe the invalid and questionable equipment authorizations were caused by—

Inventory managers increasing equipment requirements, without the adequate research or analysis of available data.

Failure of some commands either to forecast or to properly forecast equipment authorizations, and

Failure of the bases either to make effective equipment utilization surveys, as required, or to otherwise follow prescribed procedures.

The Air Force generally concurred in our findings and proposals for improvements in the equipment management system. We have recommended that at the earliest possible opportunity the Air Force make every effort to incorporate sufficient data in its system to provide an effective means of verifying the accuracy of reported inventories of in-use equipment.

As part of our continuing reviews of supply management activities of the Air Force, we intend to inquire into the effectiveness of its actions to improve management controls over nonexpendable equipment.

2. Accounting and Reporting System for Disposal Activities

The need for a uniform accounting and reporting system for Department of Defense disposal activities was discussed during hearings held by this Committee in May 1967. The Department of Defense had advised the GAO that a new accounting and reporting system had been developed after special consideration of the findings and recommendations reflected in our report of March 18, 1966, (B–140389), and DOD internal audit report dated December 1966. We were advised that the new system was established to provide a uniform cost accounting structure and procedures for accumulating and reporting cost and performance data pertaining to all disposal operations.

A target date of July 1, 1967, was set for implementation of the new system. The new system, however, was not implemented on this date and has not yet been implemented.

In February 1967, the proposed system had been referred to the Military Services for review and coordination. We have been informed that coordination could not be obtained because the Services objected to the proposed detailed cost accounts and the requirement that individual disposal activity reports be submitted directly to the Defense Supply Agency. We were also informed that while DOD was attempting to resolve these objections, they were overtaken by time and in view of the many changes scheduled in the accounting systems for July 1, 1967, (Project PRIME), it became necessary to establish a cut-off for further mandatory system changes. The new target date for implementation of the disposal accounting and reporting system is July 1, 1968. At the present time, DOD is attempting to clarify definitions of reimbursable expenses and establish an interim reporting system.

3. Unfilled Orders for Air Force Materiel

The Air Force depots had unfilled orders (backorders) for materiel amounting to $875 million as of May 31, 1966. Our review at 9 Air Force bases in the United States showed that about $1,224,000 or 22 percent of the backorders, included in our tests, were not supported by valid requirements. Further, our visit to 4 depots

revealed unrecorded assets in the warehouses amounting to about $893,000. As a result, unrecorded assets valued at $444,000 were released for shipment against backorders, some of which were for Southeast Asia.

We believe that our review demonstrated a significant problem which could be alleviated by taking actions, as we proposed, to identify and cancel backorders not supported by valid requirements. Such actions include special physical inventories for items on backorder at both the base and depot level.

4. Requirements for Aircraft Ground Support Equipment

In November 1967, we reported to the Congress on our review of determination of requirements for aircraft ground support equipment by the Departments of the Navy and the Air Force (B–152600). This review was directed primarily toward determining whether the selection, authorization, and purchase of F–4 ground support equipment was properly correlated with actual needs.

We found that the costs for the F–4 weapons system could have been significantly reduced had the Navy and Air Force performed adequate reviews of the need for certain F–4 ground support equipment and of its utilization in the field.

Our review of 562 ground support equipment items, showed that authorized allowances for 129 (23 percent) were questionable. We also found that if the Navy and the Air Force had effectively coordinated their needs in the selection of this type of equipment the cost of the aircraft program could have been reduced by over $1.2 million.

In addition, we believe that costs amounting to as much as $12.5 million could have been avoided, or deferred, had the Navy and Air Force properly considered all available equipment, and losses of aircraft, at the time F–4 aircraft ground support equipment requirements were computed.

The Deputy Assistant Secretary of Defense (Materiel), by letter dated June 19, 1967, informed us that the Department of Defense concurred generally with our findings and conclusions. The Department's reply identified procedures which the Navy and Air Force have developed for the overall management, selection and procurement of support equipment required for subsequent joint service aircraft programs.

We believe that the corrective actions outlined, if properly implemented, should assist in preventing recurrences of the situations disclosed by our review. We will inquire in our future reviews into the effectiveness and adequacy of the new procedures and other actions to be taken.

5. Military Housing Construction

Recently the General Accounting Office furnished a draft report for comment to the Secretary of Defense on its review of the comparison of the cost and quality of military family housing with private housing. The draft brings out that new private housing being built in the area surrounding the installations reviewed was generally selling for less than the Government paid for comparable size military units constructed on base for use of military personnel. The private housing used for costs and quality comparisons were single family units, whereas the military housing generally consisted of duplex units or multi-family apartment units. Too, the private housing, in most instances, had more desirable features than the military housing such as garages, fireplaces, or basements.

While the military houses contained some materials of higher quality than those used in the construction of private housing, there is some doubt that the useful life of the military housing was extended significantly by such materials. In fact, the costs to maintain military housing and comparable private housing seemed about the same.

It appeared that the major reasons for the higher cost of the military housing were that (1) military construction standards and practices were not as economical as those normally followed by Federal Housing Administration and industry, (2) inspections of construction on military projects were more frequent and required more rigid adherence to specifications than those which industry is accustomed to under Federal Housing Administration standards, thereby adding to the cost of construction, and (3) at some locations, the wage and labor rates paid on Government contracts were higher than those prevailing in the area for the construction of private housing. A number of suggestions were made to the Secretary of Defense which, if followed, should help in obtaining the full dollar value for the money being spent for military housing and result in military

personnel being furnished accommodations which would more closely correspond to those now being occupied by civilian counterparts.

To date, a reply has not been received from the Secretary of Defense.

6. Consolidation of Field Organizations and Facilities

At the hearings in May 1967 we reported on the potential savings to be achieved by consolidating certain organizations and facilities which we had reviewed and of our intentions to review additional activities. The status of Department of Defense actions on reviews completed and of new reviews undertaken by us are as follows:

FACILITIES FOR RECRUITING MILITARY PERSONNEL

In the past, the four military services were maintaining separate field recruiting organizations and facilities substantially in excess of their combined needs. Following our report in June 1966, the Department of Defense issued a directive establishing uniform policies and procedures for providing adequate space for use by recruiting offices and stations and for co-locating such facilities to the maximum extent practicable.

With respect to the progress the Department of Defense has made, we have been advised that it plans to reduce the number of recruiting locations in 14 large metropolitan areas from 524 to 186 locations. In this connection, as of September 30, 1967, 32 recruiting sites have been co-located. It is planned that the remaining 154 co-locations will be accomplished by the fourth quarter of fiscal year 1969.

MOTION PICTURES

During a preliminary survey of the management and utilization of photographic facilities within the Department of Defense, the General Accounting Office found strong indications that the Army and the Navy motion picture production facilities were not being used to capacity and that the Air Force planned to establish a prime motion picture production center at Norton Air Force Base, California, at an estimated cost of $7 million. In June 1967, a letter report of the General Accounting Office was transmitted to the Secretary of Defense setting out views and observations that the Army Pictorial Center, Long Island, New York, appeared to have sufficient capacity to absorb a substantially increased workload comparable to the requirements of the Air Force. It appeared that it would be most feasible for the Air Force motion picture activities to be combined at the Army Pictorial Center. It was suggested to the Secretary of Defense that the Norton project be delayed until he had considered the observation in the letter report.

By letter dated August 29, 1967, however, the General Accounting Office was informed by the Assistant Secreary of Defense (Administration)—replying for the Secretary of Defense—that combining the Air Force motion picture activities at the APC is not considered feasible. The Assistant Secretary stated that "* * * such a combining would raise difficult interface problems by separating the Air Force motion picture production, processing, distribution and depository from other mission elements which represent an effective integrated system. I therefore consider it appropriate for the Air Force to proceed with plans for construction at Norton AFB."

MILITARY CALIBRATION SYSTEMS AND LABORATORIES

We have surveyed the establishment and operation of calibration laboratories by the Departments of the Army, Navy, and Air Force. The Survey was based primarily upon a review of the laboratories in the Puget Sound area of the State of Washington, but we also evaluated the management control exercised by higher command levels within the services and by the Department of Defense (DOD).

There are at least six separate calibration systems in the Department of Defense: one in the Air Force, one in the Army, and at least four in the Navy. These systems consist of a large number of calibration laboratories at the base level to calibrate test and measurement equipment, a lesser number of secondary level laboratories to calibrate the instruments used by the base level laboratories, and a limited number of primary level laboratories to calibrate the instruments of the secondary laboratories. The instruments of the primary laboratories are calibrated by the National Bureau of Standards.

We were advised that these calibration systems and their component laboratories had been established substantially without interservice coordination and without DOD guidance or direction.

The responsibility for providing calibration services is thus dispersed throughout the military department, and, with the exception of the Air Force, each major command activity separately determines the calibration capabilities needed to support its individual mission. Our study showed that, altogether, the three services were operating about 280 calibration laboratories in the United States, Far East, and Europe.

We also noted that 36 geographical areas within the United States, including the Puget Sound area, had three or more separate military calibration laboratories within 95 miles or less of one another. For example, military calibration laboratories were concentrated in the following areas:

Area	Number of laboratories	Maximum statute miles between laboratories
Norfolk	9	65
Los Angeles	9	95
San Francisco	9	75
Washington, D.C.	6	20
Baltimore	5	50
Puget Sound	7	95

We were informed that the total investment in equipment associated with military calibration laboratories was about $66,000,000 in 1963 and by December 1966 it had risen to about $115,200,000.

The seven military calibration laboratories in the Puget Sound area, located within 6 to 95 miles of one another, were individually established and expanded during the period from 1956 to 1965 as parts of separate calibration systems developed to meet the needs and requirements of the individual services or major commands within a service. Our preliminary studies and discussions indicate that these laboratories, which have an investment of about $1,300,000 in equipment alone, have significant duplication of facilities and that much of the equipment of each laboratory is in actual use for only a small percentage of its available time. Because of the technical nature and variety of the equipment, however, we were unable to determine the full extent of unneeded duplication, without performing a more detailed review.

The present proliferation of military calibration systems and laboratories appears to have been caused by a dispersal of authority among major commands within the Army and Navy and an absence of coordination from the Department of Defense.

The Department of Defense has a program designed to encourage voluntary interservice support initiated at the operating level and thus achieve greater utilization of facilities and eliminate and avoid unnecessary duplications. This Defense Retail Interservice Logistic Support Program appears to have been quite successful to date, having achieved, according to a recent DSA study, interservice support agreements with measurable benefits of $26,000,000 at a reported cost of $29,000. We believe, however, that even greater benefits may be realized through increased participation in the program by higher commands.

The current program seems to be most successful when dealing with functions that lie fully within the control of commanders at an operating level. We have noted, however, that functions, such as calibration, which are part of a service-wide system, do not respond to this program as readily as functions that lie fully within the control of local commanders. We believe that interservice calibration support on a significant scale can be more readily achieved by introducing, at the planning or major command level, a program similar to the Defense Retail Interservice Logistic Support Program.

We advised the Secretary of Defense of our survey findings and observations in a letter dated October 6, 1967. We have not as yet received his comments.

SERVICE-TYPE ACTIVITIES

Since at least 1960 the Department of Defense has had a policy that the military services should jointly utilize support facilities wherever possible. The Gen-

eral Accounting Office has a review under way at two locations to ascertain whether the above policy is being carried out with respect to maintenance of facilities in areas where there are concentrations of military installations. The areas we are reviewing are Oahu, Hawaii, and Norfolk, Virginia. Findings to date indicate that further centralization of maintenance functions at these locations should provide substantial savings in maintenance expenditures.

7. Competition in Procurement

Contracts negotiated on the basis of adequate price competition represent a significant portion of all contracts negotiated by the Department of Defense during the past three years. DOD statistics indicate that contracts negotiated on the basis of price and other competition aggregated about $5.5 billion in fiscal year 1965, $9.8 billion in fiscal year 1966, and $11 billion in fiscal year 1967.

Public Law 87–653 provides that in the award of a negotiated contract over $100,000, cost or pricing information and a certificate need not be obtained in instances where the contract price is based on adequate price competition.

The Department of Defense in its procurement regulations defines adequate price competition and sets out general guidelines for the use of contracting officials. The guidelines provide that price competition exists if offers are solicited on the basis that the contract is to be awarded to the responsive and responsible offeror submitting the lowest evaluated price and at least two offerors who can satisfy the Government's requirements independently contend for the contract by submitting priced offers responsive to the expressed requirements of the solicitation.

If these conditions are met, contracting officials may presume that price competition is adequate unless they determine that the solicitation was unreasonably restricted, the low offeror had such an advantage over other competitors that he was immune to the stimulus of competition, or the lowest price was not reasonable. The determination of whether there is adequate price competition for a given procurement is largely a matter of judgment on the part of contracting officials.

We are currently performing a review to determine how these guidelines are being applied by contracting officials and whether there is a need for additional or revised instructions pertaining to contracts negotiated on the basis of this exception to the requirement for obtaining certified cost or pricing information. Our work has not progressed to the point we can draw any conclusions.

8. Reporting of Negotiated Procurement Actions as Competitive or Noncompetitive by the Department of Defense

At the May 1967 hearings we stated that a significant number of the procurement actions valued at $2,500 and under as well as other actions in excess of $10,000 each, were classified and reported as competitively awarded, which, in our opinion, were awarded under noncompetitive conditions. Our work showed that the primary causes for these misclassifications stemmed from inadequate criteria in the Armed Services Procurement Regulation, the manner in which the Regulation was applied, and from the format of reports used to report the procurement actions. We felt that the Regulation needed revision to provide additional guidance to contracting officers for classifying and reporting of negotiated procurement actions. In September, 1967 the Department of Defense issued its revised instructions. The revisions, if appropriately applied by contracting officers, should improve the reporting of negotiated procurement actions.

With respect to negotiated procurement actions of $2,500 and under, the Department has provided that these actions be reported as noncompetitive unless it is economically feasible to record and tabulate the price competition status of such actions.

Among the more important changes in determining whether price competition existed in procurements in excess of $2,500, is the general requirement that at at least two offers should be received from responsible offerors capable of satisfying the Government's requirements. In the past, one offer would be classified as competitive so long as two or more bids had been solicited. The proposed changes still permits the reporting of one offer as competitive where offers were solicited from two or more firms who normally contend for the same or similar items. However, provision is made that contracting officers exercise sound judgment in

evaluating the relevant information concerning the reporting of a transaction as price competitive.

We plan to test the effectiveness of the revised procedures in our future work.

9. Real Estate Management

Related to the Subcommittee's continuing interest in the management of real estate owned by the Federal Government, we have recently completed and will shortly report on a review of the need for land held by the Coast Guard in 4 of the 12 Coast Guard Districts.

Our review showed that the Coast Guard was retaining land which seemed be be excess to its present or planned needs because Coast Guard Headquarters' instructions did not specifically require, and Coast Guard district offices had not developed, a program for systematically and continuously reviewing land holdings. We found that about 1,500 of the 11,435 acres held by the 4 districts may be excess to needs. Information supplied by local realtors and Coast Guard district officials indicated that about 400 of the 1,500 acres had a value of about $250,000. We did not obtain valuation information for the remaining 1,100 acres.

The Commandant of the Coast Guard in a letter dated August 23, 1967, agreed that instructions were needed for a systematic evaluation of the Coast Guard's land holdings, and stated that an instruction will be issued to reemphasize the necessity for an active real property management board in each district. He stated also that the instruction will include specific criteria for retention and disposal of real property, and provide for a regular review of operational requirements in relation to property holdings.

10. Savings and Economies to the Government as a Result of General Services Administration Operations

In its July 1967 report the Subcommittee suggested that the General Accounting Office review the report submitted by GSA on the savings and economies realized and give consideration to whether similar savings might be obtainable elsewhere in the Government. The report was entitled "Savings and economies to the Government as a result of GSA operations, fiscal years 1965 and 1966", and for fiscal year 1966 showed a total savings and economies figure of about $1.6 billion.

The principal savings and economies reported by GSA for 1966 were—

$363.1 million—Savings from large volume buying of supplies and materials for distribution through the GSA supply system and FSS schedule purchasing by using agencies.

$952.0 million—The transfer of excess personal and real property among Federal agencies for further Federal use.

$138.0 million—Proceeds from sales of personal property ($13.0 million) and real property ($125.0 million).

$90.0 million—Rehabilitation of personal property and distribution of such property through the GSA supply system.

General Services Administration operates under the mandate of the Federal Property and Administrative Services Act and provides a host of direct services to other agencies of the Federal Government as well as policy guidance in the "general services" field. Almost all the savings reported by GSA relate to these Government-wide responsibilities. Accordingly, the savings do not represent opportunities generally applicable to other agencies of the Government, although such savings may serve to emphasize to them the importance of cooperating with GSA in its endeavors.

GSA has an established system for compiling annual savings figures used in its annual report and elsewhere. The figures reported to the Subcommittee were drawn from this system and appear to have been intended to show the *gross* savings and economies resulting from its activities.

The Subcommittee has requested that we verify "the reality of net savings." Generally speaking, the figures reported by GSA were not intended to show *net* savings in the sense that (1) all GSA costs were deducted, or (2) the GSA cost of carrying on an activity was less than the costs which would have been incurred by the Government if the activity had been carried on by each of the benefiting agencies. Also, the figures reported for property transferred and rehabilitated are based on acquisition cost and, for purposes of estimating net savings, need be qualified by considerations such as condition, nature of use by

the receiving agency, and the proceeds which might have been obtainable through sale.

In examining the GSA report, we have noted three matters which warrant specific comment:

1. The $952.0 million in savings reported under the reutilization program includes $233 million representing properties which were withdrawn from excess status by the agencies which had previously reported them as excess to their needs. GSA has informed us that these withdrawals are included because (a) it expends some effort in processing the reports of excess property and attempting to achieve other agency utilization prior to withdrawal and (b) withdrawal for reuse by the reporting agency avoids expenditures for new procurement to the same extent as would be the case had the property been transferred to another agency. We believe that, except where clear evidence exists to the contrary, such withdrawals should be considered as corrections of declarations of excess properties by the holding agencies. We did not attempt to establish what part of the $233 million in withdrawals would be appropriate for reporting.

2. The report omits the savings on intercity telephone calls realized through the Federal Telecommunications System. GSA studies show that savings amounted to about $62 million in 1966.

3. The reported figures for 1966 show savings of $0.2 million from the motor pool program. This is in error. The backup material shows savings of $19 million.

Subject to the foregoing comments, we found that generally the reported savings and economies were adequately described, based on reasonable assumptions and appropriately supported. Minor exceptions, which do not materially affect the total reported savings, will be discussed with GSA.

11. Methods of Financing Agency Programs

In its July 1967 report, the Subcommittee requested the General Accounting Office to provide to the Congress from time to time a summary of methods of financing Government programs other than through direct appropriations.

Our previous survey in this area was performed at the request of Congressman Thomas B. Curtis, and resulted in our report to him dated May 8, 1967. The report was made available to the Subcommittee for use during its hearings held in May 1967.

In response to the Subcommittee's request, we plan to review laws enacted through the first session of the 90th Congress and subsequent to the date of the information included in our May 8, 1967, report, and furnish a supplemental report to the Subcommittee in about March 1968. In the future we plan to prepare a complete report on this subject as of the close of each Congress, giving consideration to ways of improving the usefulness of the information provided through refining the types of information to be reported and the criteria by which the various methods of financing may be classified.

APPENDIX 2

TRUTH IN NEGOTIATIONS ACT

PUBLIC LAW 87-653, 87TH CONGRESS, H.R. 5532, SEPTEMBER 10, 1962

AN ACT To amend chapter 137, of title 10, United States Code, relating to procurement

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That title 10 of the United States Code is hereby amended as follows:

(a) Subsection 2304(a) is amended to read as follows:

"(a) Purchases of and contracts for property or services covered by this chapter shall be made by formal advertising in all cases in which the use of such method is feasible and practicable under the existing conditions and circumstances. If use of such method is not feasible and practicable, the head of an agency subject to the requirements for determinations and findings in section 2310, may negotiate such a purchase or contract, if—".

(b) Subsection 2304(a)(14) is amended to read as follows:

"(14) the purchase or contract is for technical or special property that he determines to require a substantial initial investment or an extended period of preparation for manufacture, and for which he determines that formal advertising would be likely to result in additional cost to the Government by reason of duplication of investment or would result in duplication of necessary preparation which would unduly delay the procurement of the property;".

(c) Section 2304 is amended by adding a new subsection as follows:

"(g) In all negotiated procurements in excess of $2,500 in which rates or prices are not fixed by law or regulation and in which time of delivery will permit, proposals shall be solicited from the maximum number of qualified sources consistent with the nature and requirements of the supplies or services to be procured, and written or oral discussions shall be conducted with all responsible offerors who submit proposals within a competitive range, price, and other factors considered: *Provided, however,* That the requirements of this subsection with respect to written or oral discussions need not be applied to procurements in implementation of authorized set-aside programs or to procurements where it can be clearly demonstrated from the existence of adequate competition or accurate prior cost experience with the product, that acceptance of an initial proposal without discussion would result in fair and reasonable prices and where the request for proposals notifies all offerors of the possibilty that award may be made without discussion."

(d) The second sentence of subsection 2306(a) is amended by subsituting "(f)" for "(e)".

(e) Section 2306 is amended by adding a new subsection as follows:

"(f) A prime contractor or any subcontractor shall be required to submit cost or pricing data under the circumstances listed below, and shall be required to certify that, to the best of his knowledge and belief, the cost or pricing data he submitted was accurate, complete and current—

"(1) Prior to the award of any negotiated prime contract under this title where the price is expected to exceed $100,000;

"(2) Prior to the pricing of any contract change or modification for which the price adjustment is expected to exceed $100,000, or such lesser amount as may be prescribed by the head of the agency;

"(3) Prior to the award of a subcontract at any tier, where the prime contractor and each higher tier subcontractor have been required to furnish such a certificate, if the price of such subcontract is expected to exceed $100,000; or

"(4) Prior to the pricing of any contract change or modification to a subcontract covered by (3) above, for which the price adjustment is expected to exceed $100,000, or such lesser amount as may be prescribed by the head of the agency.

"Any prime contract or change or modification thereto under which such certificate is required shall contain a provision that the price to the Government, including profit or fee, shall be adjusted to exclude any significant sums by which it may be determined by the head of the agency that such price was increased because the contractor or any subcontractor required to furnish such a certificate, furnished cost or pricing data which, as of a date agreed upon between the parties (which date shall be as close to the date of agreement on the negotiated price as is practicable), was inaccurate, incomplete, or noncurrent: *Provided*, That the requirements of this subsection need not be applied to contracts or subcontracts where the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, prices set by law or regulation or, in exceptional cases where the head of the agency determines that the requirements of this subsection may be waived and states in writing his reasons for such determination."

(f) The first sentence of subsection 2310(b) is amended to read as follows:

"Each determination or decision under clauses (11)–(16) of section 2304(a), section 2306(c), or section 2307(c) of this title and a decision to negotiate contracts under clauses (2), (7), (8), (10), (12), or for property or supplies under clause (11) of section 2304(a), shall be based on a written finding by the person making the determination or decision, which finding shall set out facts and circumstances that (1) are clearly illustrative of the conditions described in clauses (11)–(16) of section 2304(a), (2) clearly indicate why the type of contract selected under section 2306(c) is likely to be less costly than any other type or that it is impracticable to obtain property or services of the kind or quality required except under such a contract, (3) clearly indicate why advance payments under section 2307(c) would be in the public interest, or (4) clearly and convincingly establish with respect to the use of clauses (2), (7), (8), (10), (12), and for property or supplies under clause (11) of section 2304(a), that formal advertising would not have been feasible and practicable."

(g) Section 2311 is amended to read as follows:

"§ 2311. Delegation

"The head of an agency may delegate, subject to his direction, to any other officer or official of that agency, any power under this chapter except the power to make determinations and decisions under clauses (11)–(16) of section 2304(a) of this title. However, the power to make a determination or decision under section 2304(a)(11) of this title may be delegated to any other officer or official of that agency who is responsible for procurement, and only for contracts requiring the expenditure of not more than $100,000."

(h) The amendments made by this Act shall take effect on the first day of the third calendar month which begins after the date of enactment of this Act.

Approved September 10, 1962.

APPENDIX 3

SECRETARY NITZE'S MEMO OF SEPTEMBER 29, 1967, AND VIEWS THEREON BY THE COMPTROLLER GENERAL

THE SECRETARY OF DEFENSE,
Washington, September 29, 1967.

Memorandum for: Secretaries of the Military Departments.
Assistant Secretary of Defense (Comptroller).
Assistant Secretary of Defense (I. & L.).
Directors of Defense Agencies.

Subject: Access to cost performance records on noncompetitive firm fixed price contracts.

I have given careful consideration to the arguments for and against access to contractor post-award cost performance records on noncompetitive firm fixed price contracts, for the purpose of determining the degree of contractor compliance with PL 87-653. Clearly, it has been and remains our policy that in firm fixed price contracts the cost and profit consequences are the full responsibility of the contractor since he assumes all the risk of performing in accordance with the contract. Likewise, it is our policy that such contracts be used only where there exists a reliable basis for judging reasonableness of contractor cost estimates. Where such a basis does not exist, other contract forms should be used.

The Department of Defense is required to conduct a program of review and audit sufficient to ascertain that the cost or pricing data submitted by contractors in connection with the negotiation of noncompetitive firm fixed price contracts were current, accurate and complete as required by PL 87-653. It is our policy to make such audits, as fully as possible, prior to completing the negotiation of the contract. However, when it is necessary to provide assurance that defective cost or pricing data were not submitted, audits should also be conducted of actual costs incurred after contracts are consummated. To assure that such post-award audits may be conducted when deemed appropriate, action shall be taken to include in all noncompetitive firm fixed price contracts involving certified costs or pricing data, a contractual right to have access to the contractor's actual performance records.

Circumstances which may dictate the use of a post-award cost performance audit include such cases as those where: (1) factors of urgency in placing the initial procurement were clearly present; (2) material costs are a significant portion of the contractor's total cost estimate; (3) a substantial portion of the contract is proposed for subcontracting; or (4) there was a substantial interval between completion of the pre-contract cost evaluation and agreement on price.

In directing this action, I wish to make it clear that the purpose of any post-award cost performance audit, as provided herein, is limited to the single purpose of determining whether or not defective cost or pricing data were submitted. Access to a contractor's records shall not be for the purpose of evaluating profit-cost relationships, nor shall any repricing of such contracts be made because the realized profit was greater than was forecast, or because some contingency cited by the contractor in his submission failed to materialize—unless the audit reveals that the cost and pricing data certified by the contractor were, in fact, defective.

I desire that the Assistant Secretary of Defense (Installations and Logistics) and the Assistant Secretary of Defense (Comptroller) issue implementing instructions to place the above policies into effect.

PAUL H. NITZE.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., October 30, 1967.

HON. WILLIAM PROXMIRE,
United States Senate,

DEAR SENATOR PROXMIRE: In view of your interest in the implementation of Public Law 87–653 by the Department of Defense, we are offering our views on a memorandum issued by the Deputy Secretary of Defense dated September 29, 1967, on *access to cost performance records on noncompetitive firm fixed-price contracts.*

The memorandum is addressed to the Secretary of the Military Departments, the Assistant Secretaries of Defense (Comptroller) and (I. & L.) and Directors of Defence Agencies. It contains statements on contracting and auditing policies of the Department of Defense and *directs the Assistant Secretaries of Defense to issue implementing instructions to place the policies, summarized below, into effect.*

Noncompetitive firm fixed-price contracts shall be used only where there exists a reliable basis for judging reasonableness of contractor cost estimates; where such a basis does not exist, other contract forms shall be used.

A program shall be conducted for review and audit sufficient to ascertain that the cost or pricing data submitted by contractors in connection with the negotiation of noncompetitive firm fixed-price contracts were current, accurate and complete as required by P.L. 87–653. Such audits shall be made, as fully as possible, prior to completing the negotiation of the contract.

When is is necessary to provide assurance that defective cost or pricing data were not submitted, audits should be conducted of actual costs incurred after contracts are consummated. To assure that such postaward audits may be conducted, action shall be taken to include, in all noncompetitive firm fixed-price contracts involving certified cost or pricing data, a contractual right to have access to the contractor's actual performance records.

The memorandum also lists circumstances which may indicate the need for postaward audits of performance costs.

With respect to access to contractors' records, we believe that the memorandum would accomplish by administrative action what would be accomplished by enactment of the bill, S. 1913, submitted by you on June 6, 1967, except that, the Deputy Secretary's memorandum is silent on the matter of the agency's right of access to subcontractors' performance records which was specifically provided for in your bill. We therefore spoke to Department of Defense officials responsible for drafting regulations to implement the memorandum about this apparent omission.

We were advised that consideration would be given, in drafting the implementing regulations, to requiring prime contractors to include clauses in subcontracts giving agency representatives the right to have access to subcontractors' records of performance. As soon as we have had an opportunity to review the Department of Defense regulations on this matter we will advise you.

Sincerely yours,

ELMER B. STAATS,
Comptroller General of the United States.

APPENDIX 4(a)

REPORT TO THE CONGRESS—NEED FOR IMPROVEMENTS IN CONTROLS OVER GOVERNMENT-OWNED PROPERTY IN CONTRACTORS' PLANTS (DEPARTMENT OF DEFENSE) BY THE COMPTROLLER GENERAL OF THE UNITED STATES

LETTER OF TRANSMITTAL

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., November 24, 1967.

B-140389.

To the President of the Senate and the Speaker of the House of Representatives:

The accompanying report summarizes our findings on the need for the Department of Defense to improve its controls over Government-owned property in contractors' plants.

On the basis of our review, we believe that there is a need to improve the system of property controls over Government-owned facilities, special tooling, and material in the possession of contractors. Generally, our review disclosed weaknesses with regard to effective use of industrial plant equipment, rental arrangements, and accounting for and control of special tooling and material. Further, we found that certain aspects of the work of Government property administrators and internal auditors were in need of improvement.

Our findings and recommendations, together with the related corrective measures taken or promised by the Department of Defense, are summarized on pages 3 through 8 in the highlights section of the report.

In our cooperative efforts, we informed Defense officials, both at local and departmental levels, of the weaknesses observed in our review at the earliest practicable time and we participated in a series of meetings with departmental officials, at which time we discussed the need for the various improvements to property control systems discussed in the report. Although we have discussed the details of our findings with the contractors and universities involved, we did not obtain their written comments regarding the contents of this report.

This report is being issued so that the Congress may be informed of the actions taken, or under consideration, and the additional steps which we feel the Department of Defense must take to improve the administration and control over Government-owned property in the possession of contractors.

Copies of this report are being sent to the Director, Bureau of the Budget; Director, Office of Emergency Planning; Secretary of Defense; Secretary of the Army; Secretary of the Navy; and Secretary of the Air Force.

ELMER B. STAATS,
Comptroller General of the United States.

CONTENTS

Introduction.
Highlights.
Background.
Findings and recommendations.
Facilities.
Utilization of industrial plant equipment.
Substantial improvements needed in utilization of IPE.
Increased versatility in use of test equipment requires improved property management.
Property accounting systems not adequate for effective management.
Prior approval not obtained although prescribed for use of IPE for non-Government purposes.
Improper use of Government-owned IPE.
Conclusions.
Agency comments and our evaluation.
Recommendations.

Redistribution of industrial plant equipment.
Idle IPE not redistributed by DIPEC in some instances.
Agency comments.
Rental of industrial plant equipment—general.
Need for uniform terms in IPE lease contracts.
Prior approvals to rent IPE not always requested.
DOD reviews and corrective measures.
Conclusions.
Agency comments and our evaluation.
Recommendation.
Revised rental procedure needed to increase return on investment in heavy presses.
Conclusions.
Agency comments.
Modernization of industrial plant equipment.
Prospects of continued large Government investment in machine tools in possession of contractors.
Anticipated savings not always realized as planned.
Acquisition lead time.
Preparation and review of justification data.
Need for assurance that resulting savings will be passed on to the Government.
Private investment in plant equipment not always encouraged.
Conclusions.
Agency comments.
Transportation and installation costs.
Conclusions.
Agency comments.
Duplicate recordkeeping.
Conclusion.
Agency comments.
Real property.
Agency comments.
Special tooling and special test equipment.
Weaknesses observed in controls over special tooling and special test equipment.
General information.
Financial controls.
Need for better identification.
Physical inventories.
Need for improved controls over special tooling provided to subcontractors.
Classification.
Conclusions.
Agency comments and our evaluation.
Recommendations.
Material.
Accounting systems to control Government material need improvements.
Conclusions.
Agency comments and our evaluation.
Recommendation.
Nonprofit institutions.
Property administration at universities.
Conclusions.
Agency comments and our evaluation.
Recommendations.
Property management functions in the DOD.
Areas for improvement in administration of Government-owned property in possession of contractors.
Agency actions and our evaluation.
Conclusions.
Agency comments.

APPENDIXES

I. Letter dated August 7, 1967, from the Deputy Assistant Secretary of Defense (Procurement) to the General Accounting Office.
II. Principal officials of the Department of Defense, the military departments, and the Office of Emergency Planning responsible for the administration of activities discussed in this report.
III. Approximate cost of Government-owned property at contractors' plants included in our review as of reporting dates in fiscal year 1966.

REPORT ON NEED FOR IMPROVEMENTS IN CONTROLS OVER GOVERNMENT-OWNED PROPERTY IN CONTRACTORS' PLANTS, DEPARTMENT OF DEFENSE

INTRODUCTION

The General Accounting Office has made a review of the adequacy of controls over Government-owned property in the possession of contractors. The review was performed pursuant to recommendations made by the former Subcommittee on Federal Procurement and Regulation (now the Subcommittee on Economy in Government), Joint Economic Committee, in its May 1966 report on the "Economic Impact of Federal Procurement." The review was also made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), the Accounting and Auditing Act of 1950 (31 U.S.C. 67), and the authority of the Comptroller General to examine contractors' records, as set forth in contract clauses prescribed by the United States Code (10 U.S.C. 2313(b)).

In performing our review, we visited—

1. Various offices of the Department of Defense (DOD) at the Assistant Secretary of Defense level and at the military department headquarters and field levels;
2. The headquarters of the Defense Industrial Plant Equipment Center (DIPEC);
3. The headquarters and some field agencies of the Defense Contract Administration Services; and
4. The plants of 21 defense contractors and the campuses of two universities.

Government-owned property in the possession of 17 of the 21 defense contractors we visited and the two universities had an acquisition cost of about $944 million; comparable data were not obtained at four contractor locations. The contractor locations at which we made our reviews were selected impartially except that selections were limited to contractors which, according to available preliminary information, had Government property in their possession. We inluded contractors which had large, moderate, or small amounts of Government-owned property in their possession. The contractors selected are engaged in a variety of defense work; e.g., airframe, aircraft engine, electronics, and ordnance. Our selection included both large and small prime contractors and subcontractors.

The contractor locations selected for our review included 15 plants under the administrative cognizance of the Defense Contract Administration Services (DCAS), a component of the Defense Supply Agency (DSA). The other six plants were under the administrative cognizance of the military services. Government property we reviewed at the two universities was administered by the Office of Naval Research (ONR).

We examined DOD policies and implementing military service and DCAS regulations relating to the administration of Government-owned property. We did not examine into all aspects of property management; however, we selected for evaluation those policies which appeared, from our preliminary inquiries, to warrant particular attention. Further, we reviewed pertinent audit reports, agency management reports, workpapers generated by the property administrator, DIPEC records, and the contractors' written procedures and related records. We reviewed records of utilization of Government-owned property maintained by the contractor to assist us in examining into the adequacy of the bases used in arriving at rentals due the Government, and the extent to which such property was being utilized.

DOD has issued instructions to place the subject of contractors' liability for loss of, or damage to, Government-owned property in their possession before the Armed Services Procurement Regulation (ASPR) Committee for study. Therefore, this subject was not covered in our review, but it will be considered when the Department's study has been completed.

A draft report of our findings was submitted to the Secretary of Defense in May 1967 for comment. In our draft report we made a series of proposals to improve the administration and control over Government-owned property. By letter dated August 7, 1967, the Deputy Assistant Secretary of Defense (Procurement) commented on our proposals. (See app. I.)

Although we have discussed the details of our findings with the contractors and universities involved, we did not obtain their written comments regarding the contents of this report.

The principal officials of the Department of Defense, the military departments, and the Office of Emergency Planning responsible for the administration of the activities discussed in this report are listed in appendix II. Appendix III lists the approximate cost of the Government-owned property at the contractor locations visited.

HIGHLIGHTS

On the basis of our review, we believe that there is a need for the Department of Defense to improve its system of controls over Government-owned facilities, special tooling, and material in the possession of contractors.

Greater adherence by responsible agency officials to the prescribed Department of Defense regulations governing industrial plant equipment (IPE) in the possession of contractors as well as certain revisions to the current regulations are necessary to ensure the maximum benefits accrue to the Government from its sizable investment in these facilities.

The need for these improvements is pointed up by our findings that—

1. Some of the equipment is being used by contractors in their commercial operations without appropriate Government approval and without equitable compensation to the Government;
2. There is little or no use for extended periods of a substantial portion of the equipment, for some of which there is a current need in other plants;
3. Utilization data maintained by some contractors are not adequate to indicate the extent and manner of use;
4. DIPEC, the office responsible for the management of idle IPE, frequently permitted the purchase of equipment to fill requisitions although the requested equipment was idle and available at other locations;
5. Rental policies, in some cases, were inimical to the Government's interests, and
6. In some cases, the Government's interests might better be served by foregoing replacing outworn or outmoded equipment in favor of the contractors' acquiring the replacement at its own expense.

Special tooling, including special test equipment, in the possession of contractors represents a significant investment by the Government. Although the Government does not require contractors to report the value of such property in their possession, the estimated cost of this class of property at the contractors' plants we visited amounted to more than $347 million, or over one-third of the cost of Government property in the possession of those contractors.

We found weaknesses in the control of this property due to deficiencies in inventory practices, the absence of financial controls, and the absence of a requirement for surveillance by Government property administrators of special tooling in the possession of subcontractors. Also, in some instances, Government-owned tooling was not identified as Government property or in the property records.

Some tooling is usable for many years. Also, the adaptability of much of this tooling to commercial purposes indicates the need for financial control over such property. Further, it seems necessary for tooling and test equipment to be properly classified, identified, and accounted for to prevent unauthorized use and

unrecognized loss and to provide information to facilitate intelligent decision making in regard to acquisition, dispositions, rentals, and transfers.

We found that accounting systems employed by contractors did not provide for financial control, and in most instances acceptable physical inventories of Government-owned material were not being taken properly. We attribute these weaknesses to indefinite instructions existing in the ASPR, deficient physical inventory taking, and departure from good property management practices.

Financial control accounts are not required by the ASPR to be maintained by nonprofit institutions for IPE and special test equipment, nor were they being maintained by the two universities we visited. We found that periodic inventories were not required by the ASPR nor were they taken by the universities, even though research contracts frequently are in process for several years. Physical inventories are generally taken only upon completion of a contract. In those instances where physical inventories were taken at contract completion, we found that the procedures employed did not provide necessary internal control.

The ASPR provides for the contractor's property accounting system to be submitted to the property administrator for approval. The Regulation also requires that the property administrator periodically test the contractor's system to ensure that adequate control exists over Government-owned property.

We found that the value of the approval process of the contractor's property accounting system by Government property administrators as a means to ensure adequate control over Government-owned property was questionable because contractor systems were allowed to continue in an approved status even though the property administrator had found significant weaknesses.

We also found that relatively few internal audits have been made of the effectiveness of property administration at contractors' plants, Audits that were made regarding the adequacy of rental payments were not sufficiently comprehensive to be fully effective. Generally, the reviews were limited to (1) verifying the accuracy of data in the computations submitted by the contractor and (2) determining whether the procedure for computing the rent was in accordance with the terms of the lease. An evaluation as to whether the prevailing terms of the lease were equitable to the Government was not apparent.

In our draft report to the Secretary of Defense, we made a number of proposals to improve the administration over Government-owned property. In general, we have found agency management receptive to our suggestions. Actions have been taken or planned in response to most of our proposals which, if properly implemented, should result in significant improvements in the control and utilization of such property.

The Department of Defense, however, did not fully agree with, or did not indicate any specific corrective action on, our proposals to (1) require contractors to furnish machine-by-machine utilization data and to obtain prior Office of Emergency Planning approval on an item-by-item basis for the commercial use of industrial plant equipment and (2) strengthen the controls over special tooling and special test equipment through the use of financial accounting controls. We believe that implementation of these proposals or of other acceptable alternatives is necessary to effectively administer this property. Therefore, we are recommending to the Secretary of Defense that he reconsider the Department's position on these matters.

We are also recommending to the Director, Office of Emergency Planning, that prior approvals for planned commercial use of IPE be administered on a machine-by-machine basis.

Following is a tabulation of our major findings and actions taken or under consideration by the Department of Defense to implement improvements needed. The tabulation also sets forth our recommendations for added controls or for strengthening the Department's existing or proposed controls over Government-owned property.

SUMMARY OF MAJOR FINDINGS AND ACTIONS TAKEN OR UNDER CONSIDERATION BY THE DEPARTMENT OF DEFENSE TO IMPLEMENT IMPROVEMENTS NEEDED AND GENERAL ACCOUNTING OFFICE RECOMMENDATIONS FOR ADDED CONTROLS OR FOR STRENGTHENING THE DEPARTMENT'S EXISTING OR PROPOSED CONTROLS OVER GOVERNMENT-OWNED PROPERTY

FACILITIES

Findings	Actions taken or under consideration by the Department of Defense	Recommendations by the General Accounting Office
1. Utilization: Many items of Government owned industrial plant equipment were being retained which, in our opinion, should have been reported as excess because they were not used, were being used very little, or were being used extensively for commercial work. In the case of high commercial use, we found that generally the required prior approvals for such use had not been obtained from the Office of Emergency Planning. We believe that such use was not always in the best interest of the Government since the circumstances sometimes indicated that the most efficient IPE was not being used to process Government work. For example, about 1 year after an 8,000-ton forge press costing $1,400,000 was installed, it was used extensively for commercial production of jet engine midspan blades. In the 3-year period ended Dec. 31, 1965, the 8,000-ton press was used 78 percent of actual production time for commercial work while the majority of Government procurement of midspan blades was processed on older 4,000-ton presses.	ASPR is being revised to prescribe that the contractor be required contractually to establish and maintain a written system for controlling IPE, and property system surveys will be conducted to insure the system's effectiveness and to show the extent and manner of its use. Also a feasibility study will be made regarding maintenance of utilization records on a machine-by-machine basis; for example, IPE of selected high value.	We are recommending to the Secretary of Defense that use data of IPE be compiled on a machine-by-machine basis to the extent feasible and that this basis be emphasized in the study which DOD will perform regarding the feasibility of maintaining utilization records. We are recommending to the Director, Office of Emergency Planning, that prior approvals for planned commercial use of IPE be similarly administered.
2. Redistribution: On the basis of the results of a statistical sample, we estimate that, during a 6-month period, IPE with a value of approximately $12,000,000 could have been offered by DIPEC to fill requisitions for IPE which it stated was unavailable from its inventory.	DIPEC has established a training program for all commodity managers with particular emphasis placed on the requirement to document specific conditions under which items in inventory are rejected as being unsuitable for the intended use.	None.
3. Rent: We found that the various bases upon which the rent payments were negotiated resulted in a lack of uniformity in the rates actually charged; inequities between contractors; and, in some cases, a reduction in the rent payments to the Government. We found that the determination of rent on a machine-by-machine basis and similarly applying the rent credit for Government rent-free use to each machine above an established value in its ratio of Government versus commercial machine-hours of use would be more accurate and more equitable. At 1 contractor's plant the rent payment would have increased from $226,400 to $809,000 for the year ended Sept. 30, 1966, under such a procedure.	Several alternative proposals for administering rent are under consideration by the ASPR Committee; none of the proposals contemplate a determination of actual equipment used on a machine-by-machine basis.	We are recommending to the Secretary of Defense that the ASPR Committee closely examine the feasibility of computing rent on a machine-by-machine basis and similarly applying the rent credit for Government rent-free use to each machine above an established dollar value in its ratio of Government versus commercial hours of use.
4. Rental, heavy presses: The current policy of charging rent for both Government and commercial work, at a rate of 4 percent of sales, may not be in the best interest of the Government since the overall use of the presses has significantly increased and significant amounts of commercial sales are now being processed through the presses. We found that the rental arrangements were yielding only 1 to 2 percent annual return on the Government's investment in the heavy presses.	DOD, in conjunction with the Air Force, is reexamining existing arrangements pertaining to rental charges for the heavy presses. Also, DOD is considering such aspects as waiving the rental charges for Government work, increasing rental returns on commercial work, and the feasibility of selling some of the presses to Defense contractors.	None.

SUMMARY OF MAJOR FINDINGS AND ACTIONS TAKEN OR UNDER CONSIDERATION BY THE DEPARTMENT OF DEFENSE TO IMPLEMENT IMPROVEMENTS NEEDED AND GENERAL ACCOUNTING OFFICE RECOMMENDATIONS FOR ADDED CONTROLS OR FOR STRENGTHENING THE DEPARTMENT'S EXISTING OR PROPOSED CONTROLS OVER GOVERNMENT-OWNED PROPERTY—Continued

FACILITIES—Continued

Findings	Actions taken or under consideration by the Department of Defense	Recommendations by the General Accounting Office
5. Modernization: The DOD program for replacement of Government-owned machine tools as presently administered will, in our opinion, tend to perpetuate the large Government investment in general purpose machine tools in possession of contractors and thus defer indefinitely the time when contractors would furnish all facilities in accordance with DOD basic policy. We found instances where contractors had not been encouraged, as prescribed by DOD policy, to privately finance the purchases of new machines and other instances where the approvals to provide new Government-furnished machines had been based on inaccurate information. For example, an approved modernization program for 1 contractor included 4 gearmaking machines estimated to cost $232,100 based upon repaying the investment through reduced operating costs within 3 to 4 years. To do this the initial year's use would have had to increase 8 times over present levels. As of September 1966 the contractor had no active requisitions for additional gear machine operators; moreover, 1 of the replaced machines had been used exclusively for commercial production. In addition, DOD procedures did not include a contractual provision for recovery by the Government of all savings resulting from use of the modern and more efficient Government-furnished machines.	Guidelines to improve the administration of the modernization program will be revised, where applicable, and improvements will be made where existing guidelines are deemed adequate consistent with the improvements needed and cited.	None.
Other: At some contractor locations we noted that the cost of installation and/or transportation associated with the acquisition of IPE was not identified and recorded as prescribed by the accounting principles and standards of the Comptroller General. Also, we found that the Navy was unnecessarily maintaining records of its IPE which were a duplication of those maintained by contractors and DIPEC.	1. A study of the most feasible way of obtaining and recording IPE transportation and installation cost data will be made to insure compliance with this requirement. 2. Duplicate recordkeeping is being discontinued and ASPR is being revised to prevent such duplications in all other Defense agencies.	Do. Do.

OTHER CATEGORIES

1. Special tooling and special test equipment: We found weaknesses in the control of this property due to deficiencies in inventory practices, classification, the absence of financial controls, and the absence of a requirement for surveillance by Government property administra'ors of special tooling in the possession of subcontractors. Also, in some instances, Government-owned tooling, as prescribed by the Armed Services Procurement Regulation, was not identifiable by physical markings or in the property records. At one plant, Government-owned tooling acquired under supply contracts at an estimated cost of $55,000,000, starting in 1952, was not controlled under a system of monetary control accounts, had never been inventoried, and lacked proper identification in the stock records.	DOD agrees that proper internal control includes segregation of duties of responsible contractor personnel taking physical inventories of Government property and DOD will review ASPR to determine if a procedural revision is necessary. However, DOD felt that the present manner of administering and controlling special tooling, as prescribed in the ASPR, was adequate and it planned no study project with regard to determining the point in the contracting process at which financial control of special tooling should be maintained.	We are recommending to the Secretary of Defense that the Department of Defense establish a study project to determine the procedures to be used and the point in the contracting process at which financial control of special tooling should be maintained. (See p. 55.) We are recommending also that periodic examination and identification be made of special tooling to identify multiuse characteristics and that the items identified be reclassified and controlled as facility type items.

SUMMARY OF MAJOR FINDINGS AND ACTIONS TAKEN OR UNDER CONSIDERATION BY THE DEPARTMENT OF DEFENSE TO IMPLEMENT IMPROVEMENTS NEEDED AND GENERAL ACCOUNTING OFFICE RECOMMENDATIONS FOR ADDED CONTROLS OR FOR STRENGTHENING THE DEPARTMENT'S EXISTING OR PROPOSED CONTROLS OVER GOVERNMENT-OWNED PROPERTY—Continued

OTHER CATEGORIES—Continued

Findings	Actions taken or under consideration by the Department of Defense	Recommendations by the General Accounting Office
Material: We found that accounting systems employed by contractors did not provide for financial control and, in most instances, acceptable physical inventories of Government-owned material were not being properly taken. We attribute the weaknesses to indefinite instructions existing in the ASPR, deficient physical inventory taking, and departure from good property management practices.	Financial controls for material have been the subject of study for many years, and these studies are being continued. DOD agrees that proper internal control includes segregation of duties of responsible contractor personnel taking physical inventories of Government property, and DOD will review ASPR to determine if a procedural revision is necessary.	We are recommending to the Secretary of Defense that ASPR B-304.7 be amended to require financial accounting controls for Government-owned material in the possession of contractors. (See p. 58.)
3. Nonprofit institutions: Our review of property at 2 universities revealed that financial controls were not maintained by the universities and that at 1 university this resulted in the loss of monetary and quantitative control over at least $52,000 in Government IPE. We also found that periodic inventories were not required by the ASPR, nor were they taken by the universities even though research contracts frequently are in process for several years. When inventories were taken, the procedures employed did not provide necessary internal control. Further, we found that ASPR requirements were not being adhered to with regard to control of property by DIPEC. As a result (1) IPE, at a cost of about $260,400, was purchased in fiscal year 1966 without 1st screening DIPEC inventories to determine whether acceptable IPE was on hand and available, (2) DIPEC's central inventory files were incomplete because $1,100,000 worth of IPE on hand at the universities was not reported to DIPEC, and (3) during fiscal year 1965 and 1966, IPE in critical or short supply having a cost of $104,700 was donated to the universities without screening DIPEC to determine whether the equipment was needed elsewhere in the Government.	1. DOD feels that financial control accounts for IPE at colleges and universities are currently required by the ASPR and it will take necessary steps to insure compliance. 2. A revision to DSA regulations and ASPR will be processed to require IPE costing over $1,000, at colleges and universities, to be reported to DIPEC for management and control purposes, and IPE of this type will be screened for utilization prior to its donation under provisions of the United States Code (42 U.S.C. 1892). 3. DOD agrees that proper internal control includes segregation of duties of responsible contractor personnel taking physical inventories of Government property, and DOD will review ASPR to determine if a procedural revision is necessary.	We are recommending to the Secretary of Defense that the ASPR be revised to clearly establish the need for monetary control accounts for IPE. We are further recommending that standard IPE, now classified as special test equipment, be reclassified and controlled as facility type items. Also, we are recommending that special test equipment be accounted for under monetary control accounts. (See p. 63.)
4. Property management function in the DOD: We found that the value of the approval process of the contractor's property accounting system by Government property administrators as a means to insure adequate control over Government-owned property was questionable because (1) there was little incentive for the contractor to maintain an approved system and (2) contractor systems were allowed to continue in an approved status even though the property administrator had found significant weaknesses in the contractor's control over property which were not subsequently corrected, or when other weaknesses were, in our opinion, apparent and should have been corrected. We also found that for the past 1½ years relatively few internal audits had been made of the effectiveness of property administration at contractors' plants. Further, we found that audits that were made regarding the adequacy of rental payments were, in our opinion, not sufficiently comprehensive to be fully effective.	1. A specific ASPR requirement is being considered which will require annual reviews of contractor and nonprofit institution accounting systems. 2. A joint study project had been established with the Civil Service Commission to evaluate the current position classification standards for property administrators. 3. DOD indicated that scheduled or planned internal audits by agencies and military departments should deliver necessary audit coverage of property administration.	None. Do. Do.

BACKGROUND

This review was undertaken at the direction of the former Subcommittee on Federal Procurement and Regulation (now the Subcommittee on Economy in Government), Joint Economic Committee, in its May 1966 report on "Economic Impact of Federal Procurement." Among the recommendations the Subcommittee included in its report were (1) that the General Accounting Office cooperate with DOD in the development of an adequate contractor inventory accounting system and approve the system when found to be adequate and (2) that a thorough review also be made of any misuse or unauthorized use of Government property in the hands of contractors and proper settlement be made as soon as possible.

The Government's inventory of property in the hands of contractors consists of property which the Government has furnished and property procured or otherwise provided by contractors for the account of the Government. Basic policies governing the control of this property are set forth in the ASPR. As prescribed in this Regulation, there are five classes of Government property.

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, which is used or capable of being used in the manufacture of supplies or in the performance of services. DOD records show that as of June 30, 1966, the cost of facilities in the hands of contractors was $6.2 billion.

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.[1]

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 the items (if they are to be used separately) or assemblies is limited to testing in the development of production of particular supplies or parts thereof or in the performance of particular services.[1]

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. DOD records show that as of June 30, 1966, the cost of material in the hands of contractors was at least $4.7 billion.

Military property.—This class consists of military personal property, such as an airplane, which is provided to the contractor to assist in performing a contract but which is not consumed or incorporated in the end-items produced.[1]

In our report we make extensive reference to a type of facility referred to as IPE. The term is not specifically defined by the ASPR. However, DIPEC, a component of DSA, defines IPE as severable, general-purpose equipment used to develop, produce, maintain, and test defense material. The four major groupings of this equipment are test, metalworking, electronical and electronics, and general equipment.

The responsibility for the administration of Government-owned property in the possession of DOD contractors was vested in the property administrators of the military services until the establishment of DCAS in September 1964. Since that time, DCAS has expanded to include 11 regions and over 23,000 personnel, approximately 450 of which are property administrators. DCAS has cognizance over the administration of Government-owned property at about 5,000 contractors' plants. The individual military services have retained cognizance at 508 plants, 48 of which were major weapon systems plants.

In 1966 the Office of the Secretary of Defense (OSD), Installations and Logistics (I&L), designated ONR as the cognizant activity for field contract administration of DOD contracts with educational institutions numbering 293 as of October 1966.

DIPEC is responsible for management of idle IPE which has a unit acquisition cost of $1,000 or more. DIPEC controls the allocation and reutilization of such

[1] DOD does not collect financial data regarding the value of this class of property.

equipment and also maintains records of much of the IPE in active use and in mobilization packages controlled by the military departments and DSA. As of June 30, 1966, DIPEC's records showed that DOD components had reported approximately $3.6 billion worth of IPE. We were told that the average age of DIPEC-controlled IPE is slightly over 13 years.

Some of the current policies governing the administration of Government-owned property are contained in the following instructions:

1. DOD Directive 4275.5 dated March 13, 1964, and the superseding directive dated November 14, 1966, establishes policy on acquisition and management of industrial facilities.

2. ASPR sets forth specific policies with respect to providing property for use by contractors, clauses for inclusion in contracts, and the bases for determining rental charges for the use of Government-owned property. Appendixes B and C of ASPR set forth the basic requirements to be observed by military departments for establishing and maintaining control over Government property in the possession of contractors and nonprofit research and development contractors.

3. Title 2. General Accounting Office Policy and Procedures manual for Guidance of Federal Agencies, contains the accounting principles and standards prescribed by the Comptroller General of the United States to be observed by each executive agency.

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 for the property. The Department requires that a property administrator be designated for each contract involving Government property. The designated property administrator, who is responsible to the contract administrator, is a key Government employee with respect to the control over Government-owned property. His more significant duties 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.

In addition to the property administrator, other Government specialists are charged with certain responsibilities regarding administration of property. For example, at some contractors' plants an industrial specialist is required to examine contractor proposals for additional Government facilities and to determine the contractor's need for retaining Government-owned property. The methods to be followed in achieving the policy objectives are discussed in the instructions issued by each of the military services.

The Office of Emergencey Planning (OEP) provides planning guidance, coordination, and review on behalf of the President. In November 1963, OEP issued Defense Mobilization Order 8555.1 establishing policy guidance on Government-owned production equipment. This Order consolidated and revised then existing policies on Government-owned production equipment, including machine tools.

FINDINGS AND RECOMMENDATIONS

Facilities

Utilization of industrial plant equipment

Substantial improvements needed in utilization of IPE

Our review of IPE in the possession of contractors showed that many items were being retained which, in our opinion, should have been reported as excess and available for utilization elsewhere within the DOD. We concluded that this condition was attributable primarily to inadequacies in Government procedures for administration of property. Definitive guidelines had not been provided for determining at what usage level IPE should be declared excess; for requiring that such determinations be made periodically; nor for requiring contractors to prepare and furnish utilization data for Government property officials to use a tool of property management for controlling the use of IPE.

Our review also indicated that items of IPE which had been reported as idle and available for reutilization were not, in all cases, offered to fill requisitions received for metalworking and general plant equipment.

Further, we found that generally prior approval had not been obtained, although prescribed, for the use of IPE for non-Government purposes. It is our opinion that Government property was improperly being used in a significant number of such cases.

At the contractor locations visited, we questioned retention by the contractor of 328 items of IPE costing an estimated $15.9 million because (1) it had not been used over an extended period of time, (2) it had been used solely or predominantly for commercial work, or (3) the usage was low—below the level indicated as acceptable by the DOD. For the most part, our determinations were based on utilization data supplied by those contrators maintaining utilization records for the purpose of calculating rent payments due the Government for use of the equipment on commercial and certain Government work. We were unable to determine the manner of use of many items of equipment at a number of the contractor plants we visited because such utilization records were not maintained.

We were also restricted in our determination of need for 32 items of IPE that we had questioned at one contractor location because the need was based on estimates of expected use rather than on actual use. The balance of the items questioned, 296 items, were estimated to have cost $9.4 million.

We compared these items to incoming requisitions for IPE which DIPEC had been unable to fill during the same period of time for which we were questioning their retention by the contractors. Engineering and technical personnel at DIPEC advised us that, of the 296 items, they considered 47 to be "interchangeable" and "substitutable" with items requisitioned and that, in their judgment, the items would have been satisfactory to fill the requisitions for items which had been designated as unavailable to the requesting DOD component. Moreover, DIPEC records revealed that 81 of the 296 items of IPE were classed as being in either critical or short supply.

Our bases for questioning the 328 items are discussed in the following sections.

On the basis of our reviews of such records as were available, we believe that many other items would have reflected similar patterns of poor usage if records had been maintained to permit their identification.

IPE not in use.—DOD Directive 4275 dated March 13, 1964, and the superseding directive dated November 14, 1966, state that Government-owned facilities will be declared excess as soon as they become excess to the missions for which they were required.

We questioned retention of 133 items of IPE, estimated to cost $3.3 million, which had not been in use for extended periods of time. On the basis of our review of utilization surveys conducted by Government property officials, we concluded that in many cases undue reliance had been placed on the prospect of future production creating valid needs or desirable utilization levels for the IPE reviewed as illustrated below.

At one contractor plant we identified 74 items of equipment (estimated to have cost $1.1 million) such as screw machines, presses, lathes, and drilling machines which had not been used the first 9 months of 1966. The contractor stated that 21 of the items we identified were excess but contended that 34 items warranted retention for unknown future work. He stated that new contracts would require the use of 19 items.

The contractor did not provide the production schedules we had requested to evaluate their effect on the workload. We were advised that, as a result of recently completed surveys by Government procurement agencies, more equipment was being received. The decision to add more equipment was made without contacting the DCAS industrial specialist or requesting his assistance in the survey.

In one case a utilization survey conducted in early 1966, through floor checks, disclosed 89 items of idle IPE; however, with one exception, the contractor's justification for retention of the IPE was based on future production programs and was accepted by the Government. We could find no evidence to indicate that an investigation of the contractor's justifications had been performed. Our review of the contractor's formal justifications disclosed previous and planned use for 60 of the machines, but we found that nine of the machines were scheduled solely for commercial production only and that no production was scheduled for four others.

At another location a Government property official selectively analyzed usage-data for 3 months ended March 1966, noting many instances where IPE had little or no low use, but concluded, apparently without effective evaluation with the contractor, that incoming workload would disclose more desirable utilization in the future and that no items were excess.

IPE used for commercial work.—From the available utilization records, we determined that 115 items of IPE, estimated to have cost $11.4 million and located principally at four contractor locations, were being used solely or predominantly for commercial work. In this characterization we included IPE used for commercial work 75 percent or more of actual production time during periods ranging from 6 months to 1 year at three locations. At the other location this determination was based on the contractor's predicted use for the last 4 months of 1966.

At three locations Government property officials had not questioned retention of this IPE. Facilities contracts at these locations permitted use of the IPE for commercial work; and, in the cases where this was observed, it was apparently considered that the IPE was used for authorized purposes.

At the remaining contractor plant the Government was negotiating a long-term lease specifically to permit commercial use of the IPE. The contractor maintained projected usage data rather than utilization data for selected items of IPE. The records showing projected use indicated that 32 items of IPE estimated to have cost $6.5 million would be used predominantly for commercial work the last 4 months of 1966. According to contractor estimates, commercial use of the plant was expected to be more extensive in 1967 than in 1966. DIPEC records indicated that, by the beginning of 1967, seven of these items, estimated to cost $1.3 million, would be in a critical supply classification. This would mean that, at the present demand rate, DIPEC would not be able to fill all of the requisitions received for this IPE in 1967.

Low utilization of IPE.—On May 17, 1965, the Assistant Secretary of Defense (I&L), issued a memorandum to DSA and the military services which established criteria to be used in determining the reasonableness of the contractor's actual use of IPE. It provided that, when a contractor had two or more DOD-owned machines which are capable of the same function and which are in use 35 percent of the time (14 hours a week) or less, justification would be required for continued retention. In June 1966 the Assistant Secretary of Defense (I&L) emphasized the need for conscientious application of this criteria and stated that, pending the dissemination of more definitive criteria, the evaluation of economic utilization should include the examination and justification for retention in all instances where machines of a like function were below the usage criteria specified. DSA Manual 8300.1 provided that in performing utilization surveys, maximum use would be made of contractors' machine-loading data, production planning, and machine-time records. At the locations we visited we found no evidence to indicate that Government property representatives had implemented the criteria set forth by the Assistant Secretary of Defense.

We found that in many cases contractors did not maintain utilization data which would permit application of usage criteria. Accordingly, we could identify only four items of IPE estimated to cost $35,800 at two locations where low use was indicated by other review techniques. In three instances, however, reasonably complete utilization data were maintained. These data enabled us to question the basis for retention of 76 items of IPE, estimated to cost $1.2 million, which did not satisfy the criteria specified by the Assistant Secretary of Defense as we interpreted it. None of this equipment had been reported as excess by the contractor.

Generally, we found that, where utilization data was compiled for purposes of computing rent, Government property officials had not similarly used the data to analyze utilization of the IPE. Utilization surveys were generally limited to periodic attempts to detect idle IPE through floor checks. We noted that one contractor had developed minimum usage criteria calling for a review of idle IPE every 3 months; however, this contractor had not made the reviews.

Increased versatility in use of test equipment requires improved property management

On the basis of our review, we believe that the procedures for acquisition, administration, and redistribution of general purpose test equipment, a particular class of IPE, at contractor plants were in need of improvement. This class of IPE included primarily electronic components such as amplifiers, oscilloscopes, recorders, and signal generators.

DOD Directive 4275.5 dated March 13, 1964, and the superseding version dated November 14, 1966, placed new emphasis on property management relating to general purpose and special test equipment. The directive acknowledged that the advance of weapons technology had vastly increased the complexity, cost, and wider use of all types of test equipment. Accordingly, it provided that, to avoid duplicate investment, DOD components would thoroughly screen idle test equipment in the DIPEC inventory before procuring new items of test equip-

ment. It provided further that, when general or multipurpose components of special test equipment are no longer required, they would be reported to DIPEC in the same manner prescribed for facilities.

Our review included two contractors who had large quantities of electronic test equipment.

One of the two contractors had not requested the contracting officer to have DIPEC fill requisitions for test equipment prior to having the purchase of new equipment authorized because, in his opinion, the test equipment in DIPEC's inventory was too old, lacked warranty, and would result in lost time if found to be unacceptable. Although the Government property administrator had notified the contractor of the screening requirement in April 1966, we noted that the contractor requested that DIPEC inventories be screened only on the occasions when the acquisition was applicable to a cost-reimbursement contract.

This contractor had over 2,400 items of test equipment on hand which, according to the responsible contractor official, were not presently needed but were being held for possible future use. No system of use data had been maintained for this IPE and the Government property administrator had not required the contractor to report any of the items to DIPEC as excess. The contractor stated that the equipment had been acquired for production of a weapons system about 8 years ago and that he doubted its usefulness to anyone else at this time.

It seems evident that screening actions could not be initiated by DIPEC because the property was not reported.

At the second contractor we observed that contractor personnel were maintaining usage reports applicable to test equipment furnished under one of five facilities contracts. The usage reports were posted on a daily basis and disclosed whether the IPE was in use and, if so, the applicable sales order or contract. The data was summarized monthly, and department heads were required to justify retention of those items indicating usage below 25 percent.

We observed that the procedure resulted in periodic declarations of test equipment as excess. After our tests revealed excess items of test equipment controlled under other facilities contracts at this plant, the contractor expanded the tabulation of this data to the remaining four facilities contracts.

Property accounting systems not adequate for effective management

For the most part our findings were derived from machine utilization records prepared by contractors to compute periodic rent payments. The records sometimes were confined to a group of machines where they were necessary to make the rent computation; were of limited value because hours of machine usage were not shown; did not show commercial and Government use separately; or were not maintained at all because rent was determined on some other basis. Therefore, we lacked data, for a number of the contractors we visited, on which to base our review and our questioning of retention of the IPE.

The conditions outlined in this report were due primarily, in our opinion, to the absence of a requirement that the contractors' property accounting systems furnish meaningful utilization data as a tool for property management. Also lacking were clear and specific criteria for acceptable usage levels and provisions for its periodic measurement against utilization data furnished by the contractor.

Proposed changes to ASPR now in process (ASPR Case 66–314) place the primary responsibility with the property administrator to insure that the contractor has an effective IPE utilization system. Facilities contracts under guidelines proposed (ASPR Case 66–314) will recognize a need for maintenance of IPE utilization records in accordance with sound industrial practices and will afford the Government adequate opportunity to inspect all such records. The contracts would require that the contractor establish minimum standards of utilization and that he review the need for IPE items when utilization falls below the established standard.

Industry representatives have expressed the view that application of a rigid standard may be impractical since many factors have a bearing upon the logical point below which IPE cannot be considered economically used. However, they are in agreement that appropriate standards should be established for required degrees of utilization as suited to the item or family of items.

Prior approval not obtained although prescribed for use of IPE for non-Government purposes

The Office of Emergency Planning (OEP), in June 1957, established a requirement for contractors to request advance approval to use Government-owned machine tools on commercial work exceeding 25 percent of the total usage. OEP established the procedure for prior approval primarily to preclude contractors

from obtaining a favored competitive position through leasing Government-owned production equipment. To administer this procedure, ASPR 13-405 provides:

"Prior approval of the Office of Emergency Planning shall be obtained through the Assistant Secretary of Defense (Installations and Logistics) before more than 25% non-Government use of Government-owned machinery and tools * * * may be authorized. * * *"

We found, in inquiring at OEP, Washington, D.C., in December 1966, that since January 1, 1965, only five requests had been submitted, one of which had been disapproved. Generally, contracting officers were not requiring contractors to request and contractors were not requesting advance approval to use Government-owned IPE for commercial work in excess of the 25-percent restriction, as illustrated below. We observed that it was uncertain whether the 25-percent criteria referred to total planned use or to a fraction of the hours potentially available under one shift or two shifts, or to a certain number of days a week, etc., or if it was to be administered on a total plant or an item-by-item basis.

In four cases facilities contracts were silent or unclear as to the requirement to obtain OEP prior approval, and Government officials had not sought OEP approval even though items of IPE were being used in excess of 25 percent of actual production time for commercial work. For example, a facilities contract negotiated by the Navy required the contractor to use IPE for at least 75 per cent of the yearly total of authorized hours for Government production and it was silent as to conditions that might require OEP approval for other uses.

In another instance OEP denied a contractor the use of Army facilities for commercial work, but at the same time the contractor was using Air Force facilities extensively for commercial work without being required to submit a request. In 1965 this contractor used an average of 1,000 items of IPE a month, costing $17.2 million, for commercial work on a share basis with the Air Force. This increased to $26.5 million in 1966 and the IPE was used in the various company operating groups on an average of from 41 to 97 percent of the actual production time for commercial work. Although the Government officials administering the property were aware that submission of requests for use were appropriate, they had not required the contractor to do this because of (1) the many items of IPE subject to commercial use and (2) their assumption that the request would have to be submitted monthly since the facilities contract requires local approvals monthly for rental purposes.

At two contractor locations Air Force facilities contracts had incorporated provisions which required the contractor to notify the contracting officer when non-Government use was expected to exceed 25 percent of the total equipment use.

In one case 105 items of IPE valued at $6.1 million had been used an average of 58.5 percent of the production time for commercial work during the 6 months ended July 31, 1966, without advance approval. The contracting officer stated that the contractual requirements to obtain OEP prior approval had been added in December 1965 and that he had not checked the contractor's compliance. At the other location the contractor used 67 items of IPE, valued at more than $2 million, over 25 percent of production time for commercial work. The contractor advised us that he was unaware of the contract requirements.

Some DOD and OEP officials stated in the course of our review that approvals to use IPE should be administered on an item-by-item basis. A DOD official further stated that, by reasonable application of the rule, some exception was in order where a line of machines performed a task jointly.

Improper use of Government-owned IPE

On the basis of information available for our review, it was our opinion, that, in a significant number of cases, Government-furnished IPE was not properly used from the Government's viewpoint. In these cases advance approval for such use had not been obtained from OEP, so that the designated Government authority had not reviewed and either approved or disapproved the manner in which it was being used.

For example, an 8,000-ton mechanical forge press costing $1.4 million was installed at a contractor's plant in late 1961 on the basis that the less efficient 4,000-ton presses, also Government-owned, could not handle all of the Government orders for jet engine midspan blades. During the 3 years ended December 31, 1965, the 8,000-ton press was used 78 percent of actual production time for commercial work without advance OEP approval while the majority of Government procurement of midspan blades was processed on the 4,000-ton presses.

Also this contractor had used 10 machines, costing from $29,000 to $141,000 each, 100 percent of the time for commercial work during the first 6 months of 1966 without obtaining advance OEP approval.

In another instance the Navy furnished a contractor an automatic turret lathe costing $45,600 on the basis of the contractor's projected initial year saving of $25,800 in operating costs. We noted that during the first year the new lathe, without advance OEP approval, was used 513 hours, or 24 percent of the actual production time, on Government rent-free work and chiefly for commercial work the rest of the time. Thus the Government did not receive the benefit of most of the saving in operating costs. At the same time, Government rent-free work totaling 5,756 hours was processed on five older, less efficient turret lathes.

In another case, during the 9-year period ended September 1966, an ammunition facility was used about 80 percent of the time for commercial work which represented over $24 million in sales. The facilities contract, dated in November 1950, allowed use for commercial products provided this did not interfere with production of military items. In September 1965 the Navy activated this facility for rocket warhead production calling for delivery of 15,000 to 52,000 warheads a month through June 1966. Although the facilities contract specified that a production capability of 95,000 warheads a month be maintained, the condition of the IPE was such that the contractor could not meet delivery schedules.

We noted that the commercial work remained at about its previous level; however, the contractor advised us that this did not interfere with military production because some of the machines being used could not hold the tolerances required for rocket warhead production. We were unable to determine the effect of the commercial production on the present condition of the IPE. It should be noted however, that Navy officials were unaware of the extent of commercial production at this facility.

From the records made available to us, we could not tell whether a determination as to the condition of the IPE and the effect of commercial production, had ever been made. While Navy officials conceded that previous commercial use may have contributed to the equipment's inability to meet required tolerances, they pointed out that such commercial use was allowed under the contract. The contract had not been amended to insert the OEP approval requirement which became effective June 1957.

Conclusions

The need for good property management is evident in view of the Government's large investment in IPE and the widespread demands for these resources. In our opinion, the circumstances described in the preceding pages are indicative that the Government has not always followed a policy which results in the most desirable use of its IPE.

We believe that the present methods of controlling the use and disposition of Government-owned IPE are not adequate, primarily because of a requirement for contractor property accounting systems to include meaningful utilization data as a tool for property management. We believe also that proposed ASPR changes (ASPR Case 66–314) which require the contractor to maintain IPE utilization records in accordance with sound industrial practices and to establish utilization standards are not specific enough to protect the Government's interests.

Additionally, we believe that the Government should prescribe the standards and the information needed to properly manage its equipment, including information not only as to the extent but also as to the manner of use (i.e., commercial work, Government work for which rental is paid, Government rent-free work, etc.). Moreover, the proposed ASPR revisions, in our opinion, do not adequately delineate utilization procedures and practices to be followed or required by the Government property administrator and the contractors, with respect to the special category of IPE designated as test equipment, nor do they suggest the type of standards by which retention by the contractor should be evaluated.

We proposed therefore that the provisions of the proposed ASPR changes be revised to meet the predominate need of providing records and a means to determine whether the extent and manner of use of Government IPE is satisfactory. We recognize that this procedure may be practicable only for IPE above some established cost level, such as the $1,000 prescribed for DIPEC reporting procedures and should also exclude IPE when the Assistant Secretary of Defense has restricted and reserved use of IPE to specific military programs. Moreover, in our opinion, attention should be directed to the question of whether or not lease of IPE for commercial work is desirable. We identified a number of instances where need for equipment so used existed at other DOD contractor plants.

While OEP approval is directed primarily at precluding contractors from obtaining a competitive advantage, current practices appear to be inconsistent also with the following instructions.

ASPR 13-301(e) "Facilities shall not be provided by the Government * * * solely for non-Government use."

Defense Mobilization Order 8555.1 "* * * Government-owned production equipment should not be leased to private industry until its unavailability from private sources has been established. * * *"

We believe that, when the planned commercial use of a machine exceeds 25 percent of its total planned use, prior approval should be obtained, not only to meet OEP's reporting requirements and purposes, but also to provide the responsible DOD management activity with a comprehensive view of the extent to which Government-furnished IPE, by types, are being applied to private commercial purposes.

Therefore, we believe that ASPR 13-405 should be clarified to show that prior approval is to be made on a machine-by-machine basis and that the term "25 percent non-Government use" be more precisely defined. In addition, we believe that ASPR should be clarified to differentiate OEP approvals from local monthly approvals for rental purposes.

Agency comments and our evaluation

The Deputy Assistant Secretary of Defense (Procurement) by letter of August 7, 1967, advised us that the ASPR is being revised to prescribe that the contractor be required contractually to establish and maintain a written system for controlling utilization of IPE. The Deputy Assistant Secretary indicated that the revised regulation establishes the responsibility for each contract administration activity, and other DOD components, to conduct property system surveys to ensure the effectiveness of such a system and to show the extent and manner of use of Government-owned IPE. He indicated also that it provides for control, detection, and reporting of Government-owned IPE which are not being effectively and economically utilized by Defense contractors.

The Deputy Assistant Secretary stated that the Department will study the feasibility of maintaining utilization records on a machine-by-machine basis, as for example, IPE of selected high value and that, if the study proves the practicality of such an approach, the ASPR will be modified accordingly.

We believe that the tabulation of machine-by-machine utilization data may be excluded for IPE approved by the Assistant Secretary of Defense for specific programs, inasmuch as the utilization of this IPE is restricted to specific military hardware items and for IPE above some established cost-level, such as the $1,000 prescribed for DIPEC reporting procedures. Our report points out that we were unable to determine the manner of use of many general purpose type of equipment items at many contractor plants we visited because adequate utilization records were not maintained.

Our review established that, of the 17 contractors examined, only five contractors maintained adequately comprehensive machine-by-machine utilization data. Two of the five contractors accumulated the data by manual postings and the other three through mechanized procedures (tab card system). One of the contractors was converting from mechanized procedures to an electronic data collection system designed for manufacturing industries. Included among the applications of the electronic data collection system is "Machine and Tool Utilization," and we observed that three of the remaining 12 contractors reviewed were in the process of installing similar systems at the time of our review.

In regard to prior approval by OEP for commercial use of IPE of more than 25 percent, the Deputy Assistant Secretary stated that such approvals on a machine-by-machine basis would create a substantial administrative burden not commensurate with the goals sought. He further stated that to maintain a factual utilization record by individual machine for commingled Government and contractor-owned plant equipment on a contract-by-contract basis is impractical because it would be very time consuming, disrupt the contractor's production planning process, and result in the addition of a costly administrative burden for both Government and industry. DOD feels that a more practical approach is one of more aggressive surveillance, maximum use of all plant equipment, and additional emphasis on the collection of adequate rentals; and they stated that they were pursuing this.

The Deputy Asistant Secretary indicated that the Department intends to meet with OEP for the purpose of reaching an acceptable solution on these points: defining "25-percent non-Government use" and the differentiation of OEP approvals from local monthly approvals for rental purposes.

On the basis of available utilization records we questioned retention of 296 items of IPE at contractor plants. DIPEC records revealed that 81 of 296 items of IPE were classed as being in either critical or short supply. A closer analysis of these items indicates that commercial use was concentrated on the IPE with the highest average acquisition cost as follows:

	Number	Acquisition cost	
		Average	Total
Commercial use	24	$84,700	$2,032,000
Not used	43	27,300	1,172,400
Low use	14	12,500	174,900
Total	81	----------	3,379,300

Without requiring contractors to furnish machine-by-machine utilization data within reasonable limits and without enforcing realistic use criteria requiring prior approvals when such machines are to be utilized on commercial work, DOD lacks adequate assurance that the most efficient machines are used to process Government work, hence minimize procurement costs.

We question the Deputy Assistant Secretary's statement that the maintenance of utilization data, machine-by-machine, is impractical, very time consuming, disruptive and costly. Earlier, we pointed out that some contractors already maintained individual machine utilization data and that others were installing electronic data collection systems which had application to providing this data. It seems, therefore, that the Government will bear a share of these investments through the end-item prices it negotiates, and that the imposition of a requirement on these contractors to furnish such utilization data to distinguish Government and commercial use does not seem unreasonable.

One contractor possessing 1,091 items of IPE, each having a rental value in excess of $100 per month, would not furnish the utilization data since it was not contractually required; and, if the Government insisted on the data, he would insist on adequate reimbursement for records solely for the benefit of the Government. At this location the Government Administrative Contracting Officer estimated that it would cost about $250,000 a year to furnish utilization data for the 1,091 machines; however, he could not locate and furnish us the basis for the estimate.

We estimate that a machine-by-machine computation of the rent at this contractor would increase the annual rent payment by about $582,600. (See p. 28.)

Another contractor who reports monthly machine-by-machine utilization, broken down by Government and commercial use, furnished us an estimate of the yearly cost to provide this data on 880 machines as follows:

Recording—direct labor	$4,572
Processing—labor	1,725
EDP machine time	678
Forms	425
Total annual cost	7,400

Recommendations

It seems reasonable to expect that, if the Government provides IPE to contractors, the contractors should furnish the Government data as to how they are using it. Our review demonstrates the effectiveness of controlling IPE on the basis of use data provided on a machine-by-machine basis. Therefore, we recommend that the Secretary of Defense emphasize this basis in the study which DOD will perform regarding the feasibility of maintaining utilization records within the limits suggested earlier in this report.

Also, we recommend that the Director, Office of Emergency Planning, similarly administer prior approvals for planned commercial use of IPE.

Redistribution of industrial plant equipment

Idle IPE not redistributed by DIPEC in some instances

At DIPEC our examination was directed toward the identification of requisitions for items of IPE which were available in contractor's plants or reserve stocks and were not redistributed. Our examination of 151 requisitions selected at random from an estimated 13,620 requisitions for metalworking and general plant equipment processed by DIPEC during the 6-month period ended June 30, 1966, showed 12 instances where suitable equipment which had been reported as available was not offered to meet the requirement.

Our sample indicated that during the 6 months DIPEC could have offered to fill an additional 1,082 requisitions from metalworking and general plant equipment in its idle inventory. However, because our estimate is based on statistical sampling, the number of additional requisitions that DIPEC could have offered to fill could be as low as 487 or as high as 1,677, with 95 percent assurance that this conclusion is correct.

On the basis of the average unit value of such equipment in the inventory as of December 31, 1966, we estimate that the total value of the additional equipment that could have been offered during this 6-month period was about $12 million. We also found that additional IPE was purchased to satisfy the requirement in six of the 12 instances. In another instance, equipment on hand was modified at an undetermined cost in order to fill the requirement.

We found in five instances that available equipment was not offered because persons directly responsible for making equipment allocations had not been adequately instructed and were making decisions that certain requisitions should not be filled, even though DIPEC's policy is to allocate available equipment to fill established requirements of any authorized requisitions.

For example, in May 1966, DIPEC received a requisition for a milling machine. The requisition was funded and indicated that the item would be purchased if not available from DOD's idle equipment. DIPEC issued a Certificate of Nonavailability and the requestor purchased the item at a cost of $10,159.

Our review of DIPEC records showed that a similar piece of equipment was in an idle status at the time the requisition was processed. DIPEC representatives stated that the idle equipment was not offered because of a belief that the requesting agency intended to place the item in stock and did not have a specific use for the item. However, our review of the requisition submitted to DIPEC showed that the item was required to supply a high-priority requisition from the Aberdeen Proving Ground, Maryland.

In another instance, we found that a requisition was not filled because a suitable item had not been recovered from DIPEC's excess stocks when requirements computations showed that the item was needed. DIPEC had not issued instructions requiring the screening of items recently declared excess, but still on hand, when later computations showed additional requirements.

For the remaining six requisitions, we were unable to identify any specific reason why they were not filled from the idle equipment inventory. Officials of DIPEC agreed that the items of IPE identified by our review were suitable to meet the requirements shown on the 12 requisitions.

We proposed to the Secretary of Defense that DIPEC's management controls be reviewed and new or additional directives be initiated, where required, to ensure that all equipment which could be utilized to meet anticipated needs is considered and that suitable equipment is offered to authorized requisitioners in each instance when it is available. We proposed that a program of personnel training and supervisory review be instituted to ensure adherence to established policy and procedures.

Agency comments

The Deputy Assistant Secretary advised us that DIPEC had established a training program for all DIPEC commodity managers and that particular emphasis was being placed on the requirement to document the issuance of Certificates of Nonavailability or other specific conditions under which items in inventory are rejected as unsuitable for the intended use.

In view of the action taken by the Department of Defense, we are not making any recommendation at this time.

Rental of industrial plant equipment—general

Need for uniform terms in IPE lease contracts

Although uniform rates for rental of Government-owned machines to contractors had been prescribed, we found that the various bases upon which the

rent payments were negotiated resulted in a lack of uniformity in the rates actually charged, inequities between contractors, and, in some cases, reduced rent payments to the Government. The departure from uniform rates exists because the ASPR allows credits to the rent liability, representing the portion of usage for Government rent-free work, to be based on a variety of allocation bases applied to the total rent liability and because of other basic differences in the rental formulas applied at various locations.

Uniform rates prescribed.—In 1956 the need to establish uniform leasing policies with respect to rental rates was acknowledged in reports prepared by the Joint Committee on Defense Production and the United States Senate Select Committee on Small Business. One report states that sizable numbers of Government-owned machine tools were being leased to private industry and that, because a uniform leasing policy had not been adopted, discrimination and apparent low-rental policies tended to place small concerns at a competitive disadvantage. Moreover, the Select Committee on Small Business believed that leasing for non-Defense purposes should be held to a minimum; a policy which is currently reflected in OEP and DOD instructions.

Therefore, an Inter-Agency Task Group was formed with members representing the DOD and six other agencies of the Government. On June 19, 1957, the recommendations of the task group, which were developed by consulting representatives and leasing experts in the machine tool industry, were adopted and uniform rental rates for the leasing of Government-owned machine tools to private industry were established. The uniform rates, which are currently stated in OEP's Defense Mobilization Order 8555.1 and ASPR section 7–702.12, were adopted on the premise that all lessees should be treated alike and that all pay rent at the same rates.

The uniform rental rates for machine tools and secondary metal-forming machinery are as follows:

Age of equipment	Monthly rental rate applied against acquisition cost (percent)
	Percent
0 to 2 years	1¾
Over 2 to 6 years	1½
Over 6 to 10 years	1
Over 10 years	¾

Current lease terms permit inequities—The DOD allows rent-free use of its facilities for military orders, and, where authorized for commercial work, its use is generally shared. Although the gross rent liability usually is determined from the prescribed ASPR rates, machine by machine, inequities arise, in some cases, in computing a rent credit representing the portion of rent-free Government work. This occurs because ASPR allows and contractors compute rent reductions based on overall allocations of the workload between Government and non-Government work according to the relationship of various factors—such as sales, labor hours, or machine hours—rather than computing rent reductions machine by machine according to the ratio of shared usage of the particular machine.

We did find in one instance that the overall allocation method used produced rentals comparable to an individual machine computation. In two cases we found that the overall allocation method resulted in lower rents for the Government. This effect was caused in these cases by averaging machine utilization and combining higher utilization for Government work of lower valued machines with higher utilization for commercial work of high valued machines. In additional cases inequities were caused by other basic differences in the rental formulas applied at different locations. Some of the differences we found are illustrated below:

One contractor computed rent on a machine-by-machine basis and computed the rent credit for each machine individually on the basis of the number of machine hours applied separately to Government work and to commercial work. However, where separate tabulations of actual machine-hour use could not be made for certain support equipment, no rent was charged. As a result, the contractor used the Government-owned support IPE for commercial work without charge.

At another location, the contractor computed the rent credit on the basis of the average utilization of the machines used for Government work. The inclusion of certain downward adjustments, because it was considered a reserve plant, and the use of an average ratio of machine utilization in the calculation resulted in a lower rent liability than would have resulted from calculating rent on a machine-

by-machine basis. On the basis of machine usage for a 10-week period, we estimate that a machine-by-machine calculation would have increased the rent payment for the 12 months ended September 30, 1966, from $226,400 to $809,000 or $582,600, in excess of the present method. The cost of maintaining utilization records, machine by machine, amounted to $7,400, as estimated by this contractor and the details of this estimate are shown on page 23 of this report.

In another case, rent of IPE applicable to a Navy standby facility is based upon 2 percent of sales prices. ASPR prescribes use of the uniform rates and currently makes no provision for computing rent on this basis. We were unable to make a determination of rent based on machine-by-machine use data in this instance; however, we estimate that, under the current procedures permitted by ASPR, the rent would have increased from $83,000 to $194,000 during the year ended September 30, 1966.

Rent for IPE was computed according to varying formulas in each of four facilities contracts negotiated by different military services with the same contractor. We noted that the rent paid for use of like classes of machines of similar age and value would vary widely due to differences in rent formulas.

Rent payments in another case were minimized through the computation of the rent credit including engineering labor hours which had no relationship to machine hours or to the rent of the IPE. In the rent computation at two contractor locations, the rent liability, before applying the credit, was based on application of the ASPR rates to all Government IPE at one location, while at the other location only the Government IPE requested for commercial use was included.

Prior approval to rent IPE not always requested

We noted instances where contractors were using IPE for commercial work for which approval had not been requested in advance although approval is required by the facilities management contract.

To discourage unauthorized use of Government facilities for commercial work, ASPR 7–702.12(e) and facilities contracts provide:

"If the Contractor uses any item of the Facilities without authorization, the Contractor shall be liable for the full monthly rental, without credit, for such item for each month or part thereof in which such unauthorized use occurs. However, the Contracting Officer may waive the Contractor's liability for such unauthorized use if he determines that the Contractor exercised reasonable care to prevent such unauthorized use. In this latter event, the Contractor shall be liable only for the rental that would otherwise be due under this clause."

In a few instances where the Government property administrator found that machines had been used for non-Government work without prior approval, the machines were subjected to the rent as normally computed. Full monthly rental was not charged because it could not be shown that contractors did not use reasonable care to prevent such use.

At one contractor plant selective floor checks conducted by the Government property administrator at month-end showed numerous instances where IPE was used for commercial work which the contractor had not included in his monthly request to the Government plant representative. In March 1965, the contractor was advised that, in the past 6 months, 7.5 percent of the IPE examined was being used without prior approval. Although corrective action was promised, floor checks revealed that during the year 1965 the incidence of discrepancies was 10 percent and during the first 9 months of 1966 it rose to 13.5 percent.

We noted instances at three other contractor locations where machines were used for commercial work without obtaining prior approval as required by the facilities contracts.

DOD reviews and corrective measures

We found that the reviews of rent by the Defense Contract Audit Agency (DCAA), when performed, were generally limited to verifying the accuracy of data in the rent computations and the procedure for computing the rent in accordance with the contract formula. An evaluation as to whether the prevailing terms of the lease were equitable to the Government was not apparent.

However, inequities which we believe exist in the rent formulas, as discussed in this report, derive from the related clauses negotiated by the respective services as part of facilities contracts. The ASPR Committee now has under consideration a policy (ASPR Case 65–19) under which the contractor will be charged rent for all Government IPE in the contractor's possession. When the IPE is used on a Government contract, the contractor will reduce the gross rent liability by the amount of a rent credit negotiated for each contract. DOD officials believe that the procedure will ensure against competitive advantage and will act as an

incentive to contractors to return IPE to the Government as soon as it becomes excess.

Conclusions

In our opinion, the determination of rent on a machine-by-machine basis and similarly applying the rent credit for Government rent-free use to each machine above an established dollar value in its ratio of Government versus commercial machine hours of use would be more accurate and more equitable than the various methods presently in use.

The maintenance of utilization data for Government-owned IPE, as recommended in our discussion of utilization practices, would provide the basis to more accurately compute rent on an item-by-item basis. The feasibility of maintaining use records, machine by machine, has been established by five contractors included in our review, and one of the contractors was computing rent in the manner in which we suggested, as detailed above. Moreover, such a procedure would eliminate discrimination in rates charged to different contractors because the credits would be uniformly computed for each item based on actual machine hours used. Broad allocations are appropriate in those cases where Government versus commercial machine usage cannot be tabulated, such as for certain common support equipment or for IPE below an established value where no utilization records are maintained. Further, the tabulation of utilization data could be expected to disclose commercial use for which approval had not been requested and thus supplement the present complete reliance on floor checks.

The DOD proposal to assign a rental charge to all Government IPE in a contractor's plant could, dependent upon the form in which it may be finally implemented, be expected to provide an incentive to dispose of or to redistribute IPE which was poorly utilized. However, the proposal retains the choice of various methods of allocating the use between Government and commercial work which, we believe, will produce inequities of the type discussed in this report. We proposed, therefore, that further study of this proposal include consideration that actual use be determined on a machine-by-machine basis.

Furthermore, it appears to us that the DOD-proposed method would be exceedingly complex to administer, particularly as to the effect of contract changes after the negotiation of rental credits under the contracts, and we proposed consideration of this question if not previously considered. Industry reaction to the DOD proposal has not yet been obtained, and therefore we are unable to complete our evaluation of this alternative.

The present ASPR clause, which would make a contractor liable for the full monthly rent for use of Government IPE without authorization, was apparently intended to prevent such unauthorized use. We believe that the penalty concept is appropriate since a penalty, or even normal rent, can be assessed only in those instances where unauthorized use is detected by Government property administrators. However, in the few instances where we noted that unauthorized use had been detected, the penalty had not been imposed because of the "reasonable care" limitation in the clause. We proposed that, in order to improve control over the use of Government IPE, the Department consider the need for more stringent language in the present ASPR clause.

Agency comments and our evaluation

The Deputy Assistant Secretary indicated that several alternative proposals concerning conditions for use of Government plant equipment were being considered by the ASPR Committee, none of which contemplate a determination of actual equipment use on a machine-by-machine basis. With respect to the need for more stringent language in the present ASPR clause, the Deputy Assistant Secretary has stated that DOD has continuously taken the position that contractors should be held liable for any unauthorized use; however, he has indicated that the Department will consider the need for stronger language in paragraph (e) of the "use and charges" clause (ASPR 7-702.12) to ensure adequate control over the use of Government-owned IPE in possession of Defense contractors.

Our proposal to compute rent on a machine-by-machine basis is the most accurate system within our knowledge, and it also provides data for management determination of the contractor's continued need for the machines. Moreover, our report points out the existing inequities caused by basic differences in the rental formula applied at different locations.

Recommendation

We recommend to the Secretary of Defense that the ASPR Committee closely examine the feasibility of computing rent on a machine-by-machine basis and

similarly applying the rent credit for Government rent-free use to each machine above an established dollar value in its ratio of Government versus commercial machine hours of use.

Revised rental procedure needed to increase return on investment in heavy presses

The Air Force heavy press program was begun during World War II as an attempt to produce major aircraft structural elements through forging and extrusion processes. Since there was no commercial requirement at the time for presses of this size, the Air Force undertook the sponsorship and support of the heavy press program. The first of these presses was released to production in 1946; additional presses were acquired during the 1950's. The program currently includes about 13 presses, costing about $76.4 million, which are located at seven plants. Four of these plants are Government owned and three are contractor-owned. Also, the Air Force has provided land, buildings, and support equipment costing about $132.6 million.[1]

Rent for the use of the heavy presses has generally been charged for all work, both Government and commercial, at the rate of 4 percent of sales. Air Force officials said that one of the reasons for basing rent on sales was to relieve the operators of some of the risk of initial operation during early stages of the program. Basing rent on sales removed part of the risk, since no rent would be due from the operator unless a salable product was produced and sold. A second reason for basing rent on sales was ease of administration. Utilization records would not be necessary and Government surveillance could be held to a minimum.

At the three locations visited, we found that the heavy press rent liability for the most recent 12-month period available totaled about $1.9 million. Of this amount, about $1.4 million was applicable to Government work. The total rent liabilities in this 12-month period represented returns on the Government investment ranging from 1.03 to 2.03 percent.

In some cases the presses were used at capacity and significant amounts of commercial products were being processed. In comparison with current rates of return on Government bonds and commercial paper, the 1 to 2 percent annual return on the Government's investment in heavy presses appears to be too small from a financial point of view.

We did not review the pricing or purchase orders at higher subcontract or prime contract levels to determine the effect of the rental cost on end-item prices. However, since the press operators may be below the first tier subcontract level, the portion of the end-time price attributable to rent may include the indirect expense and profit factors of one or more tiers. Because of the application of such factors to the cost base at each tier, it seems logical that the cost of rent included in the Government's end-item prices may be significantly greater than the rent received by the Government from the heavy press operators for the same work.

One reason which has been advanced by Air Force officials for retaining the present rates was that an increase in rental rates applicable to both commercial and Government businesses would cause increased spending of appropriated procurement funds, because of the inclusion of rent costs, plus the application thereon of indirect expense and profit factors of higher tier subcontractors and the prime contractor, in the end-item prices. Air Force officials said that the reason for charging rent for all work was the difficulty of ensuring that the Government would receive adequate consideration for rent-free use, as is required by ASPR 13-402. Since the heavy press operators are often as low as the third tier subcontract level, they stated that it would be difficult to determine whether a reduction in the press operators' costs would be passed on through all the higher tiers and would result in lower end-item prices. They stated further that they would authorize rent-free use under special circumstances. They said that the Navy has prime contracts with three extrusion press operators under which rent-free use would be feasible but has not been requested.

A review of heavy press rental policies was requested by OEP in 1965, with a view to possible modifications which would increase the yearly monetary return to the Government. The review was made in 1966. Air Force officials would not provide us with information developed under this review because the report had not been released.

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[1] Data in this paragraph are based on a 1962 report; however, an Air Force official at Wright-Patterson Air Force Base advised us that there had been no significant changes after that time.

Conclusions

We believe that there is an alternative to an across-the-board increase which appears to be more equitable and which, at the same time, should bring a more realistic return to the Government. This would be to authorize rent-free use of the presses when used on Government work and to increase the rental for commercial use of the equipment.

The overall use of the presses has significantly increased since the inception of the program. Although the predominance of use is for Government end-items, significant amounts of commercial sales are now being processed through the presses. Also, the present procedure provides no assurance that Government end-item prices are not significantly increased by the pyramiding of higher tier indirect expenses and profit on the rent cost included in prices to the Government of forgings and extrusions. The authorization of rent-free use for Government work would also be consistent with the general leasing practices governing other types of IPE used by contractors and subcontractors on Government orders.

In comparison with current rates of return on Government bonds and commercial paper, the 1 to 2 percent annual return on the Government's investment in heavy presses is not acceptable, in our opinion, from a financial point of view. We proposed, therefore, that DOD reexamine its current policy of not authorizing rent-free use of Air Force heavy presses used on Government work and that priority effort be applied to increasing the Government's return through rental arrangements.

Agency comments

The Deputy Assistant Secretary has advised us that DOD, in conjunction with the Air Force, is reexamining existing arrangements pertaining to rental charges for use of these presses and is considering such aspects as the waiving of rental charges for Government work, the increasing of rental returns on commerical use, and the feasibility of selling some of the presses to Defense contractors.

Modernization of industrial plant equipment

Prospects of continued large Government investment in machine tools in possession of contractors

The basic policy of DOD, as stated in ASPR, is very restrictive as to furnishing new Government-owned facilities, including, industrial plant equipment, to contractors. It provides generally that new facilities shall not be furnished where an economical, practical, and appropriate alternative exists.

The Department of Defense program for replacement of Government-owned machine tools was initiated in 1956 for the purpose of maintaining such tools in a modern condition. To accomplish this objective, the military departments were to include in their annual budget requests from 2 to 5 percent of the acquisition cost of the machine tools listed in departmental inventories. The replacement of machine tools is distinguished, in DOD directives, from the provision of additional facilities to increase production capacity.

According to DOD reports, the cost of machine tools in military inventories as of October 1966 was $2.8 billion, with most of these tools in possession of contractors. Fiscal year 1966 expenditures amounted to about $51.5 million for modernization and replacement purposes. Such expenditures had risen from an average of $27.4 million in the 1958 through 1963 fiscal year period. Expenditures of $65.8 million were forecast for the fiscal year 1967.

Anticipated savings not always realized as planned

Department of Defense Directive 4275.5 requires that the replacement of machine tools be justified on economic grounds. This directive recommends that machines not be replaced unless their cost can be amortized through operating savings in a period of about 3½ years.

The justification, which is prescribed under another DOD instruction, 4215.14, must show that the savings were based on a comparison of the operating costs of the machines then in use with the operating costs of a new machine which could replace the older machines. The reduction in cost is then computed for a 12-month period immediately following the date of preparation of the estimate on the basis of existing and anticipated production requirements known to the contractor. Annual amortization costs of the machines are also considered in computing the saving. One year after each modernization item is released for production use, the contractor is required to submit a postanalysis report to show actual cost savings for that year.

Our examination into the justification and the first-year savings included in the postanalysis reports of five contractors, which had acquired machines under this program, indicated that savings had not been achieved as planned by four of the five contractors and that planned savings had been exceeded by the fifth contractor, as shown below. We did not review the savings reported by the contractors.

Contractor	Number of machines acquired	Cost of machines	1st-year savings		Justifications in excess of amounts realized
			Included in justification	Estimated amount realized	
A	25	$3,223,000	$1,876,000	$855,000	$1,021,000
B	18	2,438,000	1,600,000	520,000	1,080,000
C	4	886,000	405,000	49,000	356,000
D	3	471,000	272,000	176,000	96,000
E	10	1,490,000	1,380,000	2,164,000	−784,000
Total	60	8,508,000	5,533,000	3,764,000	1,769,000

Although the savings were not achieved as planned by four contractors, it appears that the reported first-year savings would have provided for the recovery of the Government's investment approximately in the 3½-year guideline prescribed by the Department for three of the five contractors. However, for contractor A, one of the machines used on military production during the first year, which accounted for $450,000 of the reported first-year savings, was subsequently diverted to commercial work for about 75 percent of the production time. For contractor E also, machines usage in later years for commercial work began at 12 percent and, in one instance, reached as high as 97 percent of production time. Most of these machines were subsequently sold to the contractor.

We found differences between the savings proposed in the justifications and the reported savings due to the failure of Department guidelines to recognize the lead time needed to acquire and put the machines in operation and due to numerous errors in justification documents for contractor machinery acquisitions.

Acquisition lead time

The present Department of Defense guidelines for the computation of cost savings to be realized through the use of new machines do not recognize the time required to approve, procure, and install a machine and to make it operational. Instead, the guidelines require that contractors use the 12-month period immediately following the date of preparation of the formal justification as the base period for computing savings expected to result from the use of the new machinery.

In our review of the five contractors' machine acquisitions, we found that a considerable amount of time had elapsed from the date the justifications were prepared until the machines were put into operation. For one contractor, for example, the elapsed time averaged 20 months. In the case of two contractors, we noted no appreciable adverse effect; however, three contractors had substantially less Government production for the machines involved than they had estimated when justifying the machine acquisition.

For example, a contractor justified acquisition of machines on the basis of known or anticipated production under certain programs for the 12-month period immediately following the date of preparation of the justifications. However, from 9 to 36 months, or an average of 20 months, elapsed before the machines became operational. After the first year of production, contractor reports showed savings of $855,000 resulting from the use of these machines compared with the $1.9 million annual savings utilized to justify acquisition. The reports showed that, during the first year, the actual use was only 53,000 hours whereas it had been estimated at 152,000 hours.

Three machines costing $345,000 had not been used to any great extent at the time of our review because they had not become operational until 19 months after completion of the production order for which the acquisition was justified. Savings attributable to these machines amounted to only about $2,000 during the first year after acquisition compared with estimated savings of $165,000 used to justify their procurement. Another contractor included in the justification the production requirements for three different missile configurations for which it was known that production would be virtually completed or substantially

curtailed by the time the machines could be installed or would be substantially curtailed during the year following installation of the machines.

Preparation and review of justification data

We found numerous errors in contractors' justifications which, if they had been detected and corrected, would have indicated that the savings anticipated from use of the machines were not sufficient to recover the cost of the machines as specified on the form submitted. Among the errors were estimates of production requirements in excess of requirements shown on contractors' productions forecasts; labor and efficiency rates in excess of the rates warranted on the basis of actual experience and records; and in two cases, inclusion of the savings anticipated on commercial production.

At the one military command headquarters visited, available records indicated to us that a detailed review had not been made of contractors' justifications. Officials at the headquarters advised us that they had relied on the accuracy of the presentation by contractors and the evaluation by the service plant representative. Further, we were advised by these officials that, due to a shortage of manpower, they had been able to perform only limited reviews.

Agency officials at one contractor's plant, in most instances, forwarded the justifications to higher headquarters without specific findings, corrections, or recommendations. Officials at another contractor's plant advised us that their review of justifications consisted of examining, on a selective basis, supporting records such as cost records and purchase order requirements. Although we found in the files at one location reference to reviews by the military service representative, we found no evidence as to the records examined or the extent of the review. The military service representatives stated they had reviewed cost savings information in a few cases, but with little success due to lack of support for the savings estimate.

For example, one contractor submitted a request for an 8,000-ton press valued at about $1.4 million. The justification was based on a projected annual production of 79,380 units of a jet engine blade, including both commercial and Government requirements. A production forecast submitted by the contractor with the justification showed 27,215 units of the blades for about the same period as the 79,380 units used in the justification. The 27,215 units consisted of 14,507 units of the military blade and 12,708 units of the commercial blade.

After installation of the 8,000-ton press, the contractor reported production of 10,118 blades on the press during the first year. Total production was about 24,000 blades on all presses during the same period. After the first year, the press was used extensively for commercial production. Prior to approval of purchase of the press, the contracting officer requested the resident auditor at the contractor's plant to review the validity of the justification data. However, officials at the command headquarters authorized procurement of the press before the review was made. The responsible military service representatives had, in several instances, attempted to verify the savings claimed but found that the contractor was unable to substantiate its computations or to show that the savings were passed on to the Government.

Expenditures of $471,000 for three machines were approved for another contractor on the basis of first-year savings of $272,000. We found that the projected estimated savings data were substantially overstated. This resulted from the contractor's basing the savings computation in part on excessive indirect labor rates and on maintenance charges lower than indicated by experience and failing to include tooling costs attributable to modern machines. After adjustment for these differences, savings of about $154,500 for the first year of operation would have been indicated. Our review of the files on the contractor justifications involved indicated to us that a thorough review of the justifications had not been performed. In most instances, justifications were forwarded to higher headquarters without specific findings, corrections, or recommendations.

Although we are unable to surmise the effect that accurate justification data would have had on the decision to purchase the machines discussed in the above examples, we believe that it is evident that such decisions should be based upon accurate information.

Need for assurance that resulting savings will be passed on to the Government

Savings resulting from the modernization and replacement of machines used under cost reimbursement contracts are passed on to the Government since reimbursement to the contractor is based on costs incurred. For incentive-type

contracts priced prior to a modernization action, the Government participates in savings resulting from use of new machines only to the extent of its profit-sharing ratio. In the case of firm fixed-price contracts priced prior to modernization action, no return is normally achieved unless special contract provisions are made.

At the time of our review, the Department's procedures did not require a contractual provision for recovery by the Government either of savings, under firm fixed-price contracts or of the full amount of savings under incentive-type contracts. In our reviews, we identified certain contracts where price adjustments seemed to be appropriate to permit the Government to realize the full savings resulting from the provision of new Government-furnished equipment. However, we also found that in many cases the savings reported by the contractor were not supported by sufficient documentation for verification.

For example, as discussed previously, in 1960 a contractor acquired an 8,000-ton press at a cost of $1.4 million for production of jet engine blades. In May 1963, the contractor submitted a report showing savings of $450,000 for the 1-year period when the press was in productive use. An Air Force review of the savings disclosed that the savings had been based on judgment and assumptions, and contractor officials agreed with the conclusions of the Air Force review. We found that there had been no price reduction under fixed-price contracts for blades produced on the new machine during the first year of production. Another Air Force review in June 1966 indicated that there had been no improvement in the contractor's accounting system with respect to determination of savings.

Another contractor had a number of multimillion-dollar incentive-type contracts which had been negotiated before various new machines were added to its facilities contract and were in an active status at least a year after the machines were placed in operation. The prices of these contracts had not been specifically adjusted to reflect modernization savings. The utilization of the machines under a contract could not be determined from the contractor's records. Government contracting officials told us, however, that, during the operating period referred to, the machines were utilized almost entirely on Government programs and that they could have been used on the incentive contracts.

The Department currently has in process a proposed new ASPR section 7-705.20 which provides that any savings under certain types of contract that result from the furnishing of new equipment are to be returned to the Government either as direct reimbursements or through contract price reductions. It also prescribes the maintenance of adequate records for this purpose. The section is limited to firm fixed-price contracts or subcontracts or to fixed-price contracts or subcontracts with escalation.

Private investment in plant equipment not always encouraged

DOD Directive 4275.5 states as a general policy that:

"Basically, the contractor will be encouraged to replace old, inefficient Government-owned equipment or manufacturing processes with modern more efficient, privately owned equipment. * * *

In submitting justifications, contractors generally were not required to include statements as to their ability or willingness to finance the equipment. At most locations where we inquired into this matter, either the contractors had not been requested to acquire privately owned equipment or the files gave no indication that use of private funds had been considered in evaluating the proposals we examined.

As to the latter cases, we were informed by Government officials that contractors had been encouraged to use private capital; however, no record of such attempts was found. At two locations, we did find evidence that the possibility of contractor financing had been questioned in connection with certain submissions; in which cases Government financing was justified because of contractor investment in other equipment of facilities. It appears to us that the Government's investment in this program is sufficiently great and that the question of contractor financing should receive positive attention in all cases.

For example, four items of IPE were being furnished to one contractor under modernization programs at a total estimated cost of $422,000. The contractor's investment in IPE was three times that of the cognizant military service and included his expending $4.4 million for 110 items of IPE in 1965 and 1966. Contractor officials indicated to us that, if the purchase of the four items had been necessary, they would have been willing to make the investment at that time. Service officials stated that they had made the replacements on the basis of estimated savings anticipated from the provision of more efficient machines and that they were following the replacement guidelines set out under DOD Directive 4275.5 which states, in part:

"Five percent of the value of the inventory of production equipment in current use will be considered as a valid level for programming annual replacement of the active industrial equipment. * * *"

The fiscal year 1966 modernization program for another contractor included four gear-making machines amounting to $232,100. The justification for replacement was based on data showing that the investment would be repaid within 3 to 4 years through reduced operating costs. We noted that, to achieve this objective, the initial-year use would have had to exceed current use by about eight times but that, as of September 1966, the contractor still had no active requisitions for additional gear machine operators. Moreover, one of the replaced machines had been used exclusively for commercial work for at least a year. Military officials informed us that the contractor had not been encouraged to invest its own capital in these machines.

DOD officials informed us that existing and experimental incentives have met with limited success in encouraging private investment in IPE. Department officials directed our attention to the following factors.

1. The weighted guidelines which provide additional profit to contractors providing equipment required for DOD contracts were generally considered insufficient by contractors to warrant purchase of the IPE.

2. The facilities amortization plan which guarantees contractors a minimum depreciation recovery had been tested at some contractor plants and was unsuccessful. Under this plan, if a contract were terminated before 50 percent of the investment had been written off for tax purposes, the Government would underwrite the difference. Contractors felt that this procedure offered no greater incentive than that currently existing under tax regulations which allows accelerated depreciation charges.

3. The short duration of Government contracts, as a practical matter, reduced the incentive for contractor investment.

4. In allocating funds under modernization programs, the Department gave consideration to the contractor's record of investing its capital in equipment. The needs of the overall military programs were the underlying consideration; however, the estimated savings shown on the application for the IPE was a primary factor in providing funds.

One contractor informed us that its policy was to invest in IPE one half of its after-tax earnings, plus the amount of depreciation for the period. The remaining IPE needed would then be requested from modernization funds and the DIPEC inventory. The stated policy appears to be in consonance with present DOD objectives in the modernization program.

Conclusions

While the Department's policy is very restrictive as to the conditions under which new Government facilities will be furnished to contractors, the modernization and replacement program appears to provide a means for contractors to acquire new machines for old ones under different and less restrictive criteria. The program as presently administered will, in our opinion, perpetuate the large Government investment in general purpose machine tools in possession of contractors and thus defer indefinitely the time when contractors must furnish all facilities, in accordance with the Department's basic policy, required for performance of a Government contract.

We proposed that, in consonance with the foregoing conclusions, the Department place concentrated effort on the revision and administration of the following aspects of its industrial facility modernization and replacement program.

1. Inclusion in procedures of a requirement for the specific consideration of, and a statement as to, the contractor's ability or willingness to privately finance modernization proposals.

2. Consideration of a revision of guidelines to make the provision of Government-furnished plant equipment more directly related to new, major defense programs.

3. Improvement in the validity and review of justification and actual experience data, with particular attention to the commercial use of Government-furnished equipment.

4. A reexamination of the principle of recovery of savings through repricing of incentive-type contracts and subcontracts.

Agency comments

The Deputy Assistant Secretary agreed with our proposals and stated that it was DOD's policy that the contractor be encouraged to replace old, inefficient Government tools with more modern, efficient, privately owned tools. He indi-

cated that current procedures would be modified to require the specific consideration of and a statement as to, the contractor's inability or unwillingness to finance equipment modernization.

The Deputy Assistant Secretary advised us that the Department would review the need to revise its guidelines as they apply to both new and existing major defense programs. He indicated that the problems highlighted in our report stemmed primarily from administration of the modernization program rather than from inadequate guidelines. He stated that such deficiencies would be corrected through a program to improve the technical competency of Government property administrators, which would require more detailed evaluations of the validity and review of justification and experience data at the local levels and workload projections far enough in the future to allow for administrative and procurement lead time.

The Deputy Assistant Secretary indicated also that the subject of recovery of savings under all types of contracts had been under consideration by the ASPR Committee for some time and that the views expressed by the General Accounting Office on recovery of savings in the repricing of incentive-type contracts were being considered by the Committee.

Transportation and installation costs

We noted at some contractor locations that the costs of installation and/or transportation associated with the acquisition of IPE had not been identified and recorded.

These circumstances are not in accordance with the accounting principles and standards prescribed by the Comptroller General of the United States providing that the basic costs of property shall reflect all costs associated with acquiring the assets in the place and form they are to be used and managed.

The ASPR, section 7–702.12, provides that, for rental computations, the cost of facilities shall include the cost of transportation and installation. We found that these costs had in some cases been applied as a percentage factor to the acquisition cost of IPE being rented by contractors. One contractor added a factor of 3.5 percent, another contractor added a factor of 1 percent. That these costs can be significant is illustrated by the fact that, in one case, a contractor increased the rental base for IPE by as much as $800,000 through the addition of a factor for transportation and installation. At one contractor location where installation and transportation costs had not been recorded, rent was computed without the addition of a factor for these costs.

The ASPR authorizes contractors to use DD form 1342 as the subsidiary property record for IPE, but the form does not provide for the costs of transportation and installation to be accumulated and recorded. Contractors sometimes rely on this record as a means of accounting control and as a basis for reporting.

Conclusions

We believe that the recording of such costs is necessary to provide reliable and visible cost experience data for property management decisions involving economic considerations such as those related to acquisition, redistribution, and disposal of these assets, as well as for rental calculations. In order to provide an accurate and uniform basis for accounting for Government-owned property, for management decisions, and for rental charges, we proposed that contracting practices and ASPR provisions be studied with the objective of providing a method for appropriately accumulating, recording, and reporting transportation and installation costs which are borne by the Government.

Agency comments

The Deputy Assistant Secretary agreed that, as a general principle, the cost of plant equipment should include the cost of transportation for delivery to the current installation site, including the cost of installation. Further, he stated that compliance with ASPR 7–702.12 made it necessary that the cost of plant equipment include the cost of transporting and installing plant equipment in the present location in Defense contractors' plants for the purpose of determining charges for use of the equipment. He stated that action would be taken to ensure compliance with this requirement by amending ASPR after study of the most feasible way of obtaining equitable cost data by accounting or statistical methods.

Duplicate recordkeeping

The Navy is maintaining records of its IPE, which duplicate those maintained by contractors and DIPEC. The Naval Supply Center located in Bayonne, New Jersey, maintains records of Navy-owned IPE involving nearly 13,000 items of

property for about 175 contractors. Similarly, the Naval Training Center, Great Lakes, Illinois, maintains records involving 22,600 items of Navy-owned IPE, which duplicates those of about 100 contractors.

Paragraphs 025307 and 036050 of the Navy Comptroller's Manual provide for this property accounting responsibility and paragraph 025307 indicates that there are a total of 21 naval activitites which maintain records of Navy-owned IPE in the possession of contractors. We were told that these records serve as a control over Navy-owned IPE. Moreover, naval accounting activities are authorized to prepare monthly reconciliations of plant account (NAVCOMPT Form 167) which are sent to contractors, DIPEC, and the respective naval regional finance centers when changes occur during the month. Otherwise the reconciliations are prepared on a semiannual basis.

Conclusion

This recordkeeping, while required by Navy procedures, appears to be in conflict with ASPR B-301(a) which relates to control records maintained by a contractor for Government property. This section states, in part, that:

"* * * It is the Government's policy to designate and use such records as the official contract records, and not to maintain duplicate property control records * * *".

We proposed that a study be made of methods by which DIPEC records could be used for Navy property management purposes, with the objective of eliminating duplicate recordkeeping by the Navy, and that DOD investigate the possibilty of similar duplications in the other military services.

Agency comments

The Deputy Assistant Secretary advised us that duplicate recordkeeping related to Navy-owned IPE in possession of contractors was being discontinued and that the requirement for records would be satisfied by reliance upon both the contractor and the DIPEC property records. He futher stated that ASPR (apps. B and C) was being revised to prevent duplication of property records in all Defense agencies and, if other duplications were found in the military departments, corrective action would be initiated.

Real property

Our review of the accounting and control of Government-owned real property facilitites being used by contractors was very limited. We did find in a few instances that capital improvements to Government-owned real property were not properly reflected in asset accounts.

For example, replacement of a portion of the plant's electrical distribution system costing about $104.100 was determined not to be of a capital nature because is replaced an existing system. We noted, however, that the capacity of the system to provide service was significantly greater after its installation and that the useful life of the property was extended by at least 10 years.

In another instance, an atmospherically-controlled room was constructed at a cost of about $37,800 to house four gear machines and related test equipment but the cost was expensed because the room did not alter the exterior dimension of the plant.

In accounting for changes as described above, the accounting principles and standards prescribed by the Comptroller General provide that the cost of replacement property will be capitalized and that the cost of features superseded or destroyed in the process will be removed from the property accounts.

We believe that it is important that guidelines be prescribed in sufficient depth to achieve accurate and uniform accounting treatment of such costs, so as to minimize inconsistencies in the records because of varying personal opinions.

Agency comments

The Deputy Assistant Secretary advised us that DOD would develop for inclusion in the ASPR necessary criteria for capitalizing or expensing costs incurred on Government real property in possession of Defense contractors.

Special Tooling and Special Test Equipment

Weaknesses observed in controls over special tooling and special test equipment

Special tooling and special test equipment in the possession of contractors represent a significant investment by the Government. The estimated cost of this class of property at the contractors' plants we visited amounted to more than $347 million, or over one third of the cost of Government property in the possession of those contractors.

We found weaknesses in the control of this property due to deficiencies in inventory practices, absence of financial controls, and absence of a requirement for surveillance by Government property administrators of special tooling in possession of subcontractors. Also, in some instances, Government-owned tooling was not identifiable by physical markings or in property records.

In addition, we noted that, as of February 1965, Air Force reviews of tooling at contractor plants disclosed that items classified as special tooling included over 72,000 items valued at about $84 million, which were facility-type or general-purpose items. Much of this property is adaptable to commercial purposes. Although our examination into the classification of tooling and test equipment was limited, we believe that the matter is of sufficient importance, particularly as evidence of the need for financial control of this property, that we have included our general observations in this section.

General information

The ASPR, under section B–103.14 which is incorporated in contracts by reference, defines special tooling, including special test equipment as items

"* * * of such a specialized nature that, without substantial modification or alteration, their use is limited to the producion of such supplies or parts thereof, or the performance of such services, as are peculiar to the needs of the Government. * * *"

The definition specifically excludes consumable small tools.[1]

The ASPR states that it is the policy of DOD to have contractors furnish and retain title to special tooling required for the performance of Defense contracts wherever practicable. The ASPR points out that Government acquisition of title or the right to title in special tooling creates substantial administrative burdens, encumbers the competitive procurement process, and frequently results in the retention of special tooling without a clear advantage to the Government. which will conform the definition in appendix B to that included in section XIII.

The DOD has directed contracting officers to consider the particular circumstances of each procurement in determining whether the advantages of acquiring special tooling or rights thereto outweigh the disadvantages. In this connection, the ASPR states that, where there is not adequate price competition, the Government typically pays the full cost of the special tooling regardless of who owns or has rights to it and that therefore it is usually appropriate for the Government to acquire special tooling or rights thereto. The regulation states, however, that for fixed-price contracts where a certificate of current cost or pricing data is not required, special tooling or rights thereto shall not be acquired unless the contracting officer determines such acquisition to be advantageous to the Government.

The ASPR provides for varying degrees of control over Government-owned special tooling, depending on the contract under which it is acquired. These provisions are summarized as follows:

1. In formally advertised procurements, each item of special tooling to be acquired by the Government is clearly identified in the invitation for bids by separate item or by category if individual items are low in value. Generally, the Government takes title to such tooling when it is delivered by the contractor.

2. In cost-reimbursement-type contracts, title to all special tooling furnished by the Government remains in the Government and title to all special tooling purchased or fabricated by the contractor, the cost of which the contractor is entitled to be reimbursed, passes to and vests in the Government. Special tooling acquired under cost-reimbursement-type contracts is subject to property controls incorporated in the ASPR. These controls in part require that the contractor maintain records of special tooling and provide that a Government property administrator be assigned to ensure that the contractor does, in fact, maintain adequate control over the property.

3. In other negotiated procurements, each item of special tooling to be acquired is identified by separate item in the contract wherever practicable or by category if individual items are low in value. If such identification is impracticable, title to special tooling may be obtained through use of a special tooling clause prescribed in ASPR.

The special tooling clause provides that the contracting officer may request the contractor to provide, within 60 days after delivery of the first production end-

[1] This definition is somewhat different from that contained in section XIII of the ASPR which is included in the background section of this report. In Contract Administration Panel Case 64–310, a change is proposed to the ASPR which will conform the definition in appendix B to that included in section XIII.

items, a list of all special tooling acquired or manufactured by the contractor for use in the performance of the contract and provides also that, at the option of the contracting officer, the contractor, upon completion or termination of all or a substantial part of the work under the contract, shall furnish a final list in the same form covering all items not previously reported.

If the contracting officer requests a list of special tooling, he is required, among other things, to furnish the contractor information regarding the special tooling to which the Government desires to take title.

Prior to the time when the Government takes title, special tooling manufactured or acquired by a contractor under the provisions of the special tooling clause is not subject to the controls of appendix B and to surveillance by the property administrator. Instead, the contractor is required to follow its normal industrial practice in maintaining property control records for all special tooling. Once the Government has taken title, however, the tooling is subjected to the property control prescribed by appendix B, ASPR, and to surveillance by the property administrator.

Financial controls

The purpose of financial or monetary control accounts is to provide a reasonable measure of assurance that the detailed records reflect all transactions affecting the property and are accurately presented. The monetary control accounts which are maintained by individuals generally independent of those maintaining the detailed property records, summarize receipts, dispositions, and balances on a dollar basis. The assurance is provided by evidence of agreement between the control account and the aggregate of the detailed records.

Through independent inventory procedures, the physical status of the property as presented in the detailed records can be verified or differences disclosed—both in units and dollars—for management investigation and disposition. The ASPR prescribes only the maintenance of individual property records reflecting, among other things, description, price, and quantity of individual items of special tooling and special test equipment.

Our review revealed that the absence of a requirement for monetary control accounts precluded the collection of reliable financial information and, in our opinion, resulted in insufficient internal control for the protection of these assets.

For example, at one contractor's plant, the contractor maintained a perpetual inventory record for special tools acquired for production contracts. Several years ago, the Government had acquired $55 million worth of special tooling at the contractor's plant. The contracts provided that the contractor would follow its normal industrial practice in maintaining property control records. The contractor was not maintaining monetary control accounts and the stock record cards included both contractor-owned and Government-owned tooling without designation of ownership and without indicating unit cost data. We could not determine from the records whether existing tooling is contractor or Government owned. The contractor indicated that, to identify Government-owned special tooling, a physical inventory would have to be taken and that 20 men would be required for such an inventory over a period of 1 full year.

At another contractor's plant, property record cards were prepared by tabulating machines for special tooling and special test equipment and were filed by Government contract numbers. The contractor was not maintaining monetary control accounts for special tooling. We requested the contractor to designate the value of Government-owned special tooling in its possession. The total cost of such property was estimated at $19.2 million. This estimate was based on a count of a measured inch of property records and an estimated average value for each of the items in that measured inch, applied to the total measurement of property records.

We have reviewed Contract Administration Panel Case 64–310 which contains proposed changes to the ASPR, and we find that these changes have not added a requirement for maintenance of monetary control accounts for special tooling and special test equipment.

Need for better identification

ASPR recognizes that special tooling should be properly marked and that records should disclose ownership and contract designation. It provides that, when the tools are commingled with those of a contractor, they be clearly identified and recorded as Government property. Additionally, ASPR states that the contractor's property control system shall provide, for each item of Government-owned special tooling, the contract number or equivalent code designation.

Our review at five contractor plants revealed that Government-owned special tooling was not readily identifiable.

We found at one contractor's plant that some tools were not marked for identification and identification could be made only by reference to engineering drawings.

At the other plants, Government-owned tooling had been commingled with like items of contractor-owned tooling and identification as to ownership could not be readily determined because inventory record cards did not indicate who owned the tooling. To illustrate, we found at one contractor's plant, that records maintained for tools included those acquired at a cost of $55 million under Government production contracts but did not identify the tooling as either contractor or Government owned. The identification of tooling ownership could be made only through physical examination of the tools and isolation of those bearing Government marks. Further, the tool records did not always show the location of the tool, which made identification of the special tooling more uncertain.

Physical inventories

The taking of physical inventories is a necessary check on the effectiveness of the contractors' systems through the identification and evaluation of the propriety of any differences between or changes in the amount of Government-owned special tooling and test equipment in their possession and that shown in the records. This important element of control is recognized both by ASPR and the accounting principles and standards prescribed by the Comptroller General. ASPR does not, however, specifically require periodic physical inventories but provides that it shall be the responsibility of the property administrator to review and approve the type and frequency of physical inventories to be taken.

We found that in some cases contractors were not taking physical inventories at regular intervals and that the Government property administrators had not required that the inventory be taken. In another case, we found that the contractor was employing poor inventory practices.

At one plant, Government-owned tooling originally acquired at a cost of $55 million under supply contracts starting in 1952 had never been inventoried.

At another plant, the corporate policies and procedures, as approved by the Government property administrator, provided for a complete inventory of special tooling at least once a year. We found that physical inventories had been taken only at the completion or termination of contracts and that, as a result, items of significant amount acquired under other than facilities contracts had not been inventoried.

At a third plant, we found that the inventory taking had been limited to determining whether a particular item was on hand, without regard to the quantity of identical items that should be on hand.

We have reviewed Contract Administration Panel Case 64–310 which contains proposed changes to ASPR. Incorporated in the proposed changes is a requirement that "The contracor shall periodically physically inventory all Government property * * *" and also that "* * * the type and frequency of physical inventory and the procedures therefore shall be established by the contractor and approved by the property administrator * * *." In our opinion, this proposed change, if properly implemented, will result in improved control over special tooling and special test equipment. We note, however, that the proposed change does not impose a requirement for appropriate segregation of duties to ensure independence in inventory taking. Thus, an important element of internal control is not prescribed.

Need for improved controls over special tooling provided to subcontractors

Under prevailing instruction in ASPR, the Government does not exercise surveillance over tooling provided by prime contractors to various subcontractors. Thus, the Government does not review the existence, condition, or use of this property unless the prime contractor or the Government property administrator at the location specifically requests the assistance of the Government property administrator having cognizance at the subcontractor's plant.

Our review of tooling in the hands of subcontractors revealed that financial accounting controls were lacking and that property records in the three cases we examined had omitted cost data. In one instance, the subcontractor had no written procedures for the control of special tooling. We found also that in some instances Government-owned tooling provided to the subcontractor had not been clearly identified and recorded and that physical inventories had not been taken.

We found that Government property administrators responsible for property at the subcontractor's plant did not review special tooling unless requested to do so by the property administrator assigned to the prime contractor's plant and that the property administrator had made very few requests of this nature. There

were occasions, however, when the prime contractor had requested the subcontractor to verify special tooling in its custody.

Contract Administration Panel Case 64–310 which contains proposed changes to ASPR requires that the property administrator at the prime contractor's plant obtain from the contractor an agreement to utilize the services of a supporting property administrator having cognizance at the subcontractor's plant or a statement that the prime contractor elects to perform the property surveillance function at the subcontractor's plant with its own personnel.

Classification

An important aspect of control over tooling and test equipment is the classification assigned to such property, both initially and as it may be affected by subsequent changes in the manner of use.

We observed that the classification of general-purpose items as special tooling or special test equipment could result in the loss of rental payments for commercial use and in inadequate utilization. We also noted the classification of expendable items as special tooling and special test equipment may result in unnecessary costs of maintaining records and controls.

At one contractor's plant, we noted that the contractor had prepared a listing of multipurpose tools costing about $36 million, which were classified as special tooling.

A report issued in March 1966 by the Air Force property administrator located at this plant stated:

"It was observed that identical items sitting side by side carried facility property tags in one instance and special tooling tags in another instance. This would reemphasize the need for a comprehensive review and reappraisal of the criteria for determining how and at what point these items were sorted into facilities or special tooling. The existence of complete machines built as special tools, articles attached to facilities or real property on a permanent or semi-permanent basis, items so general in nature and so obviously nonspecialized, and yet identified as special tooling makes an ambiguous and untenable situation."

The property administrator stated that the tooling in question was being used by the contractor on all programs without payment of rent and recommended that it be transferred to the facilities contract. Apparently as a result of the property administrator's recommendation, a pending lease agreement between the contractor and the Air Force provides for the payment of rent for commercial use of special tooling and test equipment costing about $3.6 million. This amount was determined by the contractor by reviewing the list of standard tools comprising the $36 million total previously mentioned and estimating the quantity and value of such tools that could be used for commercial purposes.

Because there was no itemized listing of the $3.6 million of tooling which the contractor intended to use, it appears to us that any amount of the $36 million of tooling could be available to the contractor for commercial use. Although the lease agreement had not been executed at the time of our review, it appears that the standard tools are to retain their special tooling classification.

It should be noted that there may exist at numerous contractor plants conditions where Government-owned special tooling is common to both commercial and Government production requirements. For example, in a letter addressed to our office, a contractor stated in part:

"Aircraft engine production for the Defense Department in the late '50's softened considerably and the engine manufacturers, no doubt, sought further use of their product in Commercial aircraft. It must be remembered that these engines were almost identical to the Military versions and were made, for the most part, off of the same production tooling. In fact, parts could be made on the same line that would be used for either Military or Commercial aircraft."

Regarding the overall problem of proper classification, we found that the Air Force in 1962 recognized that large amounts of general purpose items were incorrectly classified as special tooling and initiated a comprehensive program to correct the situation.

In a letter dated September 17, 1962, the Director of Procurement Management, Headquarters, United States Air Force, stated that a review at five major contractor plants had disclosed that the Air Force had acquired a sizable inventory of facility-type items under supply contracts as special test equipment or other special equipment but that the Air Force lacked a program to control their use and ultimate disposition or to adequately control future acquisitions of such equipment. To correct this situation, the Director initiated a project called tooling inventory and disposal evaluation (TIDE). The purpose of project TIDE

was to identify facility-type items that were misclassified as special tooling and to establish appropriate controls for such equipment.

As of February 28, 1965, according to an Air Force report, project TIDE had been completed at 2,079 contractor locations and had uncovered 72,428 items valued at $84,326,000 that were facility-type or general purpose items which had for various reasons been classified as special tooling. Further, of the items reclassified, 3,286 items valued at $3,057,000 were determined to be excess to requirements of the holding contractor and were redistributed through shipment to other contractors for use or to Air Force activities for storage or use.

We also observed at one contractor's plant that many standard expendable items had been classified as special tooling. For example, we found that special tooling records were being maintained for general purpose drill bits costing about $4 each. This practice is in conflict with the ASPR definition of special tooling, which excludes classification of consumable small tools as special tooling. In our opinion, the continued classification of standard expendable items as special tooling may result in unnecessary costs of maintaining records and controls.

The DOD has under consideration a proposal (Contract Administration Panel Case 65–19) to strengthen ASPR regarding the administration of special tooling. The proposal will require reclassification of a special tooling item to a facilities item when it acquires multipurpose characteristics. We believe that, if this proposal is incorporated in ASPR and effectively implemented, control over special tooling will be strengthened.

Conclusions

Special tooling and special test equipment represent a significant portion of the Government-owned property in the possession of contractors. In our opinion, the fact that the Government has taken title to such tooling and test equipment is evidence of its nature as property having sufficient value that it should be subjected to effective accounting control. As previously noted, some tooling is usable for many years—in some cases for commercial purposes. We think that the current and future adaptability of much of this tooling to commercial purposes is persuasive evidence of the need for financial controls over such property.

It is therefore our opinion that it is necessary for tooling and test equipment to be properly classified, identified, and accounted for to prevent unauthorized use and unrecognized loss and to provide information to facilitate intelligent decisionmaking in regard to acquisition, dispositions, rental, and transfers. Although the deficiencies discussed in this report did not exist at all of the contractor plants visited, we believe that their incidence at the locations we reviewed were sufficient to substantiate a need for improvement.

It appears that weaknesses relating to classification, identification, and control of special tooling in the possession of subcontractors can be corrected by greater attention, on the part of responsible Government personnel, to contractor compliance with existing sections of ASPR or inprocess revisions thereof. The need for improved surveillance over Government-owned property by property administrators is discussed in the last section of this report.

It appears also that the weaknesses relating to periodic inventory taking will be corrected if the current proposal to change ASPR is implemented. We note, however, that the proposed change does not impose a requirement for appropriate segregation of duties to ensure independence in inventory taking. Accordingly, we proposed that such a requirement be included either in appendix B of ASPR or in the proposed ASPR appendix which prescribes the duties and responsibilities of the property administrators.

We recognize that financial accounting for special tooling is more complex than for some other classes of property and that an examination into the practical problems which may be associated with installation of such system was not possible within the scope of the current review. It is our opinion, however, that a system incorporating financial control of these assets is desirable and will be valuable as a tool of property management. We proposed, therefore, that the Department establish a study project to determine the procedures to be used and the point in the contracting process at which financial control of special tooling should be established.

Agency comments and our evaluation

The Deputy Assistant Secretary agreed that proper internal control procedures should include segregation of duties of responsible contractor personnel taking physical inventories of Government property and he indicated that the Department would review the desirability of making a revision to ASPR.

With regard to establishing a study project to determine the procedures to be used and the point at which financial control of special tooling should be established, the Deputy Assistant Secretary advised us that no change to the special tooling provision currently in ASPR was planned. He stated that, on the basis of prior experience of both the military departments and the commercial industry, special tooling had been and should continue to be considered as expendable (consumable) property and that the provision for detailing in each contract the special tooling required to produce end-items under the contract was considered an adequate basis of control. He stated also that, normally, special tooling was produced solely for a particular process or machine and that, upon determination by the contracting officer that this special tooling was no longer required by the Government, it should be disposed of in accordance with ASPR, section VIII, part 5.

We do not agree that the provision for detailing special tooling in each contract is an adequate basis for control. The preparation of such lists may be postponed indefinitely because a contracting officer may elect to waive the requirement until completion of the contract or subsequent follow-on production contracts. We noted one such instance where preparation of the lists was still pending for special tooling originating in 1952. Also, disposal of special tooling according to ASPR, section VIII, part 5, when it is no longer required is not responsive to the matters set forth in our report inasmuch as we are concerned with control (1) while the tooling still has utility to the Government and sale or rental value for commercial purposes and (2) to ensure the integrity of special tooling at such time as a subsequent decision is made to sell or otherwise dispose of it.

The Deputy Assistant Secretary's position that special tooling is expendable is at variance with Air Force reviews which established that much tooling was, in fact, facility-type items. ASPR requires that such facility-type items be under financial control. The Government has provided special tooling under major defense programs, to the aircraft engine and air frame industries. Subsequently, the introduction and manufacture of substantially similar products for commercial uses has resulted in additional uses for much of this tooling. For example, the Air Force sold its KC–135 special tooling to a contractor because the items could be applied to similar commercial airplanes.

Special tooling at the 11 aircraft engine and air frame contractors included in our review had a total approximate acquisition cost in excess of $299 million and at five of these contractors we established that portions of the special tooling had been used at one time or was currently being used for the manufacture of commercial components. The items which we question have long-term value and in some cases have multiuse characteristics. We believe that timely determinations regarding the classification of special tooling as facility-type items is essential and that careful control of special tooling under a system of financial control accounts is needed.

Recommendations

We recommend that the Secretary of Defense establish a study project to determine the procedures to be used and the point in the contracting process at which financial control of special tooling should be maintained. Also, we recommend that periodic examinations be made of special tooling to identify multiuse characteristics and that the items identified be reclassified and controlled as facility-type items.

Material

Accounting systems to control Government material need improvements

The accounting systems employed by contractors did not provide for financial control and acceptable physical inventories of Government-owned material. We attribute the weaknesses to indefinite instructions existing in ASPR, deficient physical inventory taking, and departure from good property management practices. The physical protection and security procedures were, with one exception, adequate to protect the Government-owned material at the plants we examined. To alleviate the inadequacy, the contractor agreed to reduce from 26 to 8 the number of employees having access to storage areas.

Financial accounting controls not maintained.—Government-owned material at six contractor plants was not controlled under monetary accounts. ASPR assigns to contractors the responsibility for maintaining an adequate property control system, without clearly establishing the essential characteristics of such a system. The existence of stock record cards was usually considered to be sufficient to comply with ASPR, and these were not tied into a monetary control account. We found that contractors maintained individual property records

showing description, issues, receipts, balance on hand, and price of the material. This was in accordance with ASPR, which does not require monetary control accounts for this property.[1]

In one case differences between unit records and stocks actually on hand were adjusted by requisitions which were not authorized according to the contractor's property control procedures. We found that, during the first quarter of 1966, over $2,800 of Government-owned material was written off of the inventory records in this manner. Furthermore, the write-offs were not reported to the Government property administrator.

We could not ascertain the causes of the discrepancies at the time of our subsequent review. However, financial control accounts would expose a number of types of discrepancies which would cause differences between the stocks on hand and the records; and exposure could be made in such a way as to permit timely investigation of the reason for the differences. Furthermore, financial control accounts would facilitate an accurate reporting of the dollar amount of inventory write-offs for purposes of investigations by management.

One contractor official, who estimated that several million dollars worth of Government-furnished material was on hand at his plant, stated that monetary controls for the Government-furnished material were impractical and that the contractor was primarily concerned with only quantities. Nevertheless this contractor maintained monetary controls over its own materials inventories.

We have reviewed Contract Administration Panel Case 64–210, which contains proposed changes to ASPR, and we find that these changes have not added a requirement for maintenance of monetary control accounts for material.

Inventory taking ineffective.—The physical inventory-taking procedures contained deficiencies, of varying significance, at 7 of the 10 contractors' plants where we examined material. In some cases adequate internal control did not exist because the taking of the inventory did not incorporate appropriate segregation of duties of participating personnel. For example, at one location, the individual who maintained the stock records was custodian of the material. and he also took inventory. In such cases differences between the records and the physical count can be reconciled by adjusting the records or removing the stock cards, without independent evaluation of the propriety of the transactions.

The inventory taking was incomplete in some cases because it was limited to verifying listings prepared from the property records and furnished to participating personnel; therefore, items which may have been physically on hand but not included on the listings provided would be omitted from the count.

At one location the contractor performed a physical inventory of Government-furnished material but did not require a physical inventory of material it had acquired for the account of the Government. Also, in a few cases, written procedures were lacking, the work was not properly documented, the results were not furnished to the Government, or inventories were not priced out.

We have reviewed Contract Administration Panel Case 64–310, which contains proposed changes to ASPR. Incorporated in the proposed changes is a requirement that "The contractor shall periodically physically inventory all Government property * * *" and also that "The type and frequency of physical inventory and the procedures therefor shall be established by the contractor and approved by the property administrator." In our opinion this proposed change, if properly implemented, will result in improved control over material. We note, however, that the proposed change does not impose a requirement for appropriate segregation of duties to ensure independence in inventory taking, thus an important element of internal control over these assets is absent.

Conclusions

ASPR does not require that financial accounting controls be maintained for Government-owned material in the possession of contractors. It is our opinion that a system incorporating financial control of materials in the possession of contractors is desirable and would be advantageous as a tool of property management. We proposed, therefore, that ASPR B–304.7 be amended to require financial accounting controls for Government-owned material in the possession of contractors in order to ensure adequate control and safeguarding of the assets and reliable reporting of the amounts on hand.

The internal control weakness noted with respect to the taking of physical inventories without appropriate segregation of the duties of participating per-

[1] A description of monetary control accounts and their manner of use was previously discussed in this report, page 48.

sonnel has not been corrected under the proposed ASPR change. We proposed, therefore, that the ASPR be strengthened by providing for appropriate segregation of duties of personnel participating in the physical inventories of materials.

Agency comments and our evaluation

The Deputy Assistant Secretary indicated that financial controls for material have been the subject of study for many years in DOD and that these studies are being continued. In addition, he stated that a proposal will be submitted for consideration by the ASPR Committee for criteria to establish contractor requirements for accounting for contractor-acquired Government material. He further indicated that a segregation of duties of responsible contractor personnel will be required during the physical taking of inventories.

We were also advised by the Deputy Assistant Secretary that DOD is currently revising its procedures to exclude from the previous definition of Government-furnished material those items sent to contractors for processing and return. Accounting for these items will be performed by the cognizant inventory control point or other activity of the DOD component, in both quantitative and monetary terms. Although the contractor will be required to keep item records for scheduling purposes, he will be relieved of financial property accounting.

We acknowledge that DOD has taken constructive steps to improve the administration of Government-owned material in the hands of contractors, but we believe the records and controls maintained by the contractor over this property should be at least as good as those maintained over its own material. Also, since DOD studies have been proceeding for many years, a timetable should be established and responsibility fixed for a solution to the problem.

Recommendation

We recommend to the Secretary of Defense that ASPR B–304.7 be amended to require financial accounting controls for Government-owned material in the possession of contractors.

Nonprofit Institutions

Property administration at universities

Our review revealed that financial control accounts were not required by ASPR to be maintained by nonprofit institutions, including universities for IPE and special test equipment, nor were they maintained by the two universities we visited. At one university this resulted in the loss of monetary and quantitative control over at least $52,000 worth of Government property. We also found that periodic inventories were not required by ASPR, nor were they taken by the universities even though research contracts frequently had been in process for several years and that, when inventories were taken, the procedures employed did not provide necessary internal control.

Further, we found that ASPR requirements were not being adhered to with regard to control of property by DIPEC. As a result (1) IPE at a cost of about $260,400 was purchased in fiscal year 1966, without DIPEC's inventories first being screened to determine whether acceptable IPE was on hand and available, (2) DIPEC's central inventory files were incomplete because $1.1 million of IPE on hand at the universities was not reported to DIPEC, and (3) during fiscal years 1965 and 1966, IPE in critical or short supply having a cost of $104,700 was donated to the universities, without first screening DIPEC records to determine whether the equipment was needed elsewhere in the Government.

Property accounting system needs improvement.—We found that ASPR does not require monetary control accounts and such accounts were not maintained. As stated previously in this report, monetary control accounts are accounts which are maintained by individuals independent of those maintaining the detailed property records, and the accounts summarize receipts, dispositions and balances on a dollar basis to ensure of accuracy and completeness of the detailed records. We also found that internal control was lacking in the inventory procedures used by the universities.

At one of the universities we reviewed, we tested acquisitions of Government-owned property amounting to $156,000 and we found that $52,000 of this amount had not been recorded on property cards. As a result, quantitative control over this property was also lacking. If a monetary control account had been maintained by the university, this omission would probably have been discovered when postings on detailed property records were reconciled with the monetary control account balance.

We have reviewed Contract Administration Panel Case 64–310 which contains proposed revisions to ASPR and we found that a change is being contemplated

which appears to require a monetary control account for facilities. However, no such requirement is included for special test equipment.

With regard to inventory taking, ASPR permits the Government property administrator to request the universities to perform periodic inventories, but physical inventories are mandatory only upon contract completion. We found that the Government property administrators had not requested periodic physical inventories and that generally they had not been taken even though research contracts frequently had been in process for several years. Physical inventories were generally taken only upon completion of the contract as prescribed.

We also found that, when physical inventories were taken at the completion of contracts, procedures did not provide for appropriate segregation of duties of personnel. At both locations inventories were taken, by personnel having custody of the property, through verification of a list of the property, prepared in advance from the property records and furnished to participating personnel. Thus independent verification, an important element of internal control of the assets, was absent.

A proposed change to ASPR which is incorporated in Contract Administration Panel Case 64–310 would require the universities to periodically physically inventory Government property and prescribes that the type and frequency of physical inventory and the procedures therefor shall be established by the contractor and approved by the property administrator.

We note, however, that the proposed change does not require appropriate segregation of duties of personnel participating in the inventory taking.

Need to coordinate IPE purchase, dispositions, and inventory on hand at universities with those of DIPEC.—DOD has established an extensive system, administered by DIPEC, to ensure maximum reutilization of IPE, prevent unnecessary procurement of IPE, and maintain a central inventory of IPE, including listings of critically short items. To operate this system, ASPR requires (1) screening of DIPEC assets prior to acquisition of IPE and (2) reporting IPE on hand to DIPEC.

Our review has shown that (1) DOD agencies generally approved the universities requests to purchase IPE, without first determining whether like items were available for use from the DIPEC inventory, (2) all Government-owned IPE in the possession of the universities had not been reported to DIPEC, and (3) DOD agencies were donating IPE to universities, without first screening DIPEC records for a determination as to whether the equipment could be utilized elsewhere.

DIPEC inventory not screened prior to acquisitions.—Our review showed that, generally, DOD agencies approved the universities' requests to purchase IPE without determining whether acceptable IPE was available through DIPEC.

At the two locations reviewed, we identified 56 items purchased in fiscal year 1966 at a cost of about $260,400 for which DOD components had not required screening at DIPEC even though screening is required by Section XIII of ASPR. We were informed by DOD and university officials that it was their belief that DIPEC could not supply the equipment required by the universities, especially within the delivery time desired. The 56 items we identified are of the type that is reportable to DIPEC.

Inventory on hand not reported to DIPEC.—We found that Government-owned IPE purchased by the universities at a cost of about $1.1 million was not reported to DIPEC, even though reporting is required by ASPR, for inventory and control purposes.

We also found that, at one location, the Government property administrator had discussed with university officials the omission of reporting but had not obtained assurance that the equipment would be reported. In another case we were told that IPE had not been reported to DIPEC because at semi-annual intervals the university requested and obtained title to certain of the items.

IPE was donated to universities, without DIPEC's records first being screened.—DOD is permitted, under the authority of 42 U.S.C. 1892, to vest in nonprofit institutions title to certain equipment purchased with research funds. Our review of the House Report 2640, dated August 15, 1958, revealed that the provisions of the law were intended to minimize the cost of maintaining property records and needlessly circularizing lists of highly specialized equipment, particularly minor equipment. Further, testimony given in the House of Representatives' hearings states that 42 U.S.C. 1892, was not intended to increase Federal expenditures or to subsidize the recipients, nor was it intended that title to

Government-owned equipment be transferred if the equipment were needed elsewhere in the Government.

ASPR provides the criteria to be used by contracting officers in determining whether Government-owned property should be donated under the authority of 42 U.S.C. 1892. The criteria requires in part that property should be donated to universities if either the retention of title in the Government would create an administrative burden not warranted by the value of the equipment or the keeping of inventory and records by the contractor would become prohibitively complicated or expensive. The ASPR criteria also provides that transfer of title should be made if "the transfer of title is not precluded by controls governing the equipment involved."

Our review showed that one type of controlled property, that which is subject to control by DIPEC, was being donated to the universities, without DIPEC's records first being screened to determine whether the equipment was needed elsewhere in the Government. Further, we noted that DOD components transferred title to equipment which was considered by DIPEC to be in short or critical supply. For example:

We found that, during fiscal years 1965 and 1966, DOD components transferred title to 36 items of equipment, having a cost of $104,700, which DIPEC considered in short or critical supply. At one university the equipment transferred included 24 items of general purpose test equipment, such as oscilloscopes, signal generators, and recorders for which DIPEC had a total of 258 requests for identical and/or similar equipment from other DOD agencies, which could not be satisfied.

We also found that at the same time DOD components were donating items to universities which were subject to the control of DIPEC, they were retaining title to many items costing less than $200. DIPEC-controlled items have an acquisition cost of $1,000 or more. We note, however, that a recent ASPR revision states that title to equipment with a cost of less than $200 shall be vested in the universities upon purchase of this equipment.

We believe that the current provisions of ASPR which provide criteria for those items to be donated to universities could be made clearer and thus more effective if the criteria specifically excluded DIPEC-controlled items from the donation process. We have reviewed proposed changes to ASPR, and we find that no change to the current criteria is contemplated.

Conclusions

The proposed change to ASPR, requiring periodic inventory taking, should, if properly implemented, result in more effective control over Government-owned property in the possession of universities. We note, however, that the proposed change does not impose a requirement for adequate internal control through appropriate segregation of functions in taking physical inventory. We therefore propose that such a requirement be incorporated at an appropriate place in appendix C or the new appendix of ASPR, which prescribes the responsibilities and duties of property administrators.

We believe that an effective property accounting system should also include monetary control accounts for Government-owned industrial plant equipment, and special test equipment in the possession of the universities; and we proposed that appendix C of ASPR be strengthened by requiring such financial accounting control of such Government-owned property at nonprofit institutions.

We also believe that, to avoid the possibility of unnecessary procurements, the DIPEC inventory should be screened, prior to approving the purchase of new IPE by universities and that IPE on hand at the universities should also be reported to DIPEC, as required by ASPR. We believe that, to achieve these objectives, it will be necessary for Government property administration surveillance to be more thorough to assure that existing procedures are adhered to, and we proposed increased management effort on these matters.

We believe that transferring of title to universities of industrial plant equipment which is in short or critical supply creates a potential for increased Federal expenditures, since other DOD users may be purchasing equiupment of similar capability. We proposed, therefore, that DOD adopt more specific criteria regarding "controlled" equipment which is not to be transferred to universities (ASPR 4-214.4), particularly with respect to its application to industrial plant equipment controlled by DIPEC.

Agency comments and our evaluation

The Deputy Assistant Secretary advised us that, although paragraph C211.6, appendix C, Manual for Control of Government Property in Possession of Non-

profit Research and Development Contractors, requires colleges and universities to maintain financial accounts for Government-owned real property and plant equipment, there has been a failure to exercise compliance with the requirement. He indicated that the Department will take necessary steps to ensure compliance. With respect to financial accounting for special test equipment provided nonprofit contractors, the Deputy Assistant Secretary stated that it was DOD's policy to charge these items as operating costs to initial contracts and it did not feel it desirable to require financial accounting for them. Concerning the taking of physical inventories, the Deputy Assistant Secretary concurred that appropriate segregation of duties is needed for proper internal control and he indicated that the Department will review the desirability of an ASPR revision.

The Deputy Assistant Secretary agreed that IPE costing over $1,000 a unit should be reported to DIPEC for management and control purposes. He further stated that available IPE of this type should be screened for utilization prior to its being donated to the nonprofit contractor under provisions of 42 U.S.C. 1892 and that a revision to DSA regulations and ASPR designed to meet this objective would be processed.

The language in paragraph C211.6, appendix C, states that "The contractor's property control system *should* be such as to provide semiannually the dollar amount of Government-owned industrial facilities * * *." (Italic supplied.) Thus, as we interpret it, monetary controls are permissive rather than mandatory. Further, paragraph C211.6 is under the "Physical Inventories" paragraph, which, we believe, confuses application of the instruction. Contract Administration Panel 64–310 revises the wording from "should" to "shall" and this instruction has been placed under part 3—Records of Government Property, paragraph C–301, General. As such, the contemplated change to ASPR appears to require a monetary control account for facilities.

Special test equipment at universities at time consists of an assembly of standard items which include DIPEC-controlled-type items. These standard items have been classified as special test equipment because of their specialized nature once they are integrated with other components into complex laboratory set-ups.

Recommendations

To achieve effective accounting control over Government-owned property at nonprofit institutions, we recommend to the Secretary of Defense that ASPR be revised to clearly establish the need for monetary control accounts for IPE. We further recommend that standard IPE now classified as special test equipment be reclassified and controlled as facility-type items. Also, we recommend that special test equipment be accounted for under monetary control accounts.

Property Management Functions in the DOD

Property Management Functions in the DOD Areas for improvement in administration of Government-owned property in possession of contractors

Appendices B and C of the ASPR provide that the contractor will maintain the official records of Government property in its possession. ASPR further provides that the contractor's property accounting system must be submitted to the property administrator for approval. ASPR also requires that the property administrator periodically test the contractor's system to ensure that adequate control exists over Government-owned property.

We found that the value of the approval process as a means to ensure adequate control over Government-owned property was questionable because (1) there was little incentive for the contractor to maintain an approved system and (2) contractor systems were allowed to continue in an approved status even though the property administrator had found a significant weakness in the contractor's control over property, which was not subsequently corrected, or, when other weaknesses were, in our opinion, apparent and should have been corrected. We found that the property administrators' examinations either did not disclose many of the conditions discussed throughout this report, which, in our opinion, were unsatisfactory, or did not produce effective corrective measures. Further, we noted that in some cases the property administrator did not adequately document his work.

We also found that, for the past 1½ years, relatively few internal audits have been made of the effectiveness of property administration at contractors' plants. In addition, audits that were made regarding the adequacy of rental payment were, in our opinion, not sufficiently comprehensive to be fully effective.

DOD has taken or is in the process of taking action to improve the quality of

the work of property administrators and internal auditors. For example, a recent policy decision appears to have established the responsibility for audit of the administration of Government property. Also, the Department has in process a new ASPR section which is expected to more clearly establish the responsibilities and duties of Government property administrators.

Property administrators' surveillance and approval of systems.—Our review showed that the property administrator had withheld approval to systems employed at 5 of the 19 contractors in our review. Further, we found that ASPR does not provide an incentive for the contractor to maintain an approved system. For example:

At one location we reviewed, the contractor's system was disapproved in July 1962 because the contractor's property control procedures were not adequate. In January 1965, the property administrator again reviewed the contractor's manual for control over Government property and reported to the contractor that the manual was "* * * sadly lacking detail * * *," and approval of the system was withheld. Since approval of the contractor's system had already been withheld no further action was taken against the contractor. At the time of our review the contractor still did not have an approved system.

At another location, the system was disapproved in November 1966 because the property administrator found that the contractor's system for control of Government property was deficient in areas related to disposition, acquisition, recordkeeping, and inventory taking. Further, it was at this location that we found that the contractor had not reported 12 items of IPE which cost about $400,600 and had been idle for about 2 years, for possible reallocation by DIPEC. As indicated, the only action taken was to withdraw approval of the system.

We also noted instances where the contractor's system was allowed to continue in an approved status even though the property administrator had found a significant weakness in the contractor's control over property, which was not subsequently corrected, or, when other weaknesses were, in our opinion, apparent, and should have been corrected. For example:

The property control system at one of the universities we reviewed was approved in December 1959 and was again reviewed by the property administrator in August 1966 and found to be adequate. We found that IPE purchased by the university was not reported to DIPEC for its inventory and control purposes even though reporting was required by ASPR. The Government property administrator was aware of this situation and discussed the matter of nonreporting with university officials, but he did not obtain assurance that the equipment would be reported. The approval status of the university's system was not changed.

At another location, we noted that the property administrator approved in January 1964 the contractor's property control system which required a quarterly review of usage records to detect idle equipment. We found that the contractor was not following this procedure, nor had the property administrator required the contractor to do so. We made an analysis of the utilization data and, on the basis of use citeria prescribed by DOD, we questioned retention of 59 items of IPE costing about $859,000. During the time of our review, the contractor declared excess or was considering for disposal eight of the items costing about $111,300. The approval status of the contractor's system was not changed.

At a third location, we found that the contractor's system had been approved in August 1962. Selective floor checks conducted by the Government property administrator at month-end showed numerous instances where, during a 2-year period, commercial work was performed on IPE, which the contractor had not included in his monthly request to the Government plant representative. Although corrective action was promised, we noted that incidence of discrepancies rose from 7.5 percent of the IPE tested in late 1964 and early 1965, to 13.5 percent of the IPE tested during the first 9 months of 1966.

Documentation by the Property Administrator.—In March 1966 we reported to the Subcommittee on Federal Procurement and Regulation, Joint Economic Committee, that one of the military services regulations specifies that "* * * the file of work-papers 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. * * *." We reported also that the documentation of the results of the property administrator's property system surveys were inadequate at contractors' plants we visited. Our current review showed some cases where the documentation was adequate and other cases where it was inadequate.

We found that where the property administrator failed to document his work, we could not evaluate the quality and effectiveness of his surveillance examinations. For example:

At one location, we noted that the sole evidence supporting the property administrator's system survey was a two-paragraph letter of approval of the system. At another location, where the property administrator reviewed the property control system, no formal documents or workpapers had been prepared, and the evidence of such a review was limited to a notation in the control file.

DOD audit efforts.—The "Accounting Principles and Standards for Federal Agencies," published by the Comptroller General, provides that all performance should be subject to adequate review under an effective internal audit program so as to provide information as to whether performance is effective, efficient, and economical.

Our review showed that, for the past 1½ years, relatively few internal audits have been made of the effectiveness of property administration at contractors' plants. Further, we found that audits that were made regarding the adequacy of rental payment were, in our opinion, not sufficiently comprehensive to be very effective.

Since July 1965, the date when the Defense Contract Audit Agency (DCAA) was established, only a few internal audits have been performed regarding the effectiveness of control over Government-owned property. The reason for this is that DCAA, as a matter of policy, does not audit the effectiveness of their "client" which includes the contracting officer and the property administrator. Further, we were informed that, because of DOD's desire to have one audit agency deal with contractors, internal auditors assigned to the military services and DSA were not permitted access to contractors records.[1] These circumstances resulted in little internal audit effort being applied toward the effectiveness of contract administration of which property administration is a part. For example:

At one plant the most recent audit of the property control system and the property administrator's activity was made in April 1964 by the Resident Air Force audit staff. At another location we were informed that an audit of the property control system had not been made for at least 6 years. At a third location the most recent audit of the property control system was made by the Navy Area Audit Office in May 1964.

In a memorandum to the Deputy Comptroller for Audit Policy, OASD (Comptroller) dated March 22, 1966, the DSA Auditor General indicated the importance of internal audit of contract administration. He noted that internal audit organizations should have access to contractor-maintained records because such access is necessary to determine techniques used by property administrators and to provide assurance that property is properly identified and adequately protected and that utilization is authorized and retention by the contractor is justified. He further indicated that DSA and DCAA could perform most effectively with internal audit's assuming no prerogative of the DCAA for contractor review and with DCAA's assuming no responsibility of internal audit of contract administration.

With regard to audit of contractor rental payments for use of Government-owned facilities, we found that the DCAA reviews were generally limited to (1) verifying the accuracy of data in the computations submitted by the contractor and (2) determining whether the procedure for computing the rent was in accordance with the contract formula. An evaluation as to whether the prevailing terms of the lease were equitable to the Government was not apparent (see p. 29). As discussed in previous sections of this report, we found a number of lease arrangements which, in our opinion, were inequitable to the Government.

Further, at one location we found that DCAA did not consider the question of whether the Government obtained the benefits of rent-free use of the IPE for its procurements. At this location the contractor had orders from nine different customers for 2.75 rocket base blanks, and all were paying rent for use of the Government IPE even though they were entitled to a rent-free waiver. In one of the cases the customer was a Government procurement agency. After we informed the contractor of this situation, it told us that the customers would be advised of the rent-free aspect in the future.

Agency actions and our evaluation

Some actions have been or are being taken by DOD to provide more definitive guidelines in the conduct of the property administrators' surveillance of contractor systems and to improve the quality of property administrators and internal audit effort.

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[1] An exception to this policy occurred in late 1965 and early 1966 when DSA was permitted to conduct an audit at several contractors' plants. The results of the agency audit were transmitted to the Subcommittee in March 1966.

In our March 1966 report to the Subcommitee, we referred to the preparation of a comprehensive manual for control of Government property which was in process. This proposed addition to ASPR is still under active consideration. This revision specifies the duties and responsibilities of the Government property administrator and defines the position of property administration within contract administration.

As discussed earlier in our report, the proposed requirements that contractors furnish utilization data for Government-owned IPE would provide an effective tool for management of the property. We believe that the property administrator's guidelines should require that this data be analyzed and compared to usage standards and criteria to identify IPE which should be reallocated to fill other DOD needs.

Also, we believe that the guidelines should include a description of the essential characteristics of an adequate property control system. We believe this is necessary in order to make the required evaluations. For example, one essential of a control system should be to segregate review responsibilities from the recording of transactions, i.e., the physical inventory procedures should include appropriate segregation of duties. Other requirements are the establishment of monetary control accounts, and periodic reconcilement to the detailed records. Further, we note that proposed changes to ASPR, which affect property administration, do not provide incentives for contractors to maintain an acceptable property control system.

During our review we observed instances where apparently qualified personnel had left their positions as property administrators because the field offered no long-term career in the middle management classified grades of GS–12 and GS–13. Adequate internal control over Government property resources goes beyond prescribing policies and comprehensive procedures in regulations and guidelines. It includes personnel having qualifications commensurate with their responsibilities and requisite employee training programs.

In our March 1966 report to the Subcommittee we cited a 1963 management study indicating 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 administrator. The study proposed to improve the quality of the work by upgrading the assigned personnel. During our current review we noted that the Air Force has begun a program to upgrade the property administration function through the establishment of revised interim classification standards to provide career development and retention of qualified property administrators. This program also includes training courses in furthering professional development of employees.

We also have noted that the Defense Supply Agency, to which most property administrators are assigned, has been considering a proposed guideline to supplement the Civil Service Commission's standard for the Industrial Property Administration Series of positions.

With regard to internal audit effort, the Office of the Assistant Secretary of Defense (Comptroller) in a memorandum to DSA and the military services, issued on December 27, 1966, established clear lines of audit policy which provided that prime responsibility for audit of the administration of Government property, including that furnished to contractors, is a part of the internal audit mission of the military services and DSA. DCAA's primary role will be to provide accounting and financial management advisory services regarding contracts and subcontracts to all DOD components. We believe that the guidelines, set forth under this policy are essential and, if effectively implemented, will significantly improve the administration of Government property.

Conclusions

Actions taken or contemplated by DOD should, generally, improve the system of control over Government-owned property in the possession of contractors. However, regarding these changes we proposed that:

1. DOD place continuing emphasis on efforts to upgrade and improve the quality of property administrators and thus the effectiveness of surveillance.

2. DOD consider what appropriate incentives should be provided to encourage the establishment and maintenance, by contractors, of approved systems for control over Government-owned property.

3. DOD initiate an effective program of internal audit of property administration.

We believe that, in general, it is reasonable that accounting principles and standards applicable to Government-owned property in possession of contractors should be at least equivalent to the generally accepted principles and stand-

ards applied in normal industrial practices, appropriate to the circumstances, for accountability and control of a contractor's own property. However, more exacting standards may be appropriate under certain conditions where dictated by peculiar requirements of public legislation or the Department of Defense.

We proposed, therefore, that the new ASPR section, which defines the duties and responsibilities of Government property administrators, incorporate a policy statement to this effect for the guidance of such officials.

Agency comments

The Deputy Assistant Secretary stated that DOD had established a joint study project to evaluate current position classification standards for property administrators (GS–1103), establish position guidelines supplementing those of the Civil Service Commission, and provide qualification and performance standards. With regard to approving contractor property accounting systems for control over Government-owned property, the Deputy Assistant Secretary indicated that a specific ASPR (see apps. B and C) requirement for annual review of contractor property accounting systems is needed and that the ASPR Committee is considering adoption of such a requirement for both commerical and nonprofit contractors. He stated also that schedule or planned internal audits by agencies and military departments and DSA should achieve the necessary audit coverage of property administration.

The Deputy Assistant Secretary concurred in our proposal that it would be reasonable to expect that those accounting principles and standards applicable to Government-owned property in possession of contractors should be equivalent to those applied in normal industrial practices. He indicated that the new ASPR supplement, covering the duties and responsibilities of the property administrator, would be amended accordingly. He stated that, if more exacting standards than sound industrial practices should be necessary, the requirement would be established by contract provision.

APPENDIXES

APPENDIX I

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE,
Washington, D.C., August 7, 1967.

Mr. WILLIAM A. NEWMAN, JR.,
Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. NEWMAN: This is in response to your letter dated May 1, 1967 to the Secretary of Defense enclosing copies of a draft report to the Congress of the United States, on Review of Controls over Government-owned Property in the Possession of Contractors. (OSD #2603)

The report is designed to assist the Department of Defense (DOD) in improving the accounting and control of Government-owned property in the possession of contractors. Our comments on each of the 14 recommendations are attached for your consideration prior to submitting the final report to Congress.

We appreciate your interest and help in this matter.

Sincerely yours,

W. W. SNAVELY,
Brigadier General, USAF.
for J. M. MALLOY,
Deputy Assistant Secretary of Defense (Procurement).

GAO Note: Portions of this letter have been deleted because they are no longer relevant to the matters discussed in this report.

APPENDIX II

DEPARTMENT OF DEFENSE COMMENTS ON GENERAL ACCOUNTING OFFICE REPORT

REVIEW OF CONTROLS OVER GOVERNMENT-OWNED PROPERTY IN THE POSSESSION OF CONTRACTORS

1. *Recommendation.*—We are therefore recommending to the Secretary of Defense that provisions of proposed ASPR changes be revised to meet the predominant need of providing utilization records and a means of analysis of whether the extent and manner of use of Government IPE is satisfactory. [Deleted]

Comment:

The Armed Services Procurement Regulation (ASPR is being revised to prescribe that the contractor be required contractually to establish and maintain a written system for controlling utilization of IPE. It also establishes the responsibility for each Contract Administration activity and other DOD components, to conduct property system surveys to insure the effectiveness of such a system, and to show the extent and manner of use of Government-owned IPE. Finally, it provides for control, detection, and reporting of Government-owned IPE which is not being effectively and economically utilized by Defense contractors. This case is now receiving a comprehensive review throughout the Department of Defense (DOD), and by selected industrial associations.

Also, we will study the feasibility of maintaining utilization records on a machine-by-machine basis, as for example, IPE of selected high value. If our study proves the practicality of such an approach the ASPR will be modified accordingly.

2. *Recommendation.*—We are recommending to the Secretary of Defense that DIPEC's management controls be reviewed, and new or additional directives be initiated where required to insure that all equipment which could be utilized to meet anticipated needs is considered, and that suitable equipment is offered to

authorized requisitioners in each instance when it is available. In this connection we are recommending that a program of personnel training and supervisory review be instituted to assure adherence to established policy and procedures. [Deleted.]

Comment

Defense Supply Agency (DSA) Manual 4215.1, "Defense Industrial Plant Equipment Center (DIPEC) Operations", contains DOD policies, procedures and systems for reporting idle IPE and for submitting screening requirements. When screening by DIPEC results in a determination of non-availability, or an item is allocated and then rejected for valid reasons, DIPEC issues a Certificate of Non-Availability. [Deleted.]

DIPEC has established a training program for all DIPEC commodity managers. Particular emphasis is being placed on the requirement to document the issuance of Certificates of Non-Availability or other specific conditions under which items in inventory are rejected as unsuitable for the intended use.

3. *Recommendation.*—We are recommending that ASPR 13-405 be clarified to show that prior approval is to be made on a machine-by-machine basis and that the term "25 percent non-Government use" be more precisely defined. In addition, we are recommending that ASPR be clarified to differentiate OEP approvals from local monthly approvals for rental purposes. [Deleted.]

Comment

A requirement for prior approval by the Office of Emergency Planning (OEP) on a machine-by-machine basis for commercial use over 25 percent per machine would create a substantial administrative burden not commensurate with the goals sought to be achieved. To maintain a factual utilization record by individual machine for commingled Government and contractor-owned plant equipment on a contract-by-contract basis is impractical. It would be very time consuming, disrupt the contractor's production planning process, and result in the addition of a costly administrative burden for both Government and Industry. A more practical approach, which we are pursuing, is one of more aggressive surveillance, maximum use of all plant equipment, and additional emphasis on the collection of adequate rentals. However, DOD has requested that OEP meet with us for the purpose of reaching an acceptable solution on this ponit, on the question of defining "25 percent non-government use," and the differentiation of OEP approvals from local monthly approvals for rental purposes. Also, as mentioned in our comment #1, we are studying the practicality of maintaining utilization records on a machine-by-machine basis for selected high value items of IPE.

4. *Recommendation.*—Accordingly, we are recommending that the Secretary of Defense, in connection with further consideration of a current DOD proposal for revision of the rental base, consider the determination, for rental purposes, of actual machine use on a machine-by-machine basis. Since it appears to us that the proposed method which is under consideration by DOD would be exceedingly complex to administer, particularly as to the effect of contract changes, we are also recommending consideration of this matter if not previously considered by the Department. [Deleted.]

Comment

Several alternative proposals are being considered by the ASPR Committee concerning conditions for use of Government plant equipment. None of these alternatives contemplate a determination of actual equipment use on a machine-by-machine basis. Our position regarding controls on a machine-by-machine basis is stated in the response to recommendations #1 and 3.

5. *Recommendation.*—We are recommending that, in order to improve control over the use of Government IPE, the Department consider the need for more stringent language in the present ASPR clause. [Deleted.]

Comment

DOD has continuously taken the position that contractors should be held liable for any unauthorized use of IPE. However, we will consider the need for stronger language in paragraph (e) of the "use and charges" clause (ASPR 7-702.12) to assure adequate control over the use of Government-owned IPE in possession of Defense contractors.

6. *Recommendation.*—We are recommending, therefore, that DOD re-examine its current policy of not authorizing rent-free use of Air Force heavy presses used on Government work, and that priority effort be applied to increasing the Government's return through rental arrangements. [Deleted.]

Comment

The Air Force heavy press program, a unique situation because of the high cost of the presses, required special OEP approval on all leases. It continues to receive special emphasis. DOD, in conjunction with the Air Force, is re-examining existing arrangements pertaining to rental charges for use of these presses. We are considering such aspects as waiving the rental charges for Government work, increasing rental returns on commercial use, and the feasibility of selling some of the presses to Defense contractors.

7. *Recommendation.*—We are therefore recommending that the DOD place concentrated efforts on the revision and administration of the following aspects of its industrial facility modernization and replacement program: (1) inclusion in procedures of a requirement for specific consideration, and a statement, as to the contractor's ability or willingness to privately finance modernization proposals, (2) consideration of a revision of guidelines to make the provision of Government-furnished plant equipment more directly related to new, major defense programs, (3) a re-examination of the principle of recovery of savings through repricing of incentive-type contracts and subcontracts, and (4) improvement of the validity and review of justification and actual experience data, with particular attention to the aspect of commercial use. [Deleted.]

Comment

It is DOD policy (DOD Directive 4275.5, Industrial Facility Expansion and Replacement) that the contractor be encouraged to replace old, inefficient government tools with more modern, efficient, privately owned tools. We will modify our current procedures to require specific consideration, and a statement, as to the contractor's inability or unwillingness to finance equipment modernization.

We will review the need to revise our guidelines as they apply to both new, and existing, major Defense programs. However, we feel that the problems highlighted in the GAO report stem primarily from administration of the moderization program, not inadequate guidelines. These deficiencies will be corrected through a program to improve the technical competency of our property administrators, by a more detailed evaluation of the validity and review of justification and experience data at the local level, and by a requirement for workload projections far enough in the future to allow for administrative and procurement lead time.

The ASPR Committee has had under consideration for some time the subject of recovery of savings under all types of contracts. The views contained in your letter of 30 March 1967 on recovery of savings in the repricing of incentive-type contracts are being considered by the committee.

8. *Recommendation.*—We are recommending that the contracting practices and ASPR provisions be studied, with the objective of providing a method for appropriately accumulating, recording and reporting transportation and installation costs which are borne by the Government. [Deleted.]

Comment

We agree that, as a general principle, the cost of plant equipment should include the cost of transportation for delivery to the current installation site, including the cost of installation. In order to comply with ASPR 7–702.12, it is necessary that cost of plant equipment include the costs of transportation to, and installation in, the present location of plant equipment in Defense contractors' plants for the purpose of charges for use of the equipment. Action will be taken to assure compliance with this requirement by amending ASPR after study of the most feasible way of obtaining equitable cost data, by accounting or statistical methods.

9. *Recommendations.*—We are therefore recommending that a study be made of methods by which DIPEC records could be used for Navy property management purposes, with the objective of eliminating duplicate recordkeeping by the Navy; and that the Department of Defense investigate the possibility of similar duplications in the other military services. [Deleted.]

Comment

Duplicate recordkeeping related to Navy-owned IPE in possession of contractors is being discontinued. The requirement for records will be satisfied by reliance upon both the contractor and DIPEC property records.

ASPR (Appendices B and C) is being revised to prevent duplication of property records in all Defense agencies. If other duplication is found in the Military Departments, corrective action will be initiated.

10. *Recommendation.*—We are therefore recommending that the Secretary of Defense establish a study project to determine the procedures to be used and the point in the contracting process at which financial control of special tooling should be established. Further, we are recommending that an appropriate section of ASPR be revised to require that proper internal control procedures be employed in the taking of physical inventories which would include appropriate segregation of duties of participating personnel. [Deleted.]

Comment

Based upon prior experience of both the Military Departments and commercial industry, special tooling has been and should continue to be considered as expendable (consumable) property. The provision of detailing in each contract the special tooling required to produce end items under the contract is considered an adequate bases of control. Normally, special tooling is produced solely for a particular process or machine. Upon determination by the contracting officer that this special tooling is no longer required by the Government, it should be disposed of in accordance with ASPR, Section VIII, Part 5. Therefore, we plan no change to the special tooling provision currently in ASPR.

DOD concurs with the recommendation that we require proper internal control procedures, which include segregation of duties of responsible contractor personnel taking physical inventories of Government property. We will further review the desirability of an ASPR revision (Appendices B and C) in this regard.

11. *Recommendation.*—Accordingly, we are recommending to the DOD that the ASPR be changed to require (1) financial accounting controls for Government-owned material in the possession of contractors in order to assure adequate control and safeguarding of the assets and also reliable reporting of the amounts on hand, and (2) that proper internal control procedures be employed in the taking of physical inventories which would include appropriate segregation of duties of participating personnel. [Deleted.]

Comment

Financial controls for material have been the subject of study for many years in DOD. These studies are being continued. In addition, a proposal will be submitted for consideration by the ASPR Committee for criteria to establish contractor requirements for accounting for contractor-acquired Government material.

DOD is currently revising its procedures to exclude from the previous definition of Government-furnished material those items sent to contractors for processing and return. Accounting for these items will be performed by the cognizant inventory control point or other activity of the DOD component in both quantitative and monetary terms. While the contractor will be required to keep item records for rescheduling purposes, he will be relieved of financial property accounting.

12. *Recommendation.*—We are recommending that the Department increase management efforts to ensure compliance of ASPR requirements with regard to control of property by DIPEC. We are also recommending that the ASPR be revised to (1) require financial accounting control of Government owned industrial plant equipment [deleted] and special test equipment at nonprofit institutions, (2) provide more specific criteria regarding "controlled" equipment which is not to be transferred to universities, particularly with respect to its application to industrial production equipment controlled by DIPEC, and (3) require proper internal control procedures in the taking of physical inventories, which would include segregation of duties of participating personnel. [Deleted.]

Comment

Paragraph C211.6, Appendix C. Manual for Control of Government Property in Possession of Nonprofit Research and Development Contractors, requires colleges and universities to maintain financial accounts for Government-owned real property and plant equipment. We agree that there has been a failure to exercise compliance with this requirement. We will take the neceessary steps to assure compliance.

We question the advisability of requiring financial accounting for [deleted] special test equipment provided non-profit contractors. It is DOD policy to charge [deleted] special test equipment for use on the initial contract as an operating

cost. As mentioned in our comment to recommendation #10, we feel it is not desirable to require financial accounting for [deleted] special test equipment.

We agree that industrial plant equipment costing over $1,000 a unit, at colleges and universities, should be reported to DIPEC for management and control purposes. Also, available equipment of this type should be screened for utilization prior to donation to the nonprofit contractor under provisions of 42 U.S.C. 1892. A revision to DSA regulations and ASPR designed to meet this objective, will be processed.

13. *Recommendation.*—We are recommending that the DOD (1) place continuing emphasis on efforts to upgrade and improve the quality of property administrators and thus the effectiveness of their surveillance over Government-owned property in the possession of contractors, (2) consider what appropriate incentives should be provided to encourage the establishment and maintenance, by contractors, of an approved system for control over Government-owned property, and (3) initiate an effective program of internal audit of property administration. [Deleted.]

Comment

DOD has established a joint study project to evaluate current position classification standards for property administrators (GS–1103), establish position guidelines supplementing those of the Civil Service Commission, and provide qualification and performance standards. We consider this project of utmost importance. You may be assured that it will receive our close attention.

Under current ASPR procedures the contractor is required to establish and maintain an approved system for accounting and control of Government-owned property. We believe a specific ASPR (Appendices B and C) requirement for annual review of the contractors property accounting system is needed. The ASPR committee is considering adoption of such a requirement for both commercial and non-profit contractors. Motivation should not be in the form of an incentive or an award to accomplish a task otherwise required by the contract and sound industrial practice.

We concur that there should be additional emphasis on the audit of controls over, and utilization of, Government property in the possession of contractors. As noted in the GAO report, ASD(C) memorandum of December 27, 1966, to the Assistant Secretaries of the Military Departments (FM), the Director, Defense Contract Audit Agency, and the Comptroller, DSA, established areas of audit responsibility for both contract and internal auditors in Government property audits. Collaterally, the memorandum established procedures for assist audits as appropriate by either contract or internal auditors. This policy guidance, together with the internal audits scheduled or planned by the internal audit agencies of the Military Departments and DSA, should achieve the audit coverage contemplated by part three of the GAO recommendation.

14. *Recommendation.*—We are recommending, therefore, that the new ASPR section, which defines the duties and responsibilities of Government property administrators, incorporate a policy statement to this effect for the guidance of such officials. [Deleted.]

Comment

DOD agrees it is reasonable to expect that those accounting principles and standards applicable to Government-owned property in possession of contractors should be equivalent to those applied in normal industrial practices. The new ASPR supplement, covering the duties and responsibilities of the property administrator, will be amended to require acceptable accounting principles and standards commensurate with that of sound industrial practices. If more exacting standards than sound industrial practices are necessary, the requirement will be established by contract provision.

Separate Comment

The GAO pointed out in its report that guidelines should be included in ASPR for determining when to capitalize or expense costs incurred on Government real property in possession of Defense contractors. [Deleted.] DOD will develop necessary criteria for capitalizing or expensing costs incurred on Government real property in possession of Defense contractors for inclusion in ASPR.

PRINCIPAL OFFICIALS OF THE DEPARTMENT OF DEFENSE, THE MILITARY DEPARTMENTS, AND THE OFFICE OF EMERGENCY PLANNING 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:		
Paul H. Nitze	July 1967	Do.
Cyrus R. Vance	January 1964	June 1967.
Roswell L. Gilpatric	January 1961	January 1964.
Assistant Secretary of Defense (Comptroller):		
Robert N. Anthony	September 1965	Present.
Charles J. Hitch	February 1961	August 1965.
Assistant Secretary of Defense (Installations and Logistics):		
Thomas D. Morris	September 1967	Present.
Paul R. Ignatius	December 1964	June 1967.
Thomas D. Morris	January 1961	December 1964.
Deputy Comptroller for Audit Systems: K. K. Kilgore	February 1963	Present.
Department of the Army:		
Secretary of the Army:		
Stanley R. Resor	July 1965	Do.
Stephen Ailes	January 1964	July 1965.
Cyrus R. Vance	July 1962	January 1964.
Under Secretary of the Army:		
David E. McGiffert	November 1965	Present.
Stanley R. Resor	April 1965	July 1965.
Paul R. Ignatius	March 1964	December 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.
Chief of Staff:		
General Harold K. Johnson	July 1964	Present.
General Earle G. Wheeler	October 1962	June 1964.
Chief, U.S. Army Audit Agency:		
Maj. Gen. H. G. Sparrow	March 1967	Present.
Maj. Gen. P. F. Lindeman	April 1966	February 1967.
Maj. Gen. T. Sands	March 1965	February 1966.
Maj. Gen. S. Jones	April 1961	February 1965.
DEPARTMENT OF THE NAVY:		
Secretary of the Navy:		
Paul R. Ignatius	August 1967	Present.
Paul H. Nitze	November 1963	June 1967.
Under Secretary of the Navy:		
Charles F. Baird	July 1967	Present.
Robert H. B. Baldwin	July 1965	June 1967.
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	March 1965	Present.
Vice Adm. William A. Schoech	July 1963	March 1965.
Auditor General:		
Capt. E. K. Auerbach	October 1965	Present.
Capt. P. Nicks	September 1965	October 1965.
Capt. C. M. Grassino	February 1965	August 1965.
Rear Adm. E. Stanley	November 1962	February 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:		
Townsend Hoopes	October 1967	Present.
Norman S. Paul	October 1965	September 1967.
Dr. Brockway McMillan	June 1963	September 1965.
Assistant Secretary of the Air Force (Installations and Logistics) (formerly materiel): Robert H. Charles	November 1963	Present.
Chief of Staff:		
General John P. McConnell	February 1965	Present.
General Curtis E. LeMay	July 1961	January 1965.
Auditor General:		
Maj. Gen. Don Coupland	September 1964	Present.
Maj. Gen. W. W. Veal	August 1963	July 1964.
Defense Contract Audit Agency:		
Director: William B. Petty	July 1965	Present.

PRINCIPAL OFFICIALS OF THE DEPARTMENT OF DEFENSE, THE MILITARY DEPARTMENTS, AND THE OFFICE OF EMERGENCY PLANNING RESPONSIBLE FOR THE ADMINISTRATION OF ACTIVITIES DISCUSSED IN THIS REPORT—Continued

	Tenure of office	
	From—	To—
Defense Supply Agency:		
Director:		
Lt. Gen. E. C. Hedlund, U.S. Air Force	July 1967	Do.
Vice Adm. Joseph M. Lyle, U.S. Navy	July 1964	June 1967.
Deputy Director:		
Maj. Gen. W. W. Vaughn, U.S. Army	July 1967	Present.
Maj. Gen. E. C. Hedlund, U.S. Air Force	August 1966	June 1967.
Maj. Gen. F. C. Gideon, U.S. Air Force	July 1964	July 1966.
Deputy Director for Contract Administration Services:		
Maj. Gen. John A. Goshorn, U.S. Army	August 1966	Present.
Maj. Gen. W. W. Veal, U.S. Air Force	July 1964	July 1966.
Commander, Defense Industrial Plant Equipment Center:		
Col. F. Sitler, U.S. Air Force	January 1966	Present.
Col. F. Sitler, U.S. Air Force (acting)	October 1965	January 1966.
Col. S. F. Langley, U.S. Air Force	March 1963	October 1965.
Auditor General: Burk O. Barker	December 1961	Present.
Office of Emergency Planning, Executive Office of the President:		
Director:		
Price Daniel	October 1967	Do.
Farris Bryant	March 1966	October 1967.
Franklin P. Dryden (acting)	January 1966	March 1966.
Buford Ellington	February 1965	January 1966.
Edward A. McDermott	February 1962	January 1965.

APPENDIX III

APPROXIMATE COST OF GOVERNMENT-OWNED PROPERTY AT CONTRACTORS' PLANTS INCLUDED IN OUR REVIEW AS OF REPORTING DATES IN FISCAL YEAR 1966 [1]

Principal type of contractor	Number visited	Plant cognizance	Facilities				Materials	Tooling and test equipment	Military property [4]	Total
			IPE [2]	AF heavy presses [3]	Real property and improvements	Minor and other property				
Ordnance	[5] 2	DCAS	$28,333,700	$34,030,600	$5,763,800	$1,433,100	$2,247,000	$8,567,300	$84,700	$80,460,200
Electronics	1	Army	10,720,200	----------	3,649,200	4,034,200	(6)	20,333,700	275,700	39,013,000
	1	Navy	360,600	----------	117,800	[7] 9,658,900	7,871,200	19,237,500	----------	37,246,000
Aircraft engine	4	DCAS	101,160,100	----------	1,202,400	3,396,800	16,276,200	84,105,900	----------	206,141,400
Airframe	5	DCAS	18,055,900	----------	----------	548,100	5,653,400	26,293,100	2,252,100	52,802,600
	1	Air Force	33,384,100	----------	73,416,600	[8] 23,949,000	20,554,600	[9] 185,093,900	26,549,900	362,948,100
	1	Navy	3,718,400	----------	----------	1,951,700	45,636,700	4,107,200	----------	55,414,000
Heavy press	2	DCAS	----------	74,220,800	31,488,400	----------	----------	----------	----------	105,709,200
Total, manufacturing plants	17	----------	195,733,000	108,251,400	115,638,200	44,971,800	98,239,100	347,738,600	29,162,400	939,734,500
Nonprofit (universities)	2	ONR	[10] 4,149,600	----------	107,800	416,600	----------	----------	----------	4,674,000
Total, all contractors	19	----------	199,882,600	108,251,400	115,746,000	45,388,400	98,239,100	347,738,600	29,162,400	944,408,500

[1] We also visited 4 contractor locations where we did not collect comparable financial data for Government-owned property in their possession. At these locations we restricted our examination to the DOD industrial equipment modernization and replacement program.

[2] Principally metalworking machine tools.

[3] Presses and support equipment under the Air Force heavy press program.

[4] Military property consists of military personal property, such as trucks, radar equipment, and aircraft.

[5] Includes 1 heavy press operator who is also an ordnance manufacturer.

[6] Not readily determinable.

[7] Primarily test vans and test chambers.

[8] Primarily scientific equipment and furniture and fixtures.

[9] Includes tooling at subcontractor locations.

[10] Includes synchrocyclotron costing $2.4 million. Remaining items at universities refer primarily to electronic test equipment, both general purpose and specialized.

APPENDIX 4(b)

REPLIES OF CONTRACTORS TO REPORT B-140389

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., January 4, 1968.

B-140389.
Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States.

DEAR MR. CHAIRMAN: In our testimony before the Subcommittee on Economy in Government of the Joint Economic Committee of November 27, 1967, we summarized a report to the Congress of November 24, relating to control over Government-owned property in the possession of defense contractors. Our report presents the results of our review of the adequacy of Department of Defense policies and procedures with respect to Government-owned property being utilized by contractors. This review was made pursuant to recommendations made by the former Subcommittee on Federal Procurement and Regulations (now redesignated the Subcommittee on Economy in Government of the Joint Economic Committee) in its report of May 1966 entitled "Economic Impact of Federal Procurement."

The study included a review of Government-owned property at 21 defense contractors' plants and 2 university campuses. The contractors' locations were selected impartially from among those which available information indicated had Government property in their possession. We attempted to select contractors who had large, moderate, and small amounts of Government-owned property in their possession. We selected both large and small prime contractors and subcontractors. We also sought to select contractors engaged in a variety of defense work. On the basis of the selection made, we have no reason to believe the results of our review would have changed in any material respect had other contractors' plants been selected for examination.

As pointed out in our testimony and in the report, we did not request formal written comments from the contractors involved, although we did follow our usual procedure in all such reviews of discussing informally and orally the details of our findings with these contractors and universities. As we testified in our presentation before the Committee, the reason we did not obtain formal comments from the contractors and universities involved was that the primary objective of our review was to determine the adequacy of the Defense Department's policies and regulations, and their implementation by the military services and defense contractors.

During the course of the hearings the Committee requested and we agreed to furnish a list of the contractor plants and university campuses included in our review. The Committee agreed, however, that prior to supplying this information the views of the contractors should be obtained and made available to the Committee. By our letter dated November 29, 1967, copies of the report were made available to the contractors and universities involved with a notation of specific findings or observations relating to equipment, facilities, and material in their possession.

Our letter of November 29 requested that comments be supplied within two weeks. To date we have received formal responses from all but three of the contractors involved in our review. Copies of these responses are attached, together with a summary of reactions, grouped in accordance with the major findings and recommendations of our report. Names of individual contractors and universities asked to comment on each of these findings and recommendations are noted.

The Continental Aviation and Engineering Corporation has advised us that they would have no formal comments. In addition, we have not received formal replies from Sperry Rand Corporation, Aerojet-General Corporation, and TRW, Inc. In response to telephone inquiries made earlier this week, these companies indicated that replies are in process. Copies of these replies will be forwarded as soon as they are available.

The contractors' replies, in general, point out that they have complied with the provisions of their contracts and the regulations to the extent that they were required to do so. In those cases where the contractors disagree with our factual findings, a further analysis of the facts will be made and your Committee will be appropriately advised.

The Committee's attention is called to the following statement in our testimony of November 27, summarizing the views of the Department of Defense as follows:

"The Secretary of Defense was, for the most part, receptive to our suggestions. However, full concurrence was not expressed by the Department of Defense with respect to:

"1. Requiring contractors to furnish machine-by-machine utilization data and to obtain prior Office of Emergency Planning approval on an item-by-item basis for the commercial use of industrial plant equipment.

"2. Strengthening the controls over special tooling and special test equipment through the use of financial accounting controls.

"We believe that implementation of these proposals or other acceptable alternatives is necessary to effectively administer this property. The Armed Services Procurement Regulation Committee has several alternative proposals under consideration which are directed to the same problem. We will evaluate and make recommendations to the Department on these proposals as they are submitted to us for comment."

We will be glad to furnish any further information in connection with this matter that you may require. As we advised you earlier, we are making follow-up studies of the Government's controls over Government-owned facilities and equipment. These studies should provide information with respect to further corrective action required.

Sincerely yours,

(Signed) ELMER B. STAATS,
Comptroller General of the United States.

NOTE

An asterisk before the contractor's name indicates a written reply had not been received as of January 4, 1968, to the General Accounting Office letter of November 29, 1967, forwarding a copy of their report on "Need for Improvements in Controls Over Government-Owned Property in Contractors' Plants—Department of Defense (B–140389, Nov. 24, 1967)" and requesting comments.

UTILIZATION

The General Accounting Office has questioned the retention of 328 machines costing $15.9 million at the plants of 12 defense contractors due to their limited usage or their extensive use on commercial work. In addition, quantities of general purpose test equipment not in use were identified at two contractors' plants. This equipment had not been reported for reallocation elsewhere due to inadequacies in Department of Defense regulations and procedures.

In cases where commercial use exceeded 25 percent of the total machine use, the DOD was not requiring contractors to obtain the prior approvals from the Office of Emergency Planning (OEP). Such approvals by existing regulations are required, primarily to preclude contractors from obtaining a favored competitive advantage through leasing Government-owned production equipment.

The GAO concluded that in order for the DOD to properly administer its huge inventory of production equipment at plants across the country, contractors should be required to maintain utilization data for each of the machines above some established dollar level to identify the extent and manner of their use and to provide DOD officials a basis upon which to question its retention and reallocate the equipment if it is needed elsewhere. A screening of 296 of the 328 items questioned for existing need of other locations disclosed 47 instances where the equipment was, in the judgment of DOD technical personnel, suitable to fill equipment requisitions received by the Defense Industrial Plant Equipment Center, but redistribution action was not being taken.

The GAO further concluded that prior approvals should be obtained for commercial use of the equipment not only to satisfy OEP objectives but also to provide DOD with a comprehensive view of the extent to which Government-furnished equipment, by types, are being applied to private commercial purposes. The administration of such approvals was advocated by the General Accounting Office on a machine-by-machine basis. As the program is presently administered, DOD lacks adequate assurance that the most efficient machines are used to process Government work, hence minimizing procurement costs.

In responding to GAO proposals contractors pointed out that they had been abiding by the terms of facility management contracts negotiated with the services and with instructions in the DOD regulations. In several cases there was a reluctance to accept GAO proposals and declare the equipment excess due to possible future needs, including stated mobilization reserves. On the other hand, some contractors agreed with the GAO and pointed to additional quantities of machines they had declared excess after GAO had completed its review. With regard to use of the equipment for private commercial purposes, the contractors again stated that such use was permitted by the terms of facility management contracts.

The following contractors were included in the above findings:

FMC Corporation, Northern Ordnance Division
Menasco Manufacturing Company, Texas Division
Selb Manufacturing Company
Raytheon Company, Missile Systems Division
Sikorsky Aircraft Division, United Aircraft Corporation
Beech Aircraft Corporation
*Sperry Gyroscope Company, Division of Sperry Rand Corporation
The Boeing Company, Wichita Division
Curtiss-Wright Corporation, Wright Aeronautical Division
*TRW, Inc.
Rohr Corporation
Harvey Aluminum (Incorporated)
Kelsey-Hayes Company, Heintz Division
Kaiser Aluminum & Chemical Corporation

MODERNIZATION OF GOVERNMENT-OWNED INDUSTRIAL PLANT EQUIPMENT

Department of Defense Directive 4275.5 states as general policy that "Basically the contractor will be encouraged to replace old, inefficient Government-owned equipment or manufacturing processes with modern more efficient, privately owned equipment." The program for modernization and replacement of Government-owned Industrial Plant Equipment, as presently administered, will perpetuate the large Government investment in general purpose machine tools in possession of contractors and thus defer indefinitely the time when contractors must furnish all facilities, in accordance with the basic policy of the Department of Defense, required for performance of Government contracts. About $4 billion of Government-owned industrial plant equipment is in possession of contractors.

The General Accounting Office proposed that, in consonance with the foregoing conclusions, the Department place concentrated effort on the revision and administration of the following aspects of its industrial facility modernization and replacement program.

1. Inclusion in procedures of a requirement for the specific consideration of, and a statement as to, the contractor's ability or willingness to privately finance modernization proposals.

2. Consideration of a revision of guidelines to make the provision of Government-furnished plant equipment more directly related to new, major defense programs.

3. Improvement in the validity and review of justification and actual experience data, with particular attention to the commercial use of Government-furnished equipment.

4. A reexamination of the principle of recovery of savings attributable to the program through repricing of incentive-type contracts and subcontracts.

Contractor comments received have expressed no disagreement with these principles, however, a number of contractors pointed out that they have made substantially private investments in plant equipment.

*Aerojet-General Corporation
The Bendix Corporation
The Boeing Company
Continental Aviation and Engineering Corporation
FMC Corporation, Northern Ordnance Division
Menasco Manufacturing Company, Texas Division
Sikorsky Aircraft Division, United Aircraft Corporation
*TRW, Inc.

RENTAL OF INDUSTRIAL PLANT EQUIPMENT

Uniform rental rates are prescribed by regulation where Government-owned machines are used by contractors other than on Government contracts.

The regulations, however, allow considerable latitude as to the basis contractors can use in applying the rental rates and contracts in effect did not in all cases incorporate the ASPR guidance which existed. The absence of a standard procedure for computing rentals has resulted in the Government sometimes receiving reduced rent payments, and in some contractors paying lower rental than other contractors for the same type of equipment.

The GAO believes that the determination of rent on a machine-by-machine basis would be more accurate and more equitable than the various methods presently in use. The maintenance of utilization data for Government-owned industrial plant equipment, previously referred to, would permit the computation of rent on an item-by-item basis. Also, in some cases contractors have been using Government-owned industrial plant equipment in their commercial operations without obtaining the advance Government approval required by their facilities contracts.

Regarding the advance approval for commercial use, two contractors stated their intent to conform to the contract requirements in the future. Only one contractor took strong exception to the machine-by-machine rental formula.

The following contractors were included in the above findings:

Beech Aircraft Corporation
Blades Manufacturing Corporation
Curtiss-Wright Corporation
FMC Corporation
Harvey Aluminum (Incorporated)
Heintz Division of Kelsey-Hayes Company
Menasco
Rohr Corporation
Selb Manufacturing Company
*TRW, Inc.
United Aircraft Corporation

HEAVY PRESSES

Rent for the use of Government-owned heavy presses has generally been charged for both Government and commercial work at the rate of 4 percent of sales. Rental income to the Government during a recent 12-month period represented returns on the Government's investment ranging from 1.03 to 2.03 percent. In comparison with current rates of returns on Government bonds and commercial paper, this anual rate of returns appears to be too low from a financial point of view.

Several of the contractors involved pointed out that a return on investment was not the substantial or controlling factor in the financing and establishing of these facilities, but rather, the purpose was to insure a production capability. They further pointed out that, in their opinion, the overall savings to the Government in the cost of the products being produced have given the Government a much more significant return on its investment than the same investment would have produced in bonds or commercial paper.

The General Accounting Office believes that an equitable solution to this problem would be to authorize rent-free use of the presses for Government work, and to increase the rental for commercial use of the equipment, commensurate with its value.

The following contractors were included in this finding:

Harvey Aluminum (Incorporated)
Kaiser Aluminum and Chemical Corporation
Wyman-Gordon Company

Transportation and Installation Costs

At some contractor locations the cost of installation and/or transportation associated with the acquisition of IPE was not identified and recorded as prescribed by the accounting principles and standards of the Comptroller General and the records did not meet the requirement of ASPR which provides that, for rental computations, the cost of facilities shall include the cost of transportation

and installation. It was found that these costs had, in some cases, been computed as a percentage factor of the acquisition cost of IPE being rented by contractors. One contractor added a factor of 3.5 percent, another contractor added a factor of 1 percent. At another contractor location where these costs had not been recorded, rent was computed without the addition of a factor for these costs.

Contractors agreed that the rental base should include transportation costs, but contended that appropriate factor for transportation can be determined statistically.

It is the General Accounting Office position that actual transportation costs should be recorded, not only for rental purposes, but also to provide reliable cost experience data for property management decisions involving economic considerations such as acquisitions, redistributions and disposals of these assets.

The following contractors were included in the above finding:

FMC Corporation, Northern Ordnance Division
Harvey Aluminum (Incorporated)
Menasco Manufacturing Company, Texas Division

SPECIAL TOOLING AND SPECIAL TEST EQUIPMENT

Special tooling and special test equipment in the possession of contractors represent a significant investment by the Government. The estimated cost of this class of property at the contractors' plants the General Accounting Office visited amounted to more than $347 million, or over one third of the cost of Government property in the possession of those contractors.

In addition, as of February 1965, Air Force reviews of tooling at contractor plants disclosed that items classified as special tooling included over 72,000 items valued at about $84 million, which were facility-type or general-purpose items. Much of this property is adaptable to commercial purposes.

The General Accounting Office found weaknesses in the control of this property due to deficiencies in inventory practices, absence of financial controls, and absence of a requirement for surveillance by Government property administrators of special tooling in possession of subcontractors. Also, in some instances, Government-owned tooling was not identifiable by physical markings or in property records.

One contractor agreed that annual inventories of special tooling and test equipment have not been taken but stated that they would be taken in the future. One contractor indicated that the danger of loss is small due to adequate plant security even if inventories were not properly taken. The contractor agreed that some special tooling was not properly marked but did not consider this a significant lack of controls since the tooling allegedly could be identified by reference to drawings. The contractor also considered the reported instances of improper inventories to be minor in nature.

The GAO proposes that the Department of Defense establish a study project to determine the procedures to be used and the point in the contracting process at which financial control of special tooling should be maintained. It believes that measures of control over this property should be at least equal to generally accepted principles and standards applied in normal industrial practices. The GAO proposes also that periodic examinations of special tooling be made for purposes of identification and reclassification as general purpose plant equipment, where appropriate.

The following contractors were included in this finding:

Kelsey Hayes Company, Heintz Division
Raytheon Company, Missile Systems Division
FMC Corp., Northern Ordnance Division
Sikorsky Aircraft Division, United Aircraft Corp.
*Sperry Gyroscope Company, Division of Sperry Rand Corp.
Curtiss-Wright Corp., Wright Aeronautical Division
*TRW, Inc.
Menasco Manufacturing Company, Texas Division
The Boeing Company, Wichita Division

MATERIAL

GAO reported that the accounting systems employed by the contractors examined did not provide for financial control and acceptable physical inventories of Government-owned material. The weaknesses were attributed to indefinite

instructions in the Department of Defense regulation, deficient physical inventory taken by the contractors, and departure from good property management practices. Generally, the physical protection and security procedures provided by contractors appeared adequate.

In commenting on the report, contractors stated that they were complying with current Defense regulations for accounting for Government-owned materials. They believed that monetary accounting controls were not necessary to ensure more accurate accountability and would increase the costs to the contractor and the Government. They considered their physical inventory procedures to be adequate for maintaining controls over Government-owned materials.

GAO believes that financial or monetary controls are desirable to provide a reasonable measure of assurance that detailed records reflect all transactions affecting Government-owned materials. GAO recommended that the regulations be amended to require financial accounting controls for such materials at least equivalant to the generally acceptable accounting principles and standards applied in normal industrial practices, appropriate to the circumstances. GAO also proposed that regulations be strengthened by providing for improved inventory procedures.

The following contractors were included in this finding:

Beech Aircraft Corp.
Curtiss-Wright Corp.
FMC Corp., Northern Ordnance Division
*Sperry Gyroscope Company, Division of Sperry Rand Corp.
Raytheon Company, Missile Systems Division
Sikorsky Aircraft Division, United Aircraft Corp.
*TRW, Inc.

NONPROFIT INSTITUTIONS

Financial control accounts were not required by the Armed Services Procurement Regulation to be maintained by nonprofit institutions, including universities, for items of industrial plant equipment and special test equipment, nor were they maintained by the universities visited by the General Accounting Office. Also, periodic inventories were not required by the Regulation, nor were they taken by the universities, even though research contracts frequently are in process for several years. When inventories were taken, the procedures employed did not provide necessary internal control. Further, the requirements of the regulation were not being adhered to with regard to control of the property by the Defense Industrial Plant Equipment Center, in that Industrial Plant Equipment was purchased without screening Government inventories, plant equipment on hand was not always reported to the Center, and certain plant equipment which was in critical short supply was donated to the universities without first screening Government inventories to determine needs elsewhere in Government.

The universities involved in the General Accounting Office review generally agreed with its findings except that one university maintained that its method of financial control was adequate. They indicated that procedures have been revised to ensure compliance with the Department of Defense regulation.

The following Universities were included in the above finding:

The University of Chicago
University of Maryland

Property Management Functions in the DOD

The General Accounting Office reported that the value of the approval process of contractor Government property accounting systems by Government officials was questionable because the Government did not insist that the contractor maintain an adequate system, and contractor systems were allowed to continue in an approved status even though significant weaknesses existed. The General Accounting Office also reported that the Department of Defense internal auditors had performed relatively few reviews of the effectiveness of property administration at contractors' plants.

Generally, contractors did not comment on the issues raised in this section because they deal with matters relating to the effectiveness of Department of Defense property management. It appears, however, from the contractor replies, that necessary action on three contractor property accounting systems were

taken to obtain approval subsequent to the review performed by the General Accounting Office.

The following contractors were included in the above finding:

Beech Aircraft Corporation
Blades Manufacturing Corporation
Curtiss-Wright Corporation, Wright Aeronautical Division
FMC Corporation, Northern Ordnance Division
Harvey Aluminum (Incorporated)
Holley Carburetor Company
Kaiser Aluminum (Incorporated)
Kelsey-Hayes Company, Heintz Division
Menasco Manufacturing Company, Texas Division
Raytheon Company, Missile Systems Division
Rohr Corporation
Selb Manufacturing Company
Sikorsky Aircraft Division, United Aircraft Corporation
*Sperry Gyroscope Company, Division of Sperry Rand Corporation
The Boeing Company, Wichita Division
*TRW, Inc.
University of Chicago
University of Maryland
Wyman-Gordon Company

CURTISS-WRIGHT CORP.,
Wood-Ridge, N.J., January 4, 1967.

(Attention: Mr. C. M. Bailey, Deputy Director).

U.S. GENERAL ACCOUNTING OFFICE,
Defense Division,
Washington, D.C.

Dear MR. BAILEY: Mr. Berner has referred to me for reply your letter of November 29th which enclosed a copy of Comptroller General Report B–140389 entitled "Need for Improvements in Controls Over Government Owned Property in Contractors' Plants".

As noted in your transmittal letter to the Congress, representatives of your office have already discussed the details of your findings with the contractors involved, and we provided comments at that time. We believe we supplied full explanations to all questions, and to the best of our knowledge, no conditions were indicated where this contractor did not fulfill all of its obligations.

To appreciate fully the government-property situation at Curtiss-Wright, it should be pointed out that the bulk of the property (including special tooling) was acquired in two major time periods, i.e. 15 years ago for the Korean Conflict and over 20 years ago for modernization, at which time we were a major engine producer for the military. It has been used since then to produce, among other products, approximately 2.4 billion dollars worth of military engines and spare parts. For many years we have not produced engines in quantity and, at present, are in essence the sole source for Reciprocating and J–65 engine spares and parts, and therefore are maintaining a capability for the production of items nearing the end of the product life cycle. In maintaining the capability to produce on a forward basis those parts on a when needed basis, we find poorer utilization, excessive rent costs to Curtiss-Wright, and the inability to surplus equipment without eliminating the Military's sole source for parts. With your indulgence, we wish to enumerate certain specific events of the past few years to exhibit the property administration problems we encounter:

In 1964–1965, a $500,000 machine shop line for the production of compressor rotor blades for jet engines was 100% idle for eight consecutive months and no orders were received for a period of two years. Curtiss-Wright was criticized for retaining this equipment despite the fact that the procurement office (SAAMA) projected future needs for at least five more years. In 1966 this sole source capability line alone produced 37% of the total J–65 blade volume and in addition, was upgraded from stainless steel to Inco 700 material.

Had we simply followed the surplus route, Curtiss-Wright may have been subjected to severe criticism for being unable to support the spares requirements for Curtiss-Wright engines still active in the military inventory.

In Wood-Ridge, about one-half of the government equipment furnished 15 to 20 years ago is represented by Test Cells and support equipment constituting heat treat, paint and plate, tool room equipment, cutter grinders and the like; which,

although very costly initially, have less salvage value than the cost of removal and just cannot be feasibly identified as to usage hours, part members, quantity and further, these are not production operations and therefore have no operation numbers. The same is true at Buffalo with the further addition of the die room. We further question the application of normal use criteria to the one of a kind machine tool needed in the production of a sole source item; nor can management just arbitrarily subcontract union operations in today's labor relations environment in order to divest itself of a given machine tool. The procedure requested for utilization surveys, therefore, must recognize these special situations which, under the proposals, are not being recognized. Further, the definition of usage is limited to the time spent in the actual cutting of chips. Set-up, repair and maintenance and other downtime essentials have been excluded from the definition of "usage hours".

Let us turn to the problem of rent and the inequity to the contractor. Because of the peculiar application of the rental formula, the rent costs to Curtiss-Wright increases whenever:

1. We acquire modern government furnished equipment for exclusive use on rent free (government) sales.
2. We acquire company owned equipment exclusively for commercial production.
3. We expand commercial sales volumes without added equipment.
4. Government sales decline with no change in commercial volume.

As now structured, the rent formulae charges rent on the basis of the percentage of hours used on commercial sales to total hours used instead of to the total hours available which includes the maintenance of the capability. As you know, the sales volume has declined drastically (at Wood-Ridge from $356 million in 1953 to $101 million in 1956). As a result, the decline in hours used for military purposes increases the rent to the commercial sales base. In addition, Curtiss-Wright has appropriated $25 million of its own funds for new equipment in 1967, which will further increase the already excessive rent costs.

As you will observe, we are extremely aware of property administration and have conscientiously sought ways and means of minimizing costs relating to a declining product line.

With this background, which unfortunately was not part of the GAO report, we will now comment on those items pertaining to Curtiss-Wright specifically:

1. Pages 13–26 of 133 items retained. The nature of our forward capability and the compressor rotor blade line cited above should explain our position relative to retention of equipment.

2. Page 29. On inclusion of engineering labor hours in rent free base. As previously stated, Curtiss-Wright, Wood-Ridge, in accordance with negotiations with the ACO, uses the total labor content of total cost of sales and this is segregated as between contracts with the rent free clause and all others. The percentage of rent free labor to total labor is the basis for the credit.

3. Page 50. Inventory of Government-owned tooling. It is not the practice of business generally to inventory tooling nor was there any requirement to do so for government tooling under those contracts. This tooling produces only those parts for which designed and are worthless for any other purpose, and by virtue of the fact that we continue to produce these parts, we must therefore have tools. Tooling, especially after 15 years, is subject to wear, tear, scrap, breakage, and modification; furthermore Curtiss-Wright has expended the initial cost and more than the total present value for the replacement of this tooling as required during this period.

4. Pages 56 and 57. Accounting and control of Government furnished material. When called to our attention in the fall of 1966, the company took immediate steps to correct this deficiency which involved Overhaul contracts amounting to less than 3% of our total volume. We recognize the need for improved physical controls and have responded accordingly. The contractor does not agree with the proposal to institute financial accounting for these items as it does not result in control, the real control being the physical accountability of material.

5. Page 64. Withholding of property administration system approval. At that time the disapproval of the entire property system of the contractor resulted from the deficiencies in the Overhaul area discussed above. As stated above, the contractor took immediate steps to correct the deficiencies without the need to have ASPR provide additional incentives to do so. Further, the contractor prefers an environment whereby a specific area disapproval would be possible rather than a total property disapproval.

As you may surmise from this lengthy response, Curtiss-Wright management recognizes its contractual responsibilities and, in our opinion, has transcended its obligations to protect the government interest in the area of military requirements. We are conscious of the need to maintain a capability to satisfy the requirements of our military customer at an optimum cost. We sincerely hope that this letter provides you with insights as to our relationship and respectfully invite further discussions as you may deem necessary.

Very truly yours,

H. C. GIESLER,
Corporate Controller.

FMC CORP.,
NORTHERN ORDNANCE DIVISION,
Minneapolis, Minn., December 22, 1967.

Mr. E. M. BAILEY,
Deputy Director, Defense Division,
U.S. General Accounting Office, Washington, D.C.

DEAR MR. BAILEY: Mr. Jack Pope, President of FMC Corporation, has asked me to reply to your letter of 29 November 1967 since we concluded it pertained entirely to the Northern Ordnance Division of FMC, and since I am fully familiar with the pertinent facts.

Your letter requested our comments on portions of your report of 24 November 1967 to the Congress on the need for the Department of Defense to improve its controls over Government-owned property in contractors' plants. As indicated above, the marginal notations on the copy of the report you have furnished us are understood to apply to the Northern Ordnance Division operations in Fridley, Minnesota. Northern Ordnance is the operator of a combined facility which includes both Government- and contractor-owned buildings and equipment. The Government-owned portion is designated as the Naval Industrial Reserve Ordnance Plant, Minneapolis, which is one of several Government-owned contractor-operated plants maintained under the provisions of the National Industrial Reserve Act of 1948. That Act, in its declaration of national policy states:

". . . it is the intent of Congress to provide a comprehensive and continuous program for the future safety and for the defense of the United States by providing adequate measures whereby an essential nucleus of Government-owned industrial plants and a national reserve of machine tools and industrial manufacturing equipment may be assured for immediate use to supply the needs of the armed forces in time of national emergency or in anticipation thereof; . . ."

The NIROP facility operated by Northern Ordnance has unique capabilities which the Navy has deemed essential to maintain for mobilization purposes in accordance with the National Industrial Reserve Act. Thus any realistic review of equipment availability and usage at the NIROP should take into account the standby mobilization role which the plant serves. It seems to us that your report does not give adequate, if indeed any, consideration to mobilization base requirements.

In any event, we respectfully submit that your comments are not properly applicable to Northern Ordnance when all of the pertinent facts are considered. We, of course, cannot comment on the compliance with DoD policies and procedures of the other companies or non-profit institutions to which your report refers.

We wish to point out that Northern Ordnance has been complying with all the terms of its Government contracts, including the facilities management contract under which we operate the Naval Industrial Reserve Ordnance Plan, Minneapolis. It is our understanding from conversations between your representatives and ours during the survey at Northern Ordnance and also from your report to Congress that your representatives recognize this.

We believe that upon review of the attached material commenting on the items in your report which you indicate are applicable to Northern Ordnance, you will find that the comments in your report concerning Northern Ordnance in major part were, in proper context, either misleading or factually incorrect. In our opinion the matters you have raised in your report fail to disclose any significant actions on the part of Northern Ordnance that are not in accordance with the Armed Services Procurement Regulations, that do not conform with sound industrial practices, or that are inimical to the best interests of the Government.

We do appreciate this opportunity to set the record straight on these matters. We would be able to do this even more fully, we believe, if the GAO were to fur-

nish us with sufficient details identifying the equipment involved, as noted in our detailed comments. We recognize very clearly our obligations to maintain, protect and control Government-owned property entrusted to our use. We pledge ourselves to continue to employ every possible means to justify this trust.

Sincerely,

H. RANDOLPH,
Vice President and General Manager.

COMMENTS ON APPLICABLE PORTIONS OF COMPTROLLER GENERAL OF THE UNITED STATES REPORT TO THE CONGRESS B–140389, NEED FOR IMPROVEMENTS IN CONTROLS OVER GOVERNMENT-OWNED PROPERTY IN CONTRACTOR'S PLANTS

The first five comments by the General Accounting Office which have been marked as being applicable to Northern Ordnance Division, FMC Corporation (see pages 5 through 8) relate to the usage of Government-owned facilities. These comments which are specifically quoted in the following pages state generally that certain Government-owned facilities were not used at all or were used very little during the period involved in the General Accounting Office study, and certain other Government-owned facilities were used in performance of commercial work. The following general comments are pertinent in connection with the usage of such Government-owned facilities by the Northern Ordnance Division:

A. The study made by the General Accounting Office involved a twelve month period ending 31 March 1966. The period selected for the study happened to reflect the contractor's lowest plant workload since immediately after the cessation of World War II in the years 1946 and 1947. As evidence of the contractor's extreme drop in workload during this period, the contractor expended 1,528,678 direct manufacturing labor hours in performance of all work at the Naval Industrial Reserve Ordnance Plant during the calendar year 1965. During the calendar year 1967, the contractor expended approximately 3,015,000 hours of direct manufacturing labor in performance of all such work. During the calendar year 1962, the contractor expended 2,958,323 direct labor manufacturing hours on all such work. Accordingly, the workload during the calendar years 1962 and 1967, both before and after the period involved in the study, was almost double the workload in the period involved in the General Accounting Office study (1965), which was the low point in workload, and thus not representative.

B. The Government-owned facilities which are operated by the Northern Ordnance Division, FMC Corporation at Fridley, Minnesota have been designated as the Naval Industrial Reserve Ordnance Plant, Minneapolis (NIROP, Minneapolis). This is a Government-owned contractor-operated industrial plant intended in part to support the needs of the Armed Forces in time of national emergency. The plant is maintained under the provisions of Public Law No. 883, known as the National Industrial Reserve Act of 1948, by which Congress attempted to establish a nucleus of Government-owned industrial facilities which would reduce to an absolute minimum the lead time required to get the materials and weapons of war into the hands of the combat forces. The purpose of these plants is to fill the gaps resulting from known deficiencies in privately-owned capacity. The mobilization capacity of the NIROP, Minneapolis under certain circumstances may be at least twice its present output. The plant is unique because of the breadth of its capacity, the extent to which its production is integrated, and its long operation in conjunction with Northern Ordnance's outstanding and highly experienced engineering department. There is no other comparable plant with these characteristics run by private industry available to the U.S. Navy for production of intermediate and major caliber gun mounts and guided missile launching systems for the Navy. The only other facility with comparable manufacturing capabilities is a Government-owned and operated plant which by itself could not meet full mobilization needs.

Since part of the capacity of the Government-owned facilities at the NIROP, Minneapolis is being maintained for mobilization purposes it is recognized that certain individual facilities may not be fully utilized during any peacetime period. The alternative suggested by the GAO would be to dispose of these facilities which would render it impossible for this activity to support the existing and contemplated mobilization plans of the Department of Defense. We doubt whether this action would be consistent with the Congressional intent as expressed in the enactment of the National Industrial Reserve Act. The General Accounting Office Report B–140389 fails to recognize the Congressional

mandate emphasizing the importance to the national defense of maintaining industrial reserve production capacity for mobilization purposes in times of national emergency.

C. The Government has contracted with Northern Ordnance for the maintenance of the NIROP plant. Under the contract, if the plant should be wholly on Government business, the Government would bear the full cost of fixed overhead. To the extent that commercial work is performed in the plant, the Government is relieved of a pro rata portion of the fixed overhead. In order to reduce the cost to the Government for the maintenance of the Government facilities during the low plant workload period referred to above, the contractor was encouraged by the Government's representatives to expand its commercial work in an effort to spread the cost of maintenance of Government-owned facilities over a larger base. At no time did the amount of commercial work (non-Government) performed on Government-owned facilities exceed 25 percent of all work performed on such facilities during any one-year period. The provisions of the Armed Services Procurement Regulations and the provisions of the contractor's Facilities Management Contract NOw 6204–u do not require the application of a 25 percent non-Government use limitation on a machine-by-machine basis, as suggested by the General Accounting Office, and the contractor has operated in accordance with the terms of its Facilities Management contract. The volume of non-Federal Government work on Government-owned facilities at NIROP, Minneapolis is less than 11 percent of the total work output at the present time.

D. The commercial work undertaken by Northern Ordnance also permitted Northern Ordnance to retain a substantial portion of its highly skilled work force during the low-volume periods of Government work. This has proved to be of major benefit to the Government as its requirements sharply escalated in the last year.

E. The plant operated by Northern Ordnance includes both buildings and equipment owned by FMC Corporation and by the Government. The Government-owned portion of these combined facilities are designated as the NIROP, Minneapolis. The Government- and contractor-owned manufacturing equipment is commingled throughout the plant in order to achieve the most efficient production possible. In order to achieve efficient scheduling of work, all machines are used as available without a concerted attempt by the contractor to perform Government work exclusively on Government-owned machines and commercial work exclusively on contractor-owned machines. Accordingly some of the contractor owned facilities may at a given time be working completely on Government work which could under ordinary circumstances necessitate use of Government-owned machines on commercial work. Moreover, while it is practicable to obtain, after the fact, machine-by-machine data on usage, it is not practicable precisely to schedule in advance machine loadings to control the portion of non-Government work on any individual machine to assure that usage does not exceed 25 percent.

F. A statement is made in the GAO report that DIPEC was unable to fill requisitions for 81 items of IPE which were in either critical or short supply. When we first heard of this situation earlier this year, we asked the GAO officials performing the audit to identify whether any of the 81 critical or short supply items were located at the NIROP, Minneapolis. If there had been any we would have discussed with DOD officials the desirability of removing the items from this reserve plant to satisfy the alleged urgent requirement. We were very puzzled that the GAO officials declined either to confirm or deny that any of these items were located at the NIROP, Minneapolis.

The specific comments which follow set forth Northern Ordnance's position with respect to each of the items appearing in GAO Report B–140389 that were identified by marginal notation as being applicable to Northern Ordnance. The first five below have been responded to above in terms of general policy and on these we simply will add a few applicable details.

1. IPE not in use

"We questioned retention of 133 items of IPE, estimated to cost $3.3 million, which had not been in use for extended periods of time." (page 13)

(GAO indicates 4 of the 133 items questioned apply to Northern Ordnance.)

Comment: Unfortunately the GAO has not specifically identified the 4 items questioned either in discussions at Northern Ordnance or in its report so it is impossible for us to furnish comments concerning these items. To the best of our knowledge, all facilities at Northern Ordnance are either in use, needed for mobilization or scheduled for disposition.

2. IPE used for commercial work

"From the available utilization records, we determined that 115 items of IPE, estimated to have cost $11.4 million and located principally at four contractor locations, were being used solely or predominantly for commercial work. In this characterization we included IPE used for commercial work 75 percent or more of actual production time during periods ranging from 6 months to 1 year at three locations." (page 14)

(GAO indicates 22 of 115 items questioned apply to Northern Ordnance.)

Comment: As in the case of comment No. 1, the GAO has not identified the specific items questioned. As already outlined above, this contractor does make use of Government-owned facilities for commercial work from time to time in strict accordance with the terms of its facility management contract, and such usage over-all is under 25 percent per year. Commercial work is performed on Government-owned equipment primarily to stabilize the manufacturing workload at this activity which objective has been consistently encouraged by the Department of Defense. Rent for the use of Government-owned equipment for commercial work is being paid in accordance with the Armed Services Procurement Regulations. Furthermore, the commercial work performed at this plant has contributed significantly (1) to the reduction of the cost of Government work through absorption of the fixed portion of plant manufacturing overhead, and (2) in preserving the contractor's skilled work force for performance of Government contracts.

3. IPE used for commercial work

"At three locations Government property officials had not questioned retention of this IPE. Facilities contracts at these locations permitted use of the IPE for commercial work; and, in the cases where this was observed, it was apparently considered that the IPE was used for authorized purposes." (page 14)

Comment: The report is correct in that Government property officials did not question the retention of IPE used periodically for commercial work since this use was in strict accordance with our facilities management contract and for purposes encouraged by the Government.

4. Low utilization of IPE

"These data enabled us to question the basis for retention of 76 items of IPE, estimated to cost $1.2 million, which did not satisfy the criteria specified by the Assistant Secretary of Defense as we interpreted it. None of this equipment had been reported as excess by the contractor." (page 14)

(GAO indicates 15 of the 76 items questioned apply to Northern Ordnance.)

Comment: Again we are not able to specifically identify the 15 items questioned by the GAO. During the course of GAO investigations at Northern Ordnance, we did provide written justification to the GAO representatives for the retention of some 41 items questioned. The GAO did not furnish us with any response to this justification. It is significant, as we noted previously, that the twelve month period of utilization selected by the GAO representatives in their study represents the period of lowest workload at the NIROP, Minneapolis since immediately after World War II. It was pointed out in prior correspondence with the GAO that a sharply increased level of activity at this plant for production of military equipment for the Government was expected. This sharp increase has now taken place and has had its predicted effect on the utilization of equipment at the NIROP, Minneapolis.

5. Prior approval not obtained although prescribed for use of IPE for non-Government purposes

"In four cases facilities contracts were silent or unclear as to the requirement to obtain OEP prior approval, and Government officials had not sought OEP approval even though items of IPE were being used in excess of 25 percent of actual production time for commercial work. For example, a facilities contract negotiated by the Navy required the contractor to use IPE for at least 75 percent of the yearly total of authorized hours for Government production and it was silent as to conditions that might require OEP approval for other uses." (page 18)

Comment: The facilities management contract held by Northern Ordnance limits the commercial use of all the Government-owned facilities covered by this contract to 25 percent of the total actual production time for all the Government-owned facilities. It has not yet been necessary to secure OEP approval since at

no time has the use of the Government-owned facilities for commercial work exceeded 25 percent. The GAO position that this 25 percent limitation should apply on a machine-by-machine basis would impose an overwhelming and exceedingly expensive burden on both the Government and the contractor and would not be consistent with the objectives sought to be achieved. It is understood that our position in this matter is supported by the cognizant component of the Department of Defense.

6. Improper use of Government-owned IPE

"In another instance the Navy furnished a contractor an automatic turret lathe costing $45,600 on the basis of the contractor's projected initial year saving of $25,800 in operating costs. We noted that during the first year the new lathe, without advance OEP approval, was used 513 hours, or 24 percent of the actual production time, on Government rent-free work and chiefly for commercial work the rest of the time. Thus the Government did not receive the benefit of most of the saving in operating costs. At the same time, Government rent-free work totaling 5,756 hours was processed on five older, less efficient turret lathes." (page 19)

Comment: Subsequent to the period of study by the GAO from which their conclusions were drawn, the machine has been used for Government work at a rate which should yield a return on investment to the Government considerably *greater* than that anticipated when the machine was requested. This was essentially the workload we anticipated which led to the acquisition of this machine. We strongly dispute the idea that the use of the new automatic chucking turret lathe in the period referred to by the GAO was in any way improper or not in accordance with our facilities management contract. The projected savings were based on an anticipated workload (which subsequently materialized) rather than the workload actually existing at the time the lathe was acquired. When this machine was installed, there was not sufficient Government work for the full use of this new equipment. The implications in the sentence "At the same time, Government rent-free work totaling 5,756 hours was processed on five older, less efficient turret lathes," are misleading since the work performed on the older machines consisted of short runs and was not suitable for production on an automatic chucking lathe which is designed for production quantity runs.

7. Agency comments and our evaluation

"Our review established that, of the 17 contractors examined, only five contractors maintained adequately comprehensive machine-by-machine utilization data. Two of the five contractors accumulated the data by manual postings and the other three through mechanized procedures (tab card system). One of the contractors was converting from mechanized procedures to an electronic data collection system designed for manufacturing industries." (page 22)

Comment: We are gratified to have been singled out as the one contractor of the 17 examined with the most advanced system of electronic data collection enabling us to maintain comprehensive machine-by-machine utilization data and to provide excellent control over the use of Government property in our possession.

8. Rental of industrial plant equipment—general current lease terms permit inequities

"At another location, the contractor computed the rent credit on the basis of the average utilization of the machines used for Government work. The inclusion of certain downward adjustments, because it was considered a reserve plant, and the use of an average ratio of machine utilization in the calculation resulted in a lower rent liability than would have resulted from calculating rent on a machine-by-machine basis. On the basis of machine usage for a 10–week period, we estimate that a machine-by-machine calculation would have increased the rent payment for the 12 months ended September 30, 1966, from $226,400 to $809,000 or $582,600 in excess of the present method. The cost of maintaining utilization records, machine-by-machine, amounted to $7,400, as estimated by this contractor, and the details of this estimate are shown on page 23 of this report." (page 28)

Comment: The provisions of our facilities management contract that permits an adjustment in the rent paid to the Government for the use of Government facilities because the NIROP, Minneapolis is maintained for industrial reserve purposes is proper and in accordance with the provisions of ASPR. The GAO calculation which demonstrates a theoretical increase in the rent does not result

so much on the machine-by-machine calculation as from the elimination of the adjustment which recognizes the mobilization function of this plant. This adjustment reflects the fact that while ASPR rentals normally are set on the basis of machine availability for use, this does not apply where machines are maintained for mobilization as well as production purposes. Section 13–404 of ASPR provides that in such circumstances, since the availability is largely for mobilization, not production purposes (i.e., for the Government's, not the contractor's benefit), rentals should be tied to authorized or actual use rather than availability. Elimination of this adjustment would result in rental charges which would be exorbitant by almost any standard of judgment—and unrealistic, as well, for the net consequence would be the emasculation of the mobilization reserve. If this adjustment were eliminated, Northern Ordance—and any other contractor so situated—would request the Department of Defense to remove the facilities maintained for mobilization from this plant which would defeat the concept of maintaining a national industrial mobilization base at this location. It is additionally noted that a change in the method of calculating rent payments would not result in increase in income to the Government since an increase in the cost of using the facilities to include contractor payment for standby capacity (i.e., mobilization availability) would preclude the economic use of the machines for commercial work. The use of the equipment for commercial work and the consequent sharing of fixed overhead results in additional benefits and lower costs to the Government which do not appear as a part of the review made by the GAO.

9. Private investment in plant equipment not always encouraged

"In submitting justifications, contractors generally were not required to include statements as to their ability or willingness to finance the equipment. At most locations where we inquired into this matter, either the contractors had not been requested to acquire privately owned equipment or the files gave no indication that use of private funds had been considered in evaluating the proposals we examined." (page 39)

Comment: This statement does not apply to Northern Ordnance. Each proposal that is submitted to the Department of Defense for the replacement of worn Government facilities includes a detailed item-by-item description (including prices) of the capital items acquired by the contractor for its own account during the two prior fiscal years and the contractor's budgetary data for acquisitions by the contractor of its capital assets in the coming fiscal year for which the proposal is submitted.

10. Private investment in plant equipment not always encouraged

"The fiscal year 1966 modernization program for another contractor included four gear-making machines amounting to $232,100. The justification for replacement was based on data showing that the investment would be repaid within 3 to 4 years through reduced operating costs. We noted that, to achieve this objective, the initial-year use would have had to exceed current use by about eight times but that, as of September 1966, the contractor still had no active requisitions for additional gear machine operators. Moreover, one of the replaced machines had been used exclusively for commercial work for at least a year. Military officials informed us that the contractor had not been encouraged to invest its own capital in these machines." (page 40)

Comment: The recent amount of usage of the old equipment to be replaced cannot always be used as an accurate basis for projecting anticipated usage of the new replacement machines. The recent usage on Government work of the 4 machines to be relpaced was relatively small. This is due in part to the fact that 2 of these machines were 24 years old and the other 2 machines were over 10 years old. Due to their age and condition these machines were not suitable for the close tolerances required for Government work. The new gear machines have just recently been installed and we still anticipate utilization in Government work that will justify the replacement of the old equipment. We regret the apparent misinformation which the GAO seems to have received with respect to the statement that "as of September 1966, the contractor still has no active requisitions for additional gear machine operators". Since September 1966 the number of operators in the contractor's gear department has increased from 10 to 15 men. Gear machinists have been solicited actively through advertising in local newspapers and radio regularly during the last two years, since we are not experiencing an expansion in the activity of our gear manufacturing department. Furthermore, it should also be noted that the contractor has recently invested nearly $200,000 of his own funds in gear manufacturing equipment at this plant.

11. Transportation and installation costs

"We found that these costs had in some cases been applied as a percentage factor to the acquisition cost of IPE being rented by contractors. One contractor added a factor of 3.5 percent, another contractor added a factor of 1 percent. That these costs can be significant is illustrated by the fact that, in one case, a contractor increased the rental base for IPE by as much as $800,000 through the addition of a factor for transportation and installation." (page 43)

Comment: Since we apply the 3.5 percent factor to the acquisition cost of IPE to account for transportation and installation costs resulting in an $800,000 addition to the base for IPE on which we pay rent. Northern Ordnance appears to be adding the highest amount for transportation and installation costs among the contractors studied and thereby increasing the rental it pays to the Government. We have recently reviewed this matter indicating that this 3.5 percent factor is somewhat higher than can be supported by the historical records of actual costs of transportation and installation, and a lower factor should be used.

12. Real property

"For example, replacement of a portion of the plant's electrical distribution system costing about $104,100 was determined not to be of a capital nature because it replaced an existing system. We noted, however, that the capacity of the system to provide service was significantly greater after its installation and that the useful life of the property was extended by at least 10 years." (page 45)

Comment: The plant's electrical distribution system is an integral part of the Government buildings. It is not normal industry practice to capitalize the replacement of a small part of a capital asset. Although $104,100 is a significant expenditure, it is only a small part of the buildings costing several million dollars. The replacement of the obsolete and unsafe switch gear for which repair and replacement parts could not be obtained does not in any way extend the useful life of the buildings of which the switch gear is a part. A smaller part of the project involved the furnishing of larger lighting transformers to safely accommodate the presently installed capacity. It was determined by appropriate DOD authority in accordance with generally accepted accounting principles that these changes did not require a change in the Government's asset accounts.

13. Real property

"In another instance, an atmospherically-controlled room was constructed at a cost of about $37,800 to house four gear machines and related test equipment but the cost was expensed because the room did not alter the exterior dimension of the plant." (page 45)

Comment: The expenditure of $37,800 involved two separate projects, both involving modifications of existing precision gear manufacturing facilities. The costs of the first modification to house the precision gear equipment was treated at the request of the Government as installation charges in connection with the gear equipment, which costs have been appropriately reflected in the installation expense account mentioned under Item 11 above so that they have been added to the base for rental purposes even though the capital account has not been changed. The second portion of this expenditure involved repairs to existing walls and other commonly acceptable expensible items.

14. Special tooling and special test equipment

Need for better identification

"We found at one contractor's plant that, some tools were not marked for identification and identification could be made only by reference to engineering drawings." (page 49)

Comment: During the GAO survey only 5 items (out of a total of approximately 18,000) were determined to be improperly marked because the identifying marks had been obliterated by painting during normal tool refurbishment. Since these tools could be readily identified by reference to drawings, we do not consider that the temporary painting over of the markings on the 5 items represent a significant lack of control on our part.

15. Physical inventories

"At a third plant, we found that the inventory taking had been limited to determining whether a particular item was on hand, without regard to the quantity of identical items that should be on hand." (page 50)

Comment: We have determined that the number of instances where duplicate items of tooling had not been properly inventoried was small. However, immediate steps were taken to correct this deficiency when it was pointed out to Northern Ordnance management. The facilities operated by Northern Ordnance are surrounded by a double chain link fence and are closely surveyed by a large staff of security guards so that the danger of loss of Government tooling with or without inventorying is very unlikely.

16. Material

Financial accounting controls not maintained

"One contractor official, who estimated that several million dollars worth of Government-furnished material was on hand at his plant, stated that monetary controls for the Government-furnished material were impractical and that the contractor was primarily concerned with only quantities. Nevertheless this contractor maintained monetary controls over its own materials inventories." (page 56)

Comment: Northern Ordnance maintains records which permit the development of the cost of inventory parts when such information is required; however, total values for individual parts in inventory or for total inventories are not maintained. Because of the volume and complexity of the items produced by Northern Ordnance, it is estimated that the establishment of detailed monetary controls over Government-owned materials would cost the Government approximately $120,000 annually. In view of the stringent controls applied to the quantities of materials, we believe the establishment of additional detailed financial accounting controls would be an unwarranted expenditure of the taxpayer's money. The statement that "this contractor maintained monetary controls over its own material inventories" is not entirely true. Detailed monetary controls are maintained only over all our raw materials and over the inventory of work-in-process for our commercial products, the sum of which represents only 5 percent of the total inventory value of contractor-owned materials. These controls are necessary for proper financial reporting in accordance with acceptable accounting principles. No detailed financial controls for individual parts are maintained over the contractor-owned materials under Government fixed-price type contracts for the same reasons that we do not maintain such controls over Government-owned materials under Government cost-type contracts. Accordingly in these situations the contractor treats its own materials in the same manner that it handles Government-owned materials.

17. Inventory taking ineffective

"In some cases adequate internal control did not exist because the taking of the inventory did not incorporate appropriate segregation of duties of participating personnel. For example, at one location, the individual who maintained the stock records was custodian of the material, and he also took inventory. In such cases differences between the records and the physical count can be reconciled by adjusting the records or removing the stock cards, without independent evaluation of the propriety of the transactions." (page 57)

Comment: We consider that the establishment of a separate crew to inventory materials in the stockroom would be an inefficient use of personnel resulting in unjustified additional costs to the Government. The inventories currently performed have been reviewed by resident Government personnel and are currently being double checked on a spot check basis by representatives of the Northern Ordnance Quality Control Department. In addition, plant peripheral controls and controls over receipt and shipment of material are considered adequate to prevent loss of Government materials by pilferage and mishandling.

18. Inventory taking ineffective

"The inventory taking was incomplete in some cases because it was limited to verifying listings prepared from the property records and furnished to participating personnel; therefore, items which may have been physically on hand but not included on the listings provided would be omitted from the count.

"At one location the contractor performed a physical inventory of Government-furnished material but did not require a physical inventory of material it had acquired for the account of the Government. Also in a few cases, written procedures were lacking, the work was not properly documented, the results were not furnished to the Government, or inventories were not priced out." (page 57)

Comment: None of these statements applies to Northern Ordnance except for the words "inventories were not priced out". Our position regarding this statement is covered under Item 16 above.

19. Property management functions in the DOD Property Administrators' surveillance and approval of systems

"At one location we reviewed, the contractor's system was disapproved in July 1962 because the contractor's property control procedures were not adequate. In January 1965, the property administrator again reviewed the contractor's manual for control over Government property and reported to the contractor that the manual was "* * * sadly lacking detail, * * * and approval of the system was withheld. Since approval of the contractor's system had already been withheld no further action was taken against the contractor. At the time of our review the contractor still did not have an approved system." (page 64)

Comment: It is noted that approval of the contractor's property control system was being withheld not because there was anything significantly wrong with the system itself but because the written manual describing the property control procedures in effect was held by the Government representatives to be lacking in detail. The property control manual has been rewritten in great detail at considerable expense and was submitted for approval in March, 1967. The contractor's written property control procedures have now been approved by the Government.

WYMAN-GORDON CO.,
Worcester, Mass., December 11, 1697.

Ref: B-140389

U.S. GENERAL ACCOUNTING OFFICE,
Defense Division,
Washington, D.C.

(Attention: Mr. C. M. Bailey, Deputy Director, Defense Division.)

GENTLEMEN: We have reviewed with interest the GAO report to the Congress entitled "Need for Improvements in Controls over Government-Owned Property in Contractor's Plants".

We cannot be critical of the majority of the recommendations contained in the report as we believe a strict accountability for all inventories, equipment, special tooling and buildings is essential. We take pride in our belief that all items of government property leased or loaned to us have been and currently are reflected in property control records in our plants. If this is contrary to the fact we have no awareness of it and would welcome any comments and/or suggestions.

We are an operator of a Heavy Press Facility (Air Force Plant No. 63) and we are naturally vitally interested in the comments relative to the heavy press program appearing on Pages 32, 33 and 34 of the report.

There are relatively few members of the Congress and few, if any, departments or agencies of the U.S. Government (excepting the Department of the Air Force) possessing an intimate knowledge of the origin of the Heavy Press Program and the subsequent outstanding contribution made by it to the defense posture of the United States.

We have full and complete knowledge of this program as we were the first company in the United States to operate a heavy press facility. The original heavy press and the forerunner of the heavy press program was an 18,000-ton forging press developed under the sponsorship of the War Production Board in 1943 and financed by funds from the Defense Plant Corporation later absorbed by the Reconstruction Finance Corporation.

The 18,000-ton forging press facility went into operation on May 1, 1946 with Wyman-Gordon, having laid out the plant and assisting in the press design, as the operator under a Management Contract for the account of the Defense Plant Corporation. This arrangement continued until June 30, 1950 at which time cognizance of the facility was turned over to the Air Force. From July 1, 1950 until the present time we have operated this facility which in the early '50's was expanded with the addition of a 35,000-ton forging press and a 50,000-ton forging press and auxiliary equipment.

From the initial development of the heavy press forging concept and techniques in 1946 until today, Wyman-Gordon in Air Force Plant No. 63 has continually

advanced forging technology and skills. The original plant designed by Wyman-Gordon was designed solely for the production of *aluminum and magnesium airframe structural forgings.* Today, the range of materials forged covers aluminum, magnesium, steel, titanium and nickel base alloys with additional capability to forge beryllium, copper, columbium and other less common materials. Products forged serve airframe, missile, land and aviation gas turbine and nuclear weapons and power applications, ordnance and commercial markets to a limited degree. This product and market diversification has been achieved through both Air Force and Wyman-Gordon investment in facilities and Wyman-Gordon investment in research and development, technology improvement and forging skills. Currently, Air Force Plant No. 63 supplies major components for most Aircraft and other DOD programs.

Those of us who participated in the various discussions preliminary to the inception of the heavy press program believe that the basic mission of the heavy presses was to produce vital components to support the Government defense posture. It was to provide a sustaining industrial base, with strong capabilities, so that important defense needs could be met with less cost and in less time. These purposes have all been accomplished and are continuing to be accomplished.

It was recognized by the Government and by Industry at the inception of the heavy press program that a return on investment was not a substantial or controlling factor in the financing and establishing of these facilities but it was, as stated, to insure a production capability for defense purposes. The savings in the end products produced by the heavy presses have been substantial and have more than offset the original cost of the facilities provided.

It has been stated that the Government should have a better return on their investment and we would emphasize that this statement has been made without thorough consideration being given to the heavy press performance and is inconsistent with the philosophies and Air Force objectives at the time of the inception of the heavy press program. It was never intended that rental income, per se, be or constitute a measure of return on investment with respect to the heavy presses. At the risk of being redundant we would repeat that the prime objectives were: (1) to provide defense capability, (2) to reduce the cost of defense hardware, and (3) to improve performance of defense hardware. These objectives were reached many years ago, in fact, the payback to the Government through reduced costs of military aircraft was achieved in a decade of the '50's.

A large number and variety of Defense Programs have benefited from the heavy presses at Air Force Plant No. 63. Accurate ultimate cost reduction in supplying this hardware from the large presses is not susceptible to definitive determination but we estimate total savings to the Government at this point in time to be in excess of $500,000,000. This estimate is predicated on an analysis of a 10% sample of the total dies involved and this 10% sampling produced savings to the Government approximating $57,000,000. Additional savings of $40,000,000 accrued to the Government in classified programs thus producing a savings approximating $97,000,000 and this on only a portion of the production from the heavy presses. To further corroborate our statements we would refer you to a written statement prepared by the Air Force and submitted to the Subcommittee on Military Operations, House Committee on Government Operations on Development and Procurement of SATS at a hearing held March 11, 1964. We are attaching a copy of this written statement by the Air Force as we believe it pertinent to our mutual understanding.

We would take liberty and quote from the report as follows: "The implications were far-reaching. If forgings and extrusions large enough to comprise key aircraft structural elements could be produced in this country, not only would fabrication time be reduced greatly, but costs would be lowered. In addition, such a technique held the promise of producing these components with greater strength-weight ratios, an extremely desirable attribute from the standpoint of aircraft design." . . . "All in all, however, it should be understood that our major reason for undertaking the heavy press program was not so much to increase the flow of revenues to the Government in the form of rentals but to provide a self-sustaining industrial base, with strong capabilities, so that important defense needs could be met with less cost and in less time."

Again we quote from the statement prepared by Air Force and submitted to the Subcommittee on Military Operations on March 11, 1964: "To catalogue the significant accomplishments of the heavy press program is almost to relate the history of our modern advanced aircraft. A case in point is the "wet wing"

for the B–52. Here the wing not only serves its traditional purpose aerodynamically, but is itself a large fuel tank that provides maximum range to this intercontinental strategic bomber. It was through the extrusions from our heavy presses that wing panels of the required strength and at reduced weight were produced, all at considerably less fabrication and machining cost than would have been possible by other methods. *Although we have never completely analyzed the cost effectiveness impact of the presses on the B–52 program, we believe that the savings resulting from the forging and extrusion techniques have exceeded the entire cost of the heavy press program.*" (Underscoring added.) The reference in the Air Force statement to the savings exceeding the entire cost of the heavy press program is to the $220,000,000 total investment in the heavy press program.

It is unfortunate that those to whom the GAO report is submitted are unaware of the significant accomplishments of the heavy press program and of the savings that have accrued to our Government. It would seem upon reading the report, that the return to the Government has been predicated solely upon rentals without any consideration being given to the savings realized as set forth in this letter and in the testimony of the Air Force.

It would be helpful to all vitally interested in and concerned with the heavy press program to be given all of the facts and history of the program. It would serve to create a much better understanding for all and particularly to members of the Congress.

We are proud of our accomplishments with our portion of the heavy press program and believe that we have adhered to the philosophy embodied in our lease agreements and propounded at the inception of the Program and further believe we have contributed most significantly to the defense capabilities of this nation.

Sincerely,

SACKET R. DURYEE.
Vice President and Treasurer.

WRITTEN STATEMENT PRESENTED BY THE AIR FORCE ON MARCH 11, 1964, BEFORE THE SUBCOMMITTEE ON MILITARY OPERATIONS, HOUSE COMMITTEE ON GOVERNMENT OPERATIONS ON DEVELOPMENT AND PROCUREMENT OF SATS

ORIGINS OF THE HEAVY PRESS PROGRAM

The Air Force heavy press program actually had its genesis during the days of World War II. Allied intelligence teams inspecting German aircraft downed behind our lines discovered that they contained extremely large and complex major structural elements. Our appraisal of the situation, confirmed immediately after the end of the war, was that the Germans had produced these aircraft components with the aid of huge forging and extrusion presses possessing capabilities far in excess of those in our own industrial complex.

The implications were far-reaching. If forgings and extrusions large enough to comprise key aircraft structural elements could be produced in this country not only would fabrication time be reduced greatly, but costs would be lowered. In addition, such a technique held the promise of producing these components with greater strength-weight ratios, an extremely desirable attribute from the standpoint of aircraft design.

Just before the conclusion of the war, we embarked upon an urgent program to build a press able to match our estimates of the productive capability of the German equipment. The Mesta Machine Company of Pittsburgh was awarded a contract to construct on 18,000 ton forging press, and the Wyman-Gordon Company of North Grafton, Massachusetts, was selected to operate it. Since the press was so enormous, a pattern to be followed when the press program went into full swing was established—a plant had to be built around the press to house both it and its supporting equipment. The war ended, however, before the project was fully completed.

When our technical/industrial teams visited Germany after the cessation of hostilities, they found that the Germans had indeed developed and learned successfully to operate presses ranging up to 30,000 metric tons. In all, three heavy die forging presses, two with a capacity of 15,000 metric tons and one with a 30,000 ton capacity, were discovered in more or less useable condition.

Three extrusion presses in the 5,000 metric ton category were also located. As a part of the post-war settlement, the United States acquired the 15,000 and 5,000 metric ton presses which were later relocated and channeled into the Air Force heavy press program. The 30,000 ton press, however, was seized by the Russians, and with the Soviets in possession of so large a press, our heavy press program received added impetus.

THE HEAVY PRESS PROGRAM GETS UNDERWAY

The heavy press program actually got underway in 1950. This marked the culmination of many months of work by top planners, in Government and industry, who had conducted extensive industrial surveys in an effort to shape the content of a successful heavy press program. At the heart of these studies was the belief that heavy presses could make vital contributions to the Defense effort by providing a capability for the production of large structural members for advanced aircraft and other systems at an unparalleled rate, at low cost, and with a high strength-weight ratio. Congress was informed of the program, and the requisite approvals, together with the necessary funds, were obtained.

THE CONCEPT OF THE HEAVY PRESS PROGRAM

Before I proceed further, there are several points which should be underscored.

First, the heavy press program was unique. To service Defense contractors, particularly those in the airframe industry, we were concerned with the establishment of a heavy press capability for the production of larger, stronger, and lighter forgings and extrusions than previously available in this country. While the Defense Department policy was then, as it is today, that Defense contractors, where practicable shall provide their own plant facilities, and equipment, an exception is warranted in the case of special facilities for which there is no known commercial market. Since there was no commercial requirement for presses of this size, the Government undertook the sponsorship and support of the heavy press program.

Second, it was desirable to establish a self-sustaining industrial base for these heavy presses. To achieve this objective, industry had to be educated and encouraged to design and engineer products suitable for the special productive capabilities of the presses and to be assured of their continued availability on an economic basis. It was essential, therefore, to have a sufficient number of qualified heavy press operators in the program so that we could provide a competitive climate upon which industry could rely for quality, price, and product availability. The heavy press industry was at first hesitant to enter the program since there was no assurance that it would be profitable either as a source of defense or commercial business. Moreover, the Government's program, which was predicated on a "strictly business" rental arrangement with the contractor assuming normal overhead and maintenance costs, could, in fact, entail a financial risk. A representative, select group of operators, however, was finally persuaded to participate.

Third, a key objective was to permit the operators to use the presses, with a minimum of Air Force supervision or interference, with due consideration, however, to the Government's primary interest to rights in their output. To the extent feasible, similar terms and conditions were to apply so as not to confer any competitive advantages on the participants.

Fourth, we sought to rest our business arrangements with the operators on a sound economic footing. Because forgings and extrusions are not end items, but are parts and components of end items and are generally produced to meet the design requirements of prime contractors and lower-tier subcontractors with respect to specifications, changes, quality control, and delivery schedules, and because the output of the presses is intended for commercial business as well, we believed that a rental charge on the basis of sales was in order. This is consistent with Department of Defense ASPR policy to charge a rental for the use of facilities for commercial work and also for Government work unless it can be shown that as a result of rent-free use by the contractor adequate consideration is received through the reduced cost of the end item. It is administratively difficult, if not at times impossible, to assure that these conditions are met in the case of lower-tier subcontractors, such as the heavy press operators.

These, then, are the reasons for charging a rental for both Government and non-Government work on the presses. It should be understood, however, that the

rental requirement is not so iron-clad as to preclude, in proper cases, the granting of deviations for rent-free use should special circumstances warrant. We are aware, however, of no past instance in which such a waiver was requested.

SOME FACTS AND FIGURES

As presently constituted, the heavy press program is being carried out at seven separate locations across the nation by six different companies. The Aluminum Company of America occupies Air Force Plant 47 at Cleveland, Ohio, and utilizes two Government-owned forging presses, one 50,0000 tons and the other 35,000 tons; while in its own facility at Lafayette, Indiana, ALCOA operates a 14,000 ton Government-furnished extrusion press. Wyman-Gordon of North Grafton, Massachusetts, one of our earliest lessees, is in possession of Air Force Plant 63, with Government-owned forging presses of 7,700, 18,000, 35,000, and 50,000 tons. The Curtis-Wright Corporation at Air Force Plant 49 in Buffalo, New York, uses a 12,000 ton Government-owned extrusion press. In Halethorpe, Maryland, at Air Force Plant 50, Kaiser Aluminum operates two 8,000 ton Government-furnished extrusion presses, and in Madison, Illinois, the Dow Chemical Company, in its own facility, has a 14,000 ton Government-owned extrusion press. Rounding out the picture is the Harvey Aluminum, Inc., of Torrance, California. Also in its own plant, Harvey employs two Government-furnished extrusion presses of 8,000 and 12,000 tons. In all, the Government has a $220 million investment in the heavy press program. By way of comparison, the lessees report that they have put in some $19 million of their own funds.

The Government-owned presses have been furnished to the firms involved usually under an instrument known as a facilities lease. Arrangements of this type are authorized by law, Section 2667, of Title 10, United States Code. In some cases, as we have seen the Government not only has provided the presses but the land, buildings, and supporting equipment as well. In other cases, although the press and auxiliary equipment are Government-furnished, privately owned plant facilities are being utilized.

Aluminum is the primary raw material involved in the extrusions and forgings, although advances in the art of metallurgy have made possible the processing of exotic "space age" metals such as titanium and zirconium, but to a more limited extent.

TERMS AND CONDITIONS OF LEASES

The Committee has already been provided with a spread sheet outlining the pertinent terms and conditions of the leases. I should like to deal briefly with a number of these provisions. The first is the clause which establishes a priority for Air Force and other Government use. Obviously, since the press program was initiated essentially as an Air Force program, supported by funds justified by the Air Force and, therefore, an Air Force responsibility, the lease requires first priority in the utilization of the presses for Air Force and other Government work, as against commercial business. While no specific direction is contained in the lease as to how the first priority contract right is to be invoked or enforced, we are aware of no problem that has necessitated an interpretation of the provision or raised any question as to its effectiveness. This may be due to an excess available capacity in the heavy press industry.

The next provision I would like to comment upon deals with the matter of maintenance. For those of you who have seen the heavy presses, I am sure you realize why the label "elephant tools" is so appropriate. Like any large complex piece of machinery, these presses must be strictly maintained. Some of this is no more than a matter of routine lubrication. But maintenance may be far more extensive and can consist of non-recurring items such as the replacement of major parts. We call this latter type "abnormal maintenance." Since the Government owns the presses, it would not be equitable to require the lessee to pay for "abnormal maintenance" out of its own capital. Instead, we have offset some of the cost of "abnormal maintenance" against the gross rentals due. Section 2667(b)(5) of Title 10, United States Code, the basic leasing authority invoked here, specifically allows the cost of "maintenance, protection, repair, or restoration" of the leased property to be taken into account as part or all of the consideration for the lease. In other instances, we have funded "abnormal maintenance" directly. Of course, "abnormal maintenance" varies from press to press, depending upon the age of the equipment, its size, how well it was constructed in the first place, the extent of its use, and other considerations. Over-

all, the total amount devoted to "abnormal maintenance" since the program began through April 1963 has been about $5,900,000.

The rental provisions bear special comment. Having determined, as we have seen, that a rental charge was appropriate, we were confronted with the question of how best to scale the rentals to achieve, on the one hand the best rate of return to the Government, while on the other hand to promote the maximum ultilization of the presses.

With these considerations in mind and aware of the difficulties in the maintenance of accurate "time in use" records for each machine, we arrived at a rental geared to a percentage of sales, a commonly accepted commercial practice. This also minimized the need for close Government supervision of the press operator's day to day business and the administrative burden which it would entail. After extensive negotiations with the prospective press operators, the across-the-board rental rates were fixed generally at 4% of sales for products fabricated from the forging presses and from 4% to 5% for products coming off the extrusion presses, with a higher rate applied to those operators in possession of plants owned by the Government.

From the beginning of the program through the first quarter of calendar year 1963, our *net* rentals have amounted to some $11 million. This can be accounted for in part by the fact that, in many cases, the rental did not begin to accrue until the presses were fully operational. In other cases, later cut backs in our aircraft programs reduced the utilization of these presses below our initial projections. And, finally we have offset some of the costs of "abnormal maintenance" in arriving at the net rental. All in all, however, it should be understood that our major reason for undertaking the heavy press program was not so much to increase the flow of revenues to the Government in the form of rentals but to provide a self-sustaining industrial base, with strong capabilities, so that important defense needs could be met with less cost and in less time.

For the future, we expect a steady rise in the rental returns, since our forecasts point to the increased utilization of the presses.

POSITIVE ACCOMPLISHMENTS OF THE HEAVY PRESS PROGRAM

To catalogue the significant accomplishments of the heavy press program is almost to relate the history of our modern advanced aircraft. A case in point is the "wet wing" for the B–52. Here the wing not only serves its traditional purpose aerodynamically, but is itself a large fuel tank that provides maximum range to this intercontinental strategic bomber. It was through the extrusions from our heavy presses that wing panels of the required strength and at reduced weight were produced, all at considerably less fabrication and machining cost that would have been possible by other methods. Although we have never completely analyzed the cost effectiveness impact of the presses on the B–52 program, we believe that the savings resulting from the forging and extrusion techniques have exceeded the entire cost of the heavy press program.

In addition to the B–52 wing skin panels, the products of our heavy presses have been used for a wide range of applications for the aerospace industry—from aircraft landing gears to bulkheads, from spars, jet engine parts, radar antennae, propeller blades, aircraft wheels, to various sections of missiles. Some of the major aircraft programs involved are the C–130, C–141, the F4C, and now the F–111. The J–52, J–57, J–75, JTFLO, J–79, J–58, and J–93 engines are similarly dependent upon the output of these presses. There are, as well, other programs equally important to the national security that substantially rely on the key contributions that our presses are making—Polaris carrying submarines, Army vehicles, Marine boats, pontoons, and aircraft landing mats, to name several. And, as new programs are unveiled, the heavy presses will continue to provide basic support in the form of strong, light-weight components not as satisfactorily produced by other means.

AIR FORCE MANAGEMENT OF THE PRESS PROGRAM

The Air Force has subjected the heavy press program to continual surveillance in an attempt to improve its management techniques and contracting procedures. Our efforts have intensified over the past two years. Particularly noteworthy, in this regard, has been the work of the Air Force Systems Command Heavy Press Task Force. We are always in the market for constructive suggestions, and you

can be assured that the keen interest of the Secretary's Office in this important program will continue.

SEATTLE, WASH.

Mr. C. M. BAILEY,
Deputy Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. BAILEY: Your letter of November 29, 1967 requested comments on the report to the Congress on the need for the Department of Defense to improve controls over Government-owned property in contractors' plants. (Report No. B-140389 dated November 24, 1967) We appreciate the opportunity to furnish comments and trust that such comments may serve a useful purpose for both your further consideration and that of the subcommittee on Economy in Government of the Joint Economics Committee of Congress.

As a general statement on the over-all report, we believe it is most unfortunate that the report was released to the Congress and subsequently to the news media without benefit of involved contractors' review and comments, even though it is recognized that most of the report comments were directed at certain Government agencies who did have the opportunity to respond. Treatment of Congressional testimony on the report and the report itself in the press has led to unjustified inferences and allegations of violations of public trust by Defense contractors in the utilization of Government property without a recitation of all facts and circumstances involved. Consequently, our principal concern is not so much with what has been covered in the report, particularly as it relates to the Boeing Company, but with what has been left unsaid and the manner in which the content of the report has been treated by the Congress and the press.

This concern is magnified by the very nature of the report which is a conglomeration of findings at various contractors' locations. Each contractor, although affected by only isolated findings and in varying degrees, is almost certain to be assumed guilty by association on all counts. In our opinion the measure of guilt, under the circumstances, will become a function of size with respect to total dollars of property surveyed. Since the Boeing-Wichita operation encompasses approximately 38% of the value of the Government property surveyed, we are concerned that the company will be subjected to unwarranted criticism even though very few of the specific findings relate to our operations and these are readily explainable. Our observations on each of the specific findings are included in the attachment hereto.

A full disclosure of the facts concerning our management and use of Government property and the steps taken by the company to circumvent problems of the nature disclosed in the report will, we believe, reveal that our relationship with the Government in this regard has been forthright and consistent with controlling regulations, policies, and statutes, including appropriate payment for commercial use of Government-owned facilities. A review of the record will confirm that Boeing has consistently obtained approval for and adequately reimbursed the Government for such use. Further, the Boeing Company is in accord with Department of Defense policy that contractors provide, to the maxium extent practicable, plant and equipment required for Defense work. We have been moving in that direction for many years as evidenced by our very substantial investment in research, development and production facilities including the purchase of two Government-owned plants and related equipment declared excess to Government ownership.

With specific reference to Boeing-Wichita and the lease arrangements entered into at that location effective January 1, 1966, it should be noted that this action was taken after it had been determined by the Government that: (1) the property was not excess to the needs of the Air Force; (2) the property was not required exclusively for public use and was available for lease; (3) the lease took into consideration all of the property to be used for non-Government purposes; and (4) very substantial benefits would accrue to the Government in the form of rental income and other tangible emoluments by making the unused plant capacity available for commercial use. The lease was concurred in by the Office of Emergency Planning and two Congressional committees in accordance with applicable statutes and was approved by the Secretary of the Air Force as promoting the national defense and advantageous to the Government.

The following are specific examples of benefits flowing to the Government and the national economy through use of Government plant and equipment on commercial work:

(1) Rental income from commercial use of the plant and equipment in lieu of maintaining idle plant capacity or low equipment utilization. (Lease payments at Wichita for commercial use in 1966 and 1967 will approximate $8,000,000.)

(2) Lower overhead on existing military programs through distribution of fixed costs over a broader business base. (Overhead savings on military work at Wichita for the five-year lease period is estimated to be approximately $14,000,000.)

(3) Preservation of the Government facilities capability for future military work and enhancement of such capability by company investment in additional facilities. (Boeing investment in facilities at Wichita during 1966 and 1967 exceeded $10,000,000.)

(4) Preservation of skilled work force and technical capability for future Government work. (Total work force at Wichita exceeds 19,000.)

(5) Favorable impact on balance of payments problem. (Boeing exports of commercial transport aircraft during 1966 and 1967 totaled $689,000,000.)

(6) Favorable impact on the domestic economy through employment of a substantial number of prime manufacturing employees and widespread subcontracting programs.

We are hopeful that the foregoing general comments and the detailed comments set forth in the attachment hereto will serve to place the portions of the report relating to The Boeing Company in proper perspective. We earnestly believe that commercial use of available Government plant and equipment capacity on a noninterference basis can and does, as evidenced above, result in substantial benefits to the Government and any inappropriate restriction of such use would not be in the public interest. However, we also encourage the strengthening and clarification of applicable regulations where necessary to assure that such use is in the best interest of the Government and in accordance with Government policy.

Although the current Congressional and public reaction to the report may be difficult to overcome and could result in a flurry of unreasonable regulatory and legislative activity, we are hopeful that the General Accounting Office will use its influence to prevent misinterpretation of the report and to achieve what we believe to be its intended objective—improvement in the management and control of Government property commensurate with the economic benefits to be obtained.

It is our considered opinion that the review by the General Accounting Office of Boeing's utilization of Government property on its commercial programs should have reflected the fact that Boeing has made full compensation to the Government for such use and it is our view that your report to Congress should have so stated.

In view of the fact the report has been submitted to the Congress it is requested that this letter and the attachment thereto be given the same distribution.

THE BOEING CO.,
H. W. NEFFNER,
Vice President, Contracts.

Exhibit A

Comments on U.S. General Accounting Office report B-140389

Page 14

"At the remaining contractor plant the Government was negotiating a long-term lease specifically to permit commercial use of the IPE. The contractor maintained projected usage data rather than utilization data for selected items of IPE. The records showing projected use indicated that 32 items of IPE estimated to have cost $6.5 million would be used predominantly for commercial work the last 4 months of 1966. According to contractor estimates, commercial use of the plant was expected to be more extensive in 1967 than in 1966. DIPEC records indicated that, by the beginning of 1967, seven of these items, estimated to cost $1.3 million, would be in a critical supply classification. This would mean that, at the present demand rate, DIPEC would not be able to fill all of the requisitions received for this IPE in 1967."

Comment: The long-term lease was proposed by Boeing in November 1965 as a solution to the concern of both the Air Force and the company about future utilization of the Wichita plant. All property at this location subject to DIPEC control was reviewed and it was determined that retention of this equipment for long-term use at the Wichita location was in the best interest of the Government.

The retention of this equipment under a long-term lease was reviewed and approved by the Office of Emergency Planning, the Secretary of the Air Force, the Department of Defense and congressional committees.

"We were also restricted in our determination of need for 32 items of IPE that we had questioned at one contractor location because the need was based on estimates of expected use rather than on actual use."

Comment: We have not been able to identify these 32 items in the total information furnished to GAO personnel. However, expected use together with cost of removal and reinstallation are of greater significance in the use and management of Government property than current actual use. We have not considered it economically justifiable to maintain machine by machine actual usage data for rental purposes.

Page 36

Contractor	E
Number of machines acquired	10
Cost of machines	$1, 490, 000
1st year savings:	
Included in justification	$1, 380, 000
Estimated amount realized	$2, 164, 000
Justifications in excess of amounts realized	−$784, 000

Comment: This schedule indicates that the first-year savings realized were in excess of the estimated amounts in the justifications.

Page 36

"For contractor E also, machines usage in later years for commercial work began at 12 percent and, in one instance, reached as high as 97 percent of production time. Most of these machines were subsequently sold to the contractor."

Comment: These machines were sold to Boeing as part of a total plant purchase, which was judged to be in the best interest of the Government.

Page 37

"Among the errors were . . . inclusion of the savings anticipated on commercial production."

Comment: The DD Form 1106 used for computation of anticipated savings did not provide for segregation of savings between Government and commercial work. It should be noted that data submitted with facilities applications did identify estimated savings applicable to Government work and that such data was used by GAO in connection with this examination. In our opinion the justification procedure was not in error and our facilities applications could not have been misleading.

Page 39

"Another contractor had a number of multimillion-dollar incentive-type contracts which had been negotiated before various new machines were added to its facilities contract and were in an active status at least a year after the machines were placed in operation. The prices of these contracts had not been specifically adjusted to reflect modernization savings. The utilization of the machines under a contract could not be determined from the contractor's records. Government contracting officials told us, however, that, during the operating period referred to, the machines were utilized almost entirely on Government programs and that they could have been used on the incentive contracts."

Comment: We consider this paragraph to be wholly misleading. Although utilization of the machines under the contracts could not be determined from the company records, the delivery dates of contract end items furnish compelling evidence that the machines were not used on contracts negotiated prior to the activation of the machines. This evidence is in the General Accounting Office files. The Boeing Company consistently forecasts improvement in operating performance without specific knowledge as to the actions required to achieve such improvements, and it is our opinion that any possible savings resulting from modernization was properly reflected in total required cost improvements, as negotiated.

"At one contractor's plant, we noted that the contractor had prepared a listing of multipurpose tools costing about $36 million, which were classified as special tooling.

"A report issued in March 1966 by the Air Force property administrator located at this plant stated:

"It was observed that identical items sitting side by side carried facility property tags in one instance and special tooling tags in another instance. This would reemphasize the need for a comprehensive review and reappraisal of the criteria for determining how and at what point these items were sorted into facilities or special tooling. The existence of complete machines built as special tools, articles attached to facilities or real property on a permanent or semi-permanent basis, items so general in nature and so obviously nonspecialized, and yet identified as special tooling makes an ambiguous and untenable situation.'

"The property administrator stated that the tooling in question was being used by the contractor on all programs without payment or rent and recommended that it be transferred to the facilities contract. Apparently as a result of the property administrator's recommendation, a pending lease agreement between the contractor and the Air Force provides for the payment of rent for commercial use of special tooling and test equipment costing about $3.6 million. This amount was determined by the contractor by reviewing the list of standard tools comprising the $36 million total previously mentioned and estimating the quantity and value of such tools that could be used for commercial purposes.

"Because there was no itemized listing of the $3.6 million of tooling which the contractor intended to use, it appears to us that any amount of the $36 million of tooling could be available to the contractor for commercial use. Although the lease agreement had not been executed at the time of our review, it appears that the standard tools are to retain their special tooling classification."

Comment: The report is correct in stating on pages 51 and 52 that the company may use, under the lease referred to above, any of the $36 million of tooling. The tooling which could or would be used on commercial work was estimated to be 10 percent of such total by acknowledgeable Boeing and Air Force personnel and the lease was prepared accordingly. The Air Force and Boeing recognize that a problem exists in the disposition of excess special tooling. We have been working with the Air Force for approximately one year in arriving at a contractual means to retain special tooling that is necessary for future Government work and to dispose of that which is truly surplus. It is believed that a significant amount of the special tooling will be authorized for disposition in the near future.

With respect to use of special tooling by Boeing on commercial programs without payment of rent, such use was of very minor significance prior to the effective date of the lease and we are presently negotiating an agreement for payment of rent for such usage prior to the date of the lease agreement.

"For example, the Air Force sold its KC–135 special tooling to a contractor because the items could be applied to similar commercial airplanes."

Comment: In addition to the purchase price, Boeing had paid rental for use of this tooling in amounts exceeding the cost of the tools. In our experience the opportunity for use of Government-owned special tooling on commercial work is a rare occurrence.

"Special tooling at the 11 aircraft engine and air frame contractors included in our review had a total approximate acquisition cost in excess of $299 million and at five of these contractors we established that portions of the special tooling had been used at one time or was currently being used for the manufacturer of commercial components. The items which we question have long-term value and in some cases have multiuse."

Comment: To the extent that this applies to the Boeing Company, it is covered by our comments on the items appearing on pages 51 and 52.

(The following wire sent today as follows:)

CLEVELAND, OHIO, *January 4, 1968.*

CHARLES M. BAILEY,
Deputy Director, Defense Accounting and Auditing Division, U.S. General Accounting Office, Washington, D.C.

This will confirm the oral comments given to your Mr. Hammond yesterday pursuant to your letter of November 29, 1967, and in response to his urging that TRW's comments concerning GAO's report to Congress dated November 24, 1967 (B–140389) had to be given at that time in order to receive any consideration before the release of TRW's name as one of the contractors referred to in that report.

TRW has complied with all the terms of its contracts, and with the applicable laws, the aarmed services procurement regulation and the directives of the administrative officers of the military departments.

We wish to protest most emphatically the gross unfairness to all concerned of the procedure followed in this case which permitted the release of a report to Congress carrying an unmistakable implication to the contrary without the essential rudimentary safeguard of first obtaining the views of the contractors affected. This unfairness has been compounded by the inadequate time permitted to us to prepare a response to this complex document. Not only were we not given an opportunity to comment on the GAO report to Congress, TRW did not know fully the basis of the GAO findings regarding TRW until December 15. Our ability to evaluate the GAO report has been hampered by the fact that the GAO findings appear to have been based in some instances on misinterpretation or misunderstanding of contract terms and on consideration of incomplete and erroneous information which distorted the true facts in several important respects.

The following points summarize TRW's position regarding matters of prime concern among the findings you designated as pertinent to TRW.

1. Contrary to the GAO allegations, TRW did not use IPE without the proper authority. For example, the statement that TRW used 10 machines 100 percent of the time for commercial work without obtaining advance OEP approval is false. In fact, the 10 machines were not used in excess of 25 percent for non-Government work and hence no advance approval was required.

2. Contrary to implications from the report in press discussions of it, TRW has paid rent for work for all commercial programs as well as for some Government programs. In fact during the 1963–65 period of the report, TRW paid over $2.5 million in rental to the Government.

3. We are puzzled by GAO's criticisms relating to accounting for use of Government equipment and for reporting. In June 1960, GAO by letter to TRW indicated that TRW's method of accounting for usage of IPE was appropriate and carried the implication that use of the method now recommended by GAO would be inappropriate. In part the letter stated:

"It is recognized that the contractor does not maintain records and data indicating usage of all individual items of facilities and the maintenance of such records would be uneconomical, impractical, and unnecessary."

4. With respect to the 8,000–ton press, the numerous GAO comments have distorted the facts and created a false impression regarding the following.

A. Contrary to the GAO report, the 8,000–ton press was acquired not only for the production of one specific jet engine blade, but also for use in connection with expected future defense needs that would require presses larger than the 4,000–ton machine then available. At the time of the proposal to acquire the press, TRW 4,000–ton presses were not able to forge certain jet engine parts without overloading. The Air Force and the press manufacturer confirmed this fact and cautioned that such use of the 4,000–ton presses would likely result in damage.

B. From the date of the original proposal to purchase until the 8,000–ton press was ready for production, numerous technological developments occurred which enabled larger parts to be forged on the 4,000–ton press than theretofore was possible. Advances in lubricants, die manufacturing, and preformed shapes all contributed to this advance in the state of the art. These advances were largely financed by TRW and have resulted in significant savings to the military departments. Thus, contrary to GAO's statement that the 4,000–ton presses are less efficient than the 8,000–ton press, because of the previously described advances in the state of the art they had become more efficient than they were, so that actually the use of the 4,000–ton presses in the instances described resulted in less cost to the Government than if military work had been forged on the 8,000–ton press.

C. Use of the 8,000–ton press in 1966 and 1967 and as projected through 1970 on the stage one fan blade for the C–5A airplane, provides abundant vindication of the acquisition of the 8,000–ton press. This C–5A blade clearly exceeds the capability of the 4,000–ton presses even with the present state of the art. If not produced on the 8,000–ton press it would require an alternative method of production known as machining. Savings to the Government attributed to the use of the 8,000–ton press on this single part compared with using the alternative production method, are conservatively estimated at $2,400,000—an amount substantially in excess of the original cost of the press.

D. TRW has paid rent for commercial work which has been run on the 8,000–ton press. Through October 1967 in excess of $375,000 has been paid to the Government. This amount exceeds the depreciation of the press attributable to commercial work under acceptable accounting standards.

E. GAO's statement that the 8,000–ton press was used from 1963 through 1965, 78 percent of the time for commercial work is erroneous and misleading. Based on the available hours during this period, use of the press for commercial work did not exceed 25 percent of such available hours. In fact, during 5 months of the year 1963, the press was not devoted to any commercial work whatsoever.

F. Most important of all, the acquisition of the 8,000–ton press made it available when needed by the Air Force to meet the required delivery dates of the C–5A aircraft engines, and the essential experience gained by TRW's use of it from 1963 through 1965 gave needed capability and assurance on this vital program. Other aircraft planned or abuilding, such as the SST, provide additional confirmation of the wisdom and correctness of the decision to procure the 8,000–ton press.

We are continuing with our evaluation of your findings concerning TRW and expect to submit more detailed comments to you within the next several days.

Meanwhile, it is requested that arrangements be made for this statement to accompany any release of information, either to the Congress or to the press, which mentions TRW in connection with your report.

TRW, INC.

THE BENDIX CORP.,
Detroit, Mich., December 16, 1967.

Mr. C. M. BAILEY,
Deputy Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. BAILEY: Thank you very much for your letter of November 29 and accompanying copy of your report of November 24, 1967, to the Congress relating to Government-owned property in contractors' plants. We appreciate the opportunity offered to comment on the findings.

Your letter indicates that the findings applicable to our company have been identified by marginal notations, and, in view of time, our attention will be limited to these. There are only two. The first appears on line C of Page 36 of your report, and relates to anticipated versus estimated realized savings from four machines costing $886,000, acquired under the Government's program for Modernization of Industrial Plant and Equipment. The second appears at the bottom of Page 39 and the top of Page 40 of your report, and relates to the question of use of private versus Government funds for this equipment.

With respect to the first item, the four machines involved are fairly sophisticated numerically controlled machine tools furnished to the Energy Controls Division of our company for use in the manufacture of aircraft landing gear struts, replacing ten machines having an average age at time of replacement of approximately 19 years. These items of IPE have been shown in the table on Page 36 of your report because our reported savings fell short of those originally anticipated. The four machines are long lead time items, and, consequently, were not installed and operational until 25 to 32 months after our justification for their acquisition was presented. As pointed out in your report, DOD instruction 4215.14 calls for an estimate of savings based on an assumed use of the machines in the production program for the next twelve months immediately following the estimate, notwithstanding the fact that the machines would not be available and operational until years later. In defense of the instruction, this does place the estimate on an established reasonbaly firm production schedule to which Government representatives might apply an appropriate correction factor to reflect any anticipated future schedule changes of which they are aware, rather than introducing further uncertainties by having the contractor attempt to forecast what production the Government might want two or three years later. In any event, the anticipated and reported savings cover two entirely different production periods spaced approximately 30 months apart.

During this 30-month period the production program to which these machines were to be applied changed significantly in two major respects. First, the amount of Government production was so reduced that the work load would have been reduced about 56% on the old machines which two of the new machines re-

placed and about 68% on the old machines which the other two new machines replaced. I am sure you will appreciate that such a drastic reduction in utilization has an even magnified effect on savings. Second, the production mix of high tensile strength steel parts to aluminum alloy parts changed during the 30-month intreval between the two production periods. The production which remained involved a greatly increased percentage of high tensile strength steel parts. This change made the machining job much more difficult and slower, with resultant loss in anticipated savings. We also encountered problems much greater than anticipated in maintenance of equipment, grinding of cutting tools, tool replacement, etc., such that the savings in machining steel were even further reduced. Thus, the estimated realized savings were on a much different set of production conditions than those which prevailed at the time of the anticipated savings were prepared.

While the changes in size and character of the production program were the greatest contributors to added cost, there were a number of other items worthy of mention which contributed to the reduction of the estimated savings.

In hindsight, we feel that the machines were prematurely subjected to savings evaluation. This evaluation was initiated immediately following the completion and acceptance of cutting tests and prior to the allowance of a normal shake-down period for equipment debugging, operator training and familiarization, and supervisory recognition of the characteristics, capabilities and weaknesses of the equipment. As a result, learning was experienced during the introductory period of this equipment with additional decrease in savings.

Although we expected the complex, sophisticated new equipment would have greater maintenance costs than the old, those costs turned out to be much higher than expected. Actually they ran more than twice what we expected and more than ten times as much as for the old machines.

We also did not realize the savings in scrap and rework costs which we anticipated. Instead of an 80% reduction, the ratio realized was only about half as much. This was in part due to the fact that during this particular reporting period the Government Zero Defects Program was initiated wtih heavy emphasis placed on deviation-free performance. With these more regid standards some increase in scrap was encountered. This had a secondary cost effect, in that efforts to eliminate defects resulted in a need for redesign of fixturing and other tooling for use with the equipment, resulting in further reduction of savings. There is some question whether we could have even attained any success on the Zero Defects Program if the old equipment had been retained.

We do want you and the Congress to know that we are not satisfied with the estimated savings realized during the post-analysis reporting period. We feel that some of the causes discussed above were temporary and have been overcome, whereas the majority are inherent in the change in the size and character of the production program. Based on our present knowledge of the equipment capability, we feel the original estimate of savings, although sincere, was optimistic: however, with the shake-down period behind us and an increasing workman familiarity with the equipment, greater savings are now being realized than those experienced in the initial year covered by the post-analysis report.

Reference is now made to the second comment applicable to our company beginning at the bottom of Page 39 and continuing on the top of Page 40 of your report. This comment relates to our willingness to privately finance the four machines under discussion and whether or not we were requested to do so. It is the recollection of our facilities people at our Energy Controls Division by whom the equipment involved was requested, that the question of private financing of this equipment was raised and discussed at length by the Air Force personnel responsible for facilities.

Recognizing that—

(1) the military requirements for struts at this time were uncertain,

(2) the pricing and competitive environment for struts did not indicate long-term stability of this business, and

(3) the specialized equipment appeared of little use to Bendix except for military strut manufacture,

a decision was reached that we would be unable or unwilling to use private financing, above capital commitments then being made at this division, to acquire the four machines here involved. In fact, the division did experience a drastic reduction in sales and profits and operated at a loss for an extended period.

It is of interest to note that this division committed itself for privately financed capital equipment through this period in amounts by fiscal years of approximately the following:

1962	$1,164,000
1963	1,853,000
1964	1,005,000

Since that time, this division has continued to make sizable capital investments. For the last three fiscal years the capital investment was approximately as follows:

1965	$ 782,000
1966	2,025,000
1967	5,446,000

In addition, at the close of the 1967 fiscal year, there were approved but unexpended capital appropriations at this division amounting to approximately $4,470,000.

We trust the above comments will be helpful. Thank you again for extending us the opportunity to comment on your report.

Very truly yours,

CHARLES HUMMEL.

UNITED AIRCRAFT CORP.,
December 8, 1967.

Mr. C. M. BAILEY,
Deputy Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. BAILEY: This is in reply to your letter of November 29, 1967 forwarding a copy of your recent report on Need for Improvements in Controls Over Government-Owned Property in Contractors' Plants, and requesting comments on the findings pertaining to our company.

Your report does not give the names of the contractor organizations included in your findings, and so far as we have been able to determine internally, only two of our divisions have recently been subject to GAO audits related to government property, and may be included in your findings. These two divisions hold government-owned facilities having an aggregate original cost of approximately $11,000,000. In neither instance did your field representatives indicate that they had any significant criticisms of our divisions as a result of these audits, and the passages in the report which you indicated as applicable to our company appear to bear this out. Accordingly, we have no comments to make.

The recommendations in your report would entail some serious administrative and other problems; however, we feel that these can best be commented upon by ourselves and other contractors in response to any proposed changes in the Armed Services Procurement Regulation which may be initiated by the Department of Defense as a result of your investigation.

Sincerely,

W. P. GWINN, *President.*

CONTINENTAL AVIATION & ENGINEERING CORP.,
December 12, 1967.

Mr. C. M. BAILEY,
Deputy Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. BAILEY: Your letter of November 29, 1967, to Mr. A. W. Wild, President of Continental Aviation and Engineering Corporation, has been referred to me.

I have now isolated the portions identified as "marginal notations" and have done some investigation. It appears that the General Accounting Office investigation effort was completed some time ago and I am attempting to locate the people at Continental identified with this activity.

Your letter requests our comments within two weeks from November 29th. Due to the above circumstances, it appears that we will not be able to make our determination as to comments prior to December 28, 1967.

Very truly yours,

EARL F. KOTTS,
Assistant General Counsel.

CONTINENTAL AVIATION & ENGINEERING CORP.,
December 27, 1967.

Mr. C. M. BAILEY,
Deputy Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. BAILEY: As a follow-up to my letter of December 12, 1967, Continental Aviation and Engineering Corporation has decided not to comment on the GAO report dated November 24, 1967.

Yours very truly,

E. F. KOTTS,
Assistant General Counsel.

KAISER ALUMINUM & CHEMICAL CORP.,
December 13, 1967.

Mr. C. M. BAILEY,
Deputy Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. BAILEY: This is in response to your letter of November 29, 1967 to Mr. T. J. Ready, Jr. which transmitted a copy of the report of November 24, 1967 to the Congress on the need for the Department of Defense to improve its controls over Government-owned property in contractors' plants.

Comments were requested on findings pertaining to this company as identified by marginal notation on the report. The first notation related to equipment which had not been in use for extended periods of time and had not been declared excess by the various contractors in accordance with applicable directives. It is our practice to work with the government in minimizing retention of excess equipment. It should be noted that our records indicate the following pieces of excess equipment have been removed from the Halethorpe Heavy Press Extrusion Facility since November 15, 1965: Production equipment, 50; furniture and fixtures, 161; and plant equipment and machinery, 14. The aggregate original value of these removals is approximately $500,000.

The first marginal notation indicated this company to be responsible for two pieces of excess equipment which we believe to be two jib cranes at Halethorpe having a combined orginal value of $2,060. Low utilization of these cranes was called to our attention during your review, and the cranes were declared to be excess equipment on November 6, 1966. In accordance with government approval of March 23, 1967, for disposal by scrapping, the cranes were sold for $20 and removed on April 24, 1967.

The second marginal notation was in reference to a discussion of return on the government's investment in heavy presses. The stated objective of improving the return via increased rental receipts is a logical one which we believe is attainable only with a relatively high constant utilization rate. From our long association with the program, we know that historically the government business on the presses has fluctuated widely as a result of sharp changes in military requirements, while commercial business has been relatively low. We believe the government should establish rental policies which will encourage commercial use and thus provide the high volume necessary for an improved return on investment. To accomplish this objective and best serve the government's purpose, it must be recognized that the aluminum extrusion industry is highly competitive with equipment rental an important cost consideration. This company has devoted considerable innovative effort to develop commercial business for the presses such as structural components of high voltage electrical transmission towers. Hopefully there are many applications which could be developed into good commercial business through continued research and marketing effort.

We have concluded that specific findings in the report applicable to this company are limited to the matter of the two small cranes. It is our opinion that prompt corrective action was taken to rectify this minor oversight. We trust that any identification of Kaiser Aluminum & Chemical Corporation with the report will clearly indicate our very limited involvement. If the conclusions we have drawn are incorrect, we would like to meet with you to clarify our position.

It is our opinion that the report is generally constructive in recommending improvements in control over property. Thank you for soliciting our comments.

Very truly yours,

A. N. WARBURTON, Jr.

HARVEY ALUMINUM, INC.,
Torrance, Calif., December 13, 1967.

U.S. GENERAL ACCOUNTING OFFICE,
Defense Division,
Washington, D.C.

(Attention: Mr. C. M. Bailey, Deputy Director, Defense Division.)

GENTLEMEN: This acknowledges receipt of your letter of November 29, 1967, addressed to Mr. L. A. Harvey, President of Harvey Aluminum, and enclosure of the Report to the Congress relating to "Need for Improvements in Controls over Government-Owned Property in Contractors' Plants."

We greatly appreciate the opportunity afforded us to comment on the report. Your office and the Subcommittee are to be commended for the practice of submitting reports to the entities and persons affected, for their comments. Such practice promotes good relationship between the Government and its citizens.

Comments pertaining to our company are contained in your report on pages 13, 28, 32, 43 and 64.

The comment on page 13, regarding utilization of industrial plant equipment, indicates that 74 items of equipment had not been used by us during the first 9 months of 1966. Twenty-six of these items have been declared excess and have been disposed of; many of these 26 items had already been identified and were in process of being declared excess prior to the time of the G.A.O. review. Thirty of the items are in use since these were being held for known future use on Army and Navy 20mm projectiles, fuse bodies, etc., as was explained to G.A.O. personnel during their visit. At request of the G.A.O. personnel, we furnished the contract numbers of the contracts which required use of some of the above retained equipment. Delivery schedules of the contracted supplies are shown therein. Fifteen additional items of equipment were also held for intended use in producing similar military supplies; however, it has been determined that these items are not required and are in process of being declared excess. Three items are being held for use on a contract presently being negotiated in connection with the Weteye Missile.

At the time of the G.A.O. review, Harvey, at the request of the Government, in coordination with personnel from Frankfort Arsenal and DCAS, was in process of establishing new production lines in order to increase and expedite our manufacture of ammunition components and related items, and it was necessary to phase in these items of equipment with additional Government equipment being furnished. These new production lines were established in order to increase production of these critically needed military supplies. To illustrate the need for this equipment, Harvey is using it to produce approximately 5 million 20mm projectiles, 900.000 40mm projectiles, 1.5 million fuse bodies, and various other items each month.

For many years, Harvey has had a policy of continuously screening all items of equipment to determine those excess to its present and planned needs. We believe that this policy has resulted in declaring items excess as soon as justified under the circumstances. We expect to continue this policy as we believe it to be in the best interests of both Harvey and the Government.

The comment on page 28, referring to rental on industrial plant equipment, states that rental was computed according to varying formulas on like classes of machines of similar age and value. This is true, however, since facilities contracts are generally negotiated to provide equipment for specific purposes under varying conditions at the time of negotiatons and further to assure the Government a reasonable rental therefor based on the required and/or expected utilization of the equipment, and the product to be produced.

This variance in rates is illustrated by the fact that one of our contracts requires us to pay a monthly rental rate of 1% of acquisition cost of the equipment even though the equipment is now over 10 years old; whereas, ASPR 7-702.12 provides for a uniform ¾% rental rate on this type of equipment which is over 10 years old.

Harvey Aluminum has been paying its rentals in accordance with the terms of its contracts.

The comment on page 32, regarding revised rental procedure needed to increase return on investment in heavy presses, must of necessity look into the requirement for the heavy presses and the ultimate savings to the Government under the program.

During the 1948–54 period, the Heavy Press Program was justified and authorized solely on the basis that the prospective products therefrom were mandatory to attaining the necessary performance of projected Aeronautical weapon systems at a reasonable cost. The size, complexity and fidelity of the forgings and extrusions produced from the equipment in the Heavy Press Program have permitted attaining the sophistication and performance of Aeronautical and Aerospace systems of the past decade. Additionally, these and even larger forgings and extrusions are requisite to the continued evolution of these systems.

While the rental return on the Government investment in this program does not appear to compare favorably with that on Government Bonds and Commercial Paper, the following factual information should be taken into consideration before reaching a conclusion in the matter:

(a) The Heavy Press Program was justified and authorized by the Gomernment as a requisite to the desired evolution of Aeronautical systems. The program has much more than returned the Government investment in the validation of this justification. Multi-millions of dollars have been saved by the Government because of lower assembly and production costs due to this concept of manufacture.

(b) The size, complexity and dependability of the forgings and extrusions available from the Heavy Press equipment are an order of magnitude improvement over those available in the 1940–1950 period.

It is our belief that the overall savings to the Government as expressed above has given the Government a much more significant return on its investment than the same investment in Government Bonds or Commercial Paper would have produced.

The comment on page 43 relates to Transportation and Installation Costs.

Installation Costs for items of Government equipment were generally paid for by Harvey Aluminum itself. In one instance the contracting agency allotted a sum estimated to cover installation costs. This amount was added to the acquisition costs of the equipment and the contractor has paid rental based thereon.

Transportation Costs were paid for by both Harvey Aluminum and the Government. An audit is now being concluded and determination will be made in the near future as to the amount of transportation costs that should be added to the acquisition costs of the equipment. It has already been determined, however, that the increase in the amount of rental to be paid the Government because of this factor will be very nominal.

The comment on page 64 indicates that the Government Property Administrator had withheld approval of the system we use in accounting for Government-owned property.

Harvey Aluminum has been operating under approved procedures for control of Government-owned plant equipment. Also, there has been regular surveillance by the Property Administrators of such equipment at our plant for a number of years. However, in order to conform with the latest instructions prescribed in ASPR, an updated procedure for control of Government-owned plant equipment was presented to the Property Administrator and his approval was received on April 24, 1967. During their visit G.A.O. representatives noted that Harvey has been following prescribed procedures in the administration for control of Government-owned plant equipment.

We again wish to express our thanks to your office in giving us the opportunity to comment on your report to the Congress. We feel that Harvey has attempted in every way to establish and maintain effective controls over Government-owned property at its facility. We trust that the foregoing explanations will

assist you in furnishing the Congressional Subcommittee with the additional information they requested.

Very truly yours.

JACK ROSS, *Treasurer.*

HOLLEY CARBURETOR CO.,
Warren, Mich., December 12, 1967.

Reference: B-104389.

U.S. GENERAL ACCOUNTING OFFICE,
Defense Division, Washington, D.C.

(Attention: Mr. C. M. Bailey, Director, Defense Division.)

DEAR MR. BAILEY: This is in reply to your letter of November 29 addressed to Mr. H. T. O'Connor, who is no longer with our company. We appreciate receiving a copy of your report to Congress on the need for the Department of Defense to improve its controls over Government-owned property in contractors' plants. We wish to state emphatically that we are entirely in accord with the general subject matter of this report and concur with the recommendations.

We note that our copy of the report contains no marginal notations which we trust means that we were found to be in compliance with your remarks.

In our own case we feel particularly strongly about the removal of machines which will no longer perform an adequate economic function in connection with our government contract work. We have, during the year 1967, declared surplus and returned 34 pieces of equipment valued at $192,000 and we intend, during the year 1968, to do likewise in connection with 16 additional pieces of equipment valued at $134,000.

We commend your efforts toward the reduction of government expenditures and the obtaining of the maximum effectiveness from the dollars spent, and we assure you of our full cooperation.

Very truly yours,

MILTON J. KITTLER.

MENASCO MANUFACTURING CO.,
Burbank, Calif., December 28, 1967.

Mr. C. M. BAILEY,
Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. BAILEY: Under date of November 29 you submitted to us a copy of the Comptroller General's report to the Congress on the "Need For Improvements In Controls Over Government-Owned Property In Contractors' Plants."

You stated that the report included examples associated with your findings that were applicable to Menasco and that these were identified by marginal notation. You requested our comments on the findings pertaining to Menasco as well as any other comments we might wish to offer on the matters presented in the report.

With respect to general comments, I believe it would be presumptuous for me to comment on matters which are beyond the scope of our personal knowledge. However, I can note that in their relationships with Menasco, the Air Force and DCASR appear to be extraordinarily diligent in protecting the interests of the Government in the matter of Government-owned property.

Page 14 of the report recites in part:

"We found that in many cases contractors did not maintain utilization data which would permit application of usage criteria.

Accordingly, we could identify only four items of IPE estimated to cost $35,800 at two locations where low use was indicated by other review techniques. In three instances, however, reasonably complete utilization data were maintained. *These data enabled us to question the basis for retention of 76 items of IPE, estimated to cost $1.2 million, which did not satisfy the criteria specified by the Assistant Secretary of Defense as we interpreted it. None of this equipment had been reported as excess by the contractor.*" [Italic ours]

It is noted in the margin that "2 of 76" relate to Menasco. We have ascertained that the machines in question were a Sheffied grinder (1952) and a Kearney & Trecker mill (1953). These machines were in fact surplus at that time to our requirements and have since been declared surplus and surrendered to the Government.

Menasco has a large number of a wide variety of Government-owned and Menasco-owned machine tools which we use in the manufacture of landing gear. Because of the changing character and changing requirements of our product programs, our facility requirements are subject to constant change. It is our policy to dispose of equipment which does not have continuing economic utility whether it be Government-owned or Menasco-owned. Our failure to declare these two machines as surplus was a Menasco administrative error. All of our product contracts are fixed price. Because of excess costs associated with space utilization and maintenance of equipment, it is in our own interest promptly to dispose of equipment no longer in use.

Page 41 of the report recites in part:

"*One contractor informed us that its policy was to invest in IPE one half of its after-tax earnings, plus the amount of depreciation for the period. The remaining IPE needed would then be requested from modernization funds and the DIPEC inventory. The stated policy appears to be in consonance with present DOD objectives in the modernization program.*" [Italic ours]

Menasco appreciates this favorable comment. You may be interested in learning that long before the recent announcement of our new $7 million modernization and expansion program, Menasco had adopted the policy of applying *all* of its after-tax earnings and depreciation recovery to finance its modernization and expansion.

Page 43 recites in part:

"The ASPR, section 7–702.12, provides that, for rental computations, the cost of facilities shall include the cost of transportation and installation. We found that these costs had in some cases been applied as a percentage factor to the acquisition cost of IPE being rented by contractors. One contractor added a factor of 3.5 percent, *another contractor added a factor of 1 percent.*" [Italic ours]

Menasco has been applying a factor of 1 percent to inbound freight for the purpose of developing a base for rental computation. The actual cost of installation of equipment if it is borne by the Government is added to the cost of the equipment for purposes of rental computation. If Menasco assumes the cost of installation, the cost is written off against current profits. A recent study by us makes it evident that the application of 1% develops an aggregate amount which is almost identical to that which would have been determined by a tabulation of the actual inbound freight bills. Finally, the question is actually academic with respect to our Texas Division—which was the subject of your inquiry—because through our fiscal 1967 ended June 30, 99% of our Texas effort was on Government contracts.

I am attaching for your further information, a copy of a talk which I recently made at Wright-Patterson Air Force Base in which from our point of view I attempted to place in focus Government-owned equipment and its utilization in the context of the economics of the landing gear industry. I hope that you will find this helpful in your further study of this question.

Sincerely,

GERALD J. LYNCH.

BEECH AIRCRAFT CORP.,
Wichita, Kans., December 18, 1967.

Mr. C. M. BAILEY,
Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. BAILEY: Your letter, referenced B–140389, addressed to Mrs. O. A. Beech has been referred to this office for reply.

In accordance with your request, we have the following comments relative to the items identified by marginal notation in your report to the Congress on Government Owned Property in Contractors Plants.

Page 14—first paragraph

Our records indicate the equipment in question is used extensively on government programs. Beech Aircraft Corporation operations include a variety of government contracts all of which do not have a long period of effort. Use of the equipment fluctuates with contractual requirements.

As a reimbursement to the Government for use on commercial programs, Beech Aircraft Corporation has paid rent in accordance with an accepted formula. In

the overall, we believe that the rent so calculated exceeds the actual time usage of the machines on commercial business.

Page 14—last paragraph

At the time of the review, the equipment questioned in this paragraph was located in our Tooling Department and due to the type of equipment had a low but vital usage at that particular time. This equipment is presently being used two full shifts per day on a government ordnance contract. This illustrates the difficulty of drawing accurate conclusions from an equipment review at any one time when the contractors government business is made up of various types of programs with relatively short production periods.

Page 29—first paragraph

In accordance with the contractual agreement, Beech Aircraft Corporation pays rental on government owned facilities used on commercial work. The rental payments are charged to the commercial programs utilizing the equipment.

Government contracts are in no way penalized by the use of government equipment on commercial programs. As a matter of fact, they are helped because the equipment is maintained and available when needed for government programs. The method of calculating rental due for commercial use, in our opinion, results in a higher cost to commercial programs than is justified by the hours of usage of the equipment. We have been willing to accept the contract formula, however, rather than set up an elaborate timekeeping system on each machine.

Page 56—second paragraph

The Contractor's records comply with ASPR requirements. We seek to perform our task at a budgeted cost and the inclusion of monetary values would increase these costs to the contractor and consequently to the government.

Page 57—second paragraph

The government review indicated they believed our procedures inadequate in that we do not physically inventory all materials both government and contractor owned. It is the Beech policy to periodically inventory government furnished materials and reconcile with the inventory record cards. We do physically inventory and reconcile all materials held in stores accounts. We do not, nor do most contractors, inventory work-in-process. The Beech work order system and parts control system provides adequate control of work-in-process inventory.

Third paragraph

A strict control is maintained on government furnished materials, which is reviewed by the Property Accountability Officer. It appears to the contractor that a physical inventory, to determine that government furnished material is on hand, fulfills accountability requirements. We do not believe it practical or required to physically inventory all contractor owned material. It must be pointed out that government furnished material is a minute portion of total material in the Beech plant.

Fourth paragraph

Beech purchases all materials for the account of the government in accordance with detail contract requirements and schedules. The Beech work order and parts control system accurately accounts for all materials after they are put in process. This system has been in use for over 25 years on both commercial and government contracts and has been found satisfactory on all types of contracts.

Beech does not maintain detail parts cost for the parts in work-in-process inventory. The work order system provides contract and lot costs which are adequate for the contractors purposes. Parts accountability is maintained and we do not believe pricing the parts adds any value or ensures any more accurate material accountability.

We believe our accounting procedures to be adequate to account for the use of the equipment and for materials furnished by the government. At the same time, our procedures provide for a great measure of economy and simplicity of records which result in less cost to the government. We believe that our interest in economy and efficiency of operation should be noted and that the regulations should stress such an approach.

In reviewing your report, we note some manufacturers have purchased from the government the facilities previously furnished to them. We have tried numerous times to purchase the government facilities in our plant. Each time we have

been informed that direct sale of the facilities to the contractor through negotiation was prohibited by either law or regulation. It appears to us that allowing contractors to purchase equipment already located in their facility would be advantageous to both the contractor and the government.

If additional information is needed regarding our portion of the referenced report, please feel free to call upon us.

Sincerely yours,

J. A. ELLIOTT.

ROHR CORP.,
Chula Vista, Calif., December 18, 1967.

Subject: General Accounting Office, Report to the Congress Regarding Government-Owned Property in Contractors' Plants B–140389.

U.S. GENERAL ACCOUNTING OFFICE,
Defense Division,
Washington, D.C.

(Attention: Mr. C. M. Bailey, Deputy Director.)

GENTLEMEN: We have received the subject report with great interest. Since we were one of the 21 defense contractors impartially selected for review, we were interested in the overall findings of the report, particularly those which may pertain to our company.

We do not believe that the report shows evidence of noncompliance on the part of Rohr Corporation no evidence of neglect on the part of the Government personnel responsible for the surveillance of Government property assigned to our plants. It would seem instead to indicate that, although Rohr complied with the ASPR and Facilities Contract clauses applicable at the time, the General Accounting Office Auditors were either (1) questioning our interpretation of the clauses or (2) questioning the propriety of the clauses themselves. This would seem quite evident in the recommendations set forth in Appendix II of the report.

Specifically the discrepancies noted at Rohr were in the area of utilization of the facilities provided. The first of these concerned a few items that were being used predominantely for commercial work.

During the review we explained to the auditing team that we did not schedule our workload by individual machines, but instead scheduled in banks of machines consisting of both Rohr-owner and Government-owned machines. This means that the first open machine gets the next job whether it be military or commercial, or whether the machine is Rohr-owned or Government-owned. Certainly there are times when the commercial work is heavy on the Government machines. However, there are also many Rohr-owned machines that are producing Government work 100% of the time due either to our method of scheduling or the inability of the older Government equipment to satisfactorily produce the parts. We believe that an integrated shop is far more efficient and economical than one where the machines would be segregated and the workload scheduled individually.

The second was the contractual provision which required the contractor to notify the contracting officer when non-Government use was expected to exceed 25 percent of the total use.

In the report it is stated that the contractual requirement to obtain OEP prior approval had been added to our contract in December, 1965. Although the "effective date" typed on our facilities contract is December 3, 1965, we did not receive this document for our signature until late March, 1966 and the fully executed copy of our contract was not mailed to us by the Government until May 5, 1966. Since the audit covered the period from February 1, 1966 through July 31, 1966 the requirement did not actually become effective until approximately two-thirds of the audit period had elapsed. This requirement has been, and still is, a very controversial matter between industry and the Government. We have been, and now are, complying with this requirement.

The third area of concern was the method used to obtain adequate machine utilization data.

At Rohr, we have a mechanized system which records the hours of use on major machinery on a machine-by-machine basis. This system is part of our cost accounting data collection system which accrues the many production costs automatically through the use of modern computerized equipment. The

machinery on which complete utilization records are maintained represents a minimum of 70 percent of all Government-owned equipment in our plants. An average use percentage based on the actual utilization of this group of equipment, is determined and the average percentage is applied to 100 percent of the Government equipment to compute our commercial use rental payment and to report our overall average utilization percentages. In the interest of economy, we are constantly striving to minimize administrative costs by utilizing existing established systems for as many reports as possible consistent, of course, with the reporting requirements. We believe our system is an exceptionally good one and we do not undertand why this was identified as a questionable example in the report.

The last problem concerned the type of inventory control required for special tooling.

Prior to the audit it was our interpretation that a perpetual inventory was sufficient to comply with the requirements as set forth in the ASPR. Therefore, we did not have a written procedure that directed our personnel to perform an annual physical inventory of special tooling. However, in January, 1967, we incorporated such a requirement into our standard practices and we are now complying with this directive.

In summary we believe that Rohr has abided by the terms of our contracts in an exemplary manner. We have maintained the equipment in better than average condition. Rental charges based on the ASPR established rates have been paid. Commercial usage percentages have been computed based on actual hours of use, which is considered by many a most equitable and economical method for such computation.

Unfortunately a straight statistical report can be very misleading when the myriad of other factors in the overall production picture are not considered.

In an effort to minimize our ratio of commercial work on Government equipment, we are acquiring capital facilities to the maximum of our ability to meet the increased demands. In addition we have returned and are continuing to make every effort to return Government-owned facilities when military requirements no longer exist.

We also recognize that economy in Government is of utmost importance. We would, therefore, hope that a thorough analysis of the contemplated changes in regulations be made to assure that the cost of their implementation does not exceed the savings which might be obtained.

Very truly yours,

F. E. McCreery,
Executive Vice President.

Heintz Division, Kelsey-Hayes Co.,
Philadelphia, Pa., December 19, 1967.

Your Ref: B-140389.

Mr. C. M. Bailey,
Deputy Director, Defense Division,
U.S. General Accounting Office, Washington, D.C.

Dear Mr. Bailey: Your letter of November 29, 1967 addressed to Mr. W. D. MacDonnell, President of Kelsey-Hayes Company, with reference to the recent report made by your office to the Congress relative to Government-owned facilities, has been forwarded to this office for reply.

We are enclosing copies of two letters from Mr. J. F. McMahon, dated December 9, 1966 and February 9, 1967, addressed to the GAO supervisory personnel who were responsible for the review at our plant in Philadelphia. These two letters cover many of the areas which are referred to in your report and, in addition, they state our position more clearly with regard to control of the facilities in our plant.

With particular reference to the marginal notes made in the copy of the report which we received from you, we submit the following comments for your consideration:—

IPE Not In Use—(Page 13): Utilization Surveys conducted by DCASR representatives within the past year have resulted in our declaring surplus nineteen (19) items covered by our Air Force Contract and thirty-seven (37) items covered by our Navy Contract. This is a continuing program and as additional items become surplus to our needs, they will also be disposed of.

Low Utilization of IPE—(Pages 14 & 15): Please refer to Mr. G. Y. Meyer's letter of December 9, 1966 (copy attached) addressed to Mr. Leon Ruderman relative to Justification of Retention of Equipment.

Prior Approval Not Obtained, etc.—(Pages 17, 18 & 19): We are still uncertain as to the meaning of the 25% criteria referred to in this Section and are presently working with DOD personnel in an attempt to comply with this requirement.

Improper Use of Government-Owned IPE—(Pages 19 & 20): When we originally entered into the agreement with the Navy to use the Cold Forming facilities in the development and production of commercial items, there were no known military requirements. We realized that if we did not continue to advance in this relatively new method of extrusion we would not long be able to remain in this field. It would only have been a matter of time until the manufacturing and engineering "know-how" which we had developed up to that time would be lost.

When the Navy had a requirement for the 2.75" general purpose rocket heads in 1965, we *were* in a position to deliver at the indicated rate of production required, namely 15,000 to 52,000 heads per month. The difficulty in meeting delivery schedules was not due to our lack of capacity, but rather to the unrealistic scheduling at the beginning of the contract. While we ordered steel immediately upon being awarded the contract, and the steel was delivered at the earliest possible time, September 27, 1965 to be exact, the September requirement of 15,000 pieces was an impossible task. As a result of this, we were not able to fully meet the schedule during the early months of the contract.

At about the same time, we were advised that the Navy anticipated a requirement of a minimum of 100,000 of these rockets per month. It was at this time that we indicated that a certain few pieces of equipment (New Britain Gridleys and an Annealing Furnace) would have to be replaced in order to guarantee such high production schedules. Our records showed that from the beginning of the production at our plant, back in 1952, we had produced approximately five (5) million rocket heads which were manufactured using these machine tools and furnace. This high production was the principal reason that these machines had to be replaced, plus the fact that the annealing furnace, by its very nature, is a self-destructive unit. It should be mentioned here that the installation of the replacement furnace necessitated the expenditure of $25,000 by Kelsey-Hayes for brick and mortar to house this unit.

As noted in your report, we did continue commercial production at the same time that we produced the new rocket head requirements in 1965 and 1966, but we maintain that at no time did this production interfere with our delivery commitments of military items.

Another important consideration relating to this contract is that it would have been necessary, had there been no military requirements, for this facility to be placed on "stand-by" and maintained in a ready to use condition. We estimate that such maintenance costs during the nine year period would have been in excess of $2,000,000, which the Government would have had to pay to keep this facility on "stand-by". We would like to point out that during this period, not only was the Government relieved of this heavy maintenance charge, but the Heintz Division also paid rental in excess of $500,000 for the use of these facilities on commercial work.

Current Lease Terms Permit Inequities—(Pages 27 & 28): Consideration in the amount of $5,000 was agreed upon in payment of rental of support type equipment on which rental had not been paid. Copies of correspondence relating to this settlement are enclosed. A Procedure has been established with DCASR and DCAA for the payment of rental on this class of equipment for periods subsequent to the GAO review.

With reference to the paragraph relating to our Navy facility and the 2% rental clause contained therein, we submit that we have calculated and paid rental in accordance with the terms of our contract, ASPR notwithstanding.

General—(Pages 52, 53 & 54): The marginal notes on these pages made reference to special tooling used in the production of commercial components. During the review we referred the GAO representatives to either our customers or their respective Contracting Officers regarding control of and authorization to use any special tooling located in our plant.

We trust that the foregoing information, together with the attached correspondence, will enable you to document our position when you report back

to the Subcommittee on Economy in Government. Joint Economic Committee. Congress of the United States.

Very truly yours,

JOHN H. HORNBERGER.

HEINTZ DIVISION, KELSEY-HAYES CO.,
December 9, 1966.

Subject: Commercial Use of Government Facilities.

Mr. LEON RUDERMAN,
General Accounting Office,
Philadelphia, Pa.

DEAR MR. RUDERMAN: In 1949 the Heintz Manufacturing Company entered into a facilities contract with the U.S. Air Force to manufacture jet engine components for the General Electric Company to be used in the production of jet engines for the Military. At about the same time, Heintz also entered into production of engine parts for the Allison Division, General Motors Corporation. Allison, under a facilities contract with the Air Force, also arranged for the installation of facilities at Heintz. For the most part the original equipment supplied by the Government came from reserve stocks. Later on, some new machine tools, such as 'Bullards' and spot welders, were furnished. The engines for which Heintz was manufacturing components at that time included the J–33, J–35, J–47, J–71, and J–79. All applications of these engines, at that time, were Military. Allison also developed a turbo-prop engine known as the T–56 for which Heintz made many parts. This engine was used to power the C–130 transport, also a military aircraft.

For several years all of the parts manufactured by the Heintz Manufacturing Company were used for Military engines. Sometime during the '50s, Allison started producing a commercial version of the T–56, to be used in the Lockheed 'Electra,' a commercial passenger ship. This was the first Commercial application of a jet engine (turbo-prop) to be produced with the facilities supplied by the Air Force to Heintz. Agreement was reached through the Contracting Officer of our facility and the Contracting Officer at Allison to pay rental on the basis of a percentage of sales volume of the commercial parts produced. The extent of this production was very small and the rental was not substantial; however, it was paid quarterly in accordance with the contract.

During the mid '50s, Heintz entered into production of J–57 engine components for Pratt & Whitney for engines supplied to the U.S. Navy, and with Ford Motor Company for the production of the same engine parts for the Air Force.

The foregoing pretty much covers the history of the facilities contracts while the plant was operated as the Heintz Manufacturing Company.

In September, 1957, the Kelsey-Hayes Corporation, Detroit, Michigan, acquired the Heintz Manufacturing Company and assumed all contractural obligations in effect, including those with the various Department of Defense agencies. There was no change in the administration of the facilities contracts on the part of the contractor as a result of this change of ownership. The Heintz Division still sought to produce engine parts for the Military using the facilities available.

Aircraft engine production for the Defense Department in the late '50s softened considerably and the engine manufacturers, no doubt, sought further use of their product in Commercial aircraft. It must be remembered that these engines were almost identical to the Military versions and were made, for the most part, off of the same production tooling. In fact, parts could be made on the same line that would be used for either Military or Commercial aircraft.

Along about '61–'62, as more of the Heintz Division's customers were supplying commercial engines, the Heintz Division started to calculate the rental charge for commercial usage of our facilities on a utilization basis. The Heintz Division was unaware of any restrictions as to the percentage of commercial use on an individual piece of equipment so long as it paid rental in accordance with the contract. Therefore, Heintz (Division) could show usage on specific pieces of equipment which exceeded any given percentage for any particular period of time. If Heintz (Division) were required to schedule the use of equipment with a maximum limit of time it could be used on Commercial parts, this would mean many additional set-ups and would hamper the Production Department so much that it would seriously effect the cost of parts being produced. In the interest of good production practice it would seem rather ridiculous to tear down and set up, tear down and set up, just because a certain part coming

through the line at one time is for a Military engine and another part is for a Commercial version of the same engine.

We, therefore, submit that although usage on certain pieces of equipment exceeds the twenty-five per cent (25%) 'bogey' established by the Department of Defense as a criteria for retaining facilities under a Government contract that the interest of the Government is best served by permitting the contractor to use the facilities in the most productive manner possible in order to make parts at the lowest cost for the engine manufacturers and, at the same time, better utilize the facilities.

In addition to producing jet engine components since the inception of the facilities contracts, we have also supplied hardware to NASA for such programs as 'Mercury' and 'Apollo.' We have also produced parts for the 'Recruit' and the 'Bullpup' missile weapons systems. All of these parts were produced by using the facilities supplied by the Government, as well as Heintz-owned equipment. It should be pointed out that at no time has the Heintz Division solicited anything but aircraft or missile work for these facilities. The evolution of commercal jet aircraft after the development by the Military of the feasibility of jet flight was the factor which led to Heintz producing other than Military requirements with the equipment covered by the contracts. And, in accordance with the terms, the Heintz Division has paid rental for such usage.

The Management of the Heintz Division is of the firm opinion that the Government has benefited in many ways as a result of the investment it has made in equipment: lower piece prices for all parts produced because no depreciation charges were included in the costs; lower piece prices due to the increased volume as a result of commercial applications (Heintz has shipped approximately $150,000,000 of aircraft & missile components); the engineering and production know-how of Heintz that resulted in improved design and performance of the engines; the availability of a completely tooled and highly qualified supplier during two military involvements of the United States (Korea & Viet Nam.) As demonstrated in the past, it becomes necessary in certain national emergencies for the Government to take over numerous commercial jet aircraft to transport troops and materiel. This was true during the Cuban Crisis and also in Viet Nam. It can be said, without too much chance of contradiction, the commercial jets flying today represent a reserve force to be called upon by the Military in the event of such emergency. These factors, plus many others, certainly are to be considered in any evaluation of the performance of Heintz under the facility contracts included in your review.

The Management of the Heintz Division would be happy to discuss any phase of your study with any technical or other interested personnel from any branch of the Government. The Management of the Heintz Division wants to assure all concerned that at no time has Kelsey-Hayes or the Heintz Manufacturing Company its predecessor, gone out into the market to secure Commercial business, per se to be run over these facilities. It just so happens that the production of jet aircraft has gone from one hundred percent (100%) Military to a mixture of Military and Commercial. Right now the backlog in this line of the Division's business reflects a two-to-one ratio of Military to Commercial work. Essentially, it boils down to the fact that if we do not have the facilities to manufacture the Commercial parts for customers, we can not produce the Military requirements for these same customers. As your study will reveal, the Heintz Division is a very important supplier (in cases the sole source) to Pratt & Whitney, General Electric, Lycoming Division of Avco Corp., and the Allison Division, G.M.C., of parts for engines used in practically every Military aircraft & helicopter flying today.

The Management of the Heintz Division would welcome the opportunity to discuss any phase of your study with any interested Government Agency.

Very truly yours,

J. F. MoMAHON, *Controller.*

HEINTZ DIVISION, KELSEY-HAYES CO.,
Philadelphia, Pa., February 9, 1967.

Mr. J. TKACHYK,
General Accounting Office,
Philadelphia, Pa.

DEAR MR. TKACHYK: During the meeting with Mr. Watson and the writer on Friday, January 27, 1967, you and members of your staff reviewed some of the highlights of the study which you made of the facility contracts which we have

with the Air Force and the Navy. Certain points were made by your group during this discussion and we will try to elaborate on our position and state the facts as we see them.

With regard to the surplusing of certain facilities under the Air Force contract, we welcome an opportunity to sustain our position and need with the appropriate technical people from D.O.D. We feel that we will be able to justify the retention of these facilities and assure you that if any pieces are not needed in our operation, we will certainly declare them surplus. As we pointed out, the production problems experienced in producing the various engine parts for which we have orders cause an imbalance in machine utilization. There are many reasons during the course of any given month why certain equipment shows a low utilization as opposed to any criteria which we might attempt to work to.

We feel that it would not be in the best interest of the Government to remove equipment from our facility which might detract from our capability of being an outstanding producer of jet engine components. The manufacture of parts for aircraft jet engines, whether they be for commercial or military use, requires the stame facilities, manufacturing "know-how", and in many instances the exact same tooling. As we have stated, our Company has in the past year either expended or committed in excess of $1,500,000 for manufacturing facilities to add to our production capabilities in this area. This money is being spent for machine tools to supplement the Government owned facilities and to round out a production complex that will produce quality parts at minimum cost to our customers. Much more, no doubt, will be appropriated as the need arises.

As you know, most of the equipment covered by the Air Force contract is in excess of ten years old, and any equipment that has been acquired under this contract since 1957 has been used equipment, either from other locations or out of surplus stock. In many cases, this equipment was brought into our plant at our expense, overhauled, and put into operating condition. When we used them for commercial parts, we, of course, paid rent. When used for military parts, the Government has had the benefit of the equipment at no cost to them for the removal from the previous locations and the reinstallation at our plant.

The instances that you pointed out to us where we were not in complete compliance with the contract will be given our attention and we will take the necessary steps to comply with the terms and conditions in the future.

During our discussion of the Navy Facility, the statement was made that we were producing commercial parts during the same period of time that the Navy requirements were not being met. It was implied that this was due to the fact that we were giving priority to the commercial activity on equipment which should have been producing Navy parts. This is absolutely not the case. The equipment referred to that was being used on commercial work could not by any stretch of the imagination have held the tolerances required to produce the 2.75" general purpose rocket. The main reason for our not being able to meet the requirements of the Navy during the first production contract was that the delivery schedule in the contract was unrealistic. We actually received the "go ahead" from the Navy in the middle of August 1965. We immediately ordered the steel from the mill. The first shipment was received in our plant on September 27, 1965, and yet the delivery requirement of the contract was that we ship 15,000 completed rocket heads during September. This, as you can see, was a physical impossibility. When we finished the production of the first contract, which was in April 1966, we immediately began shipping on the second production contract. This would not have been possible, had we not released orders to the mill at least six weeks in advance of having been awarded the second quantity, and by our action we guaranteed the continuation of deliveries between the two buys. This certainly demonstrates that we were interested in filling the Navy requirements, even to the extent of ordering material without any firm commitment from the Navy.

It should also be stated that during this same period of time, we were producing the 2.75" rocket base blanks to be used in the manufacture of the pearlitic malleable rocket, which was one of the ten top priority items on the Department of Defense list for Vietnam. This production has now increased to the extent that we shipped 263,000 units in the month of January 1967. While we do not make the finished product, we supply the base to at least ten important producers of this rocket throughout the country. It should be pointed out that we developed the process to produce this part in conjunction with the Frankford Arsenal to fulfill a demand which was not able to be supplied by the malleable iron foundry sources in this country.

With regards to the replacement of the five New Britain Gridley lathes and the Despatch furnace, at the time our request was made for this replacement, all indications which we had from the Navy were that there would be a requirement of unknown duration for the production of the 2.75" general purpose rocket at the rate of 100,000 per month. It was our opinion that it would be in the best interest of the Government to replace the above equipment as we could not guarantee such high production quantities with the existing equipment.

You asked for our position as to the Navy continuing to maintain the facility contract with us. We would like to point out that the equipment under this contract is special purpose equipment with a limited number of applications. Over the several years we have worked with the cold forming process, we have been able to develop commercial applications making use of much of the facility. We feel that the Navy should continue on this basis since we have proven that we could produce military items on short notice without having to go through the reactivation expense and the start-up time required to place heavy production equipment back into operation. At the same time there has been no cost to the Navy since 1958 for the maintenance of this facility on a stand-by basis. For your information, these costs would have exceeded $200,000 per year based on prior amendments to the contract. During this same period of time, we paid over $500,000 in the form of rental for the commercial application of these facilities.

We recognize the right of the Navy to review at any time their commitment under this contract, but we respectfully submit that any changes to the present agreement would have to be agreeable to both parties.

If you feel that there is any further information we can supply that will be helpful to you to completely evaluate our position concerning both the Air Force and Navy contracts, please do not hesitate to contact the writer.

Very truly yours,

JOSEPH F. MCMAHON, *Controller.*

HEINTZ DIVISION, KELSEY-HAYES CO.,
December 9, 1966.

Subject: Justification of Retention of Equipment.

Mr. LEON RUDERMAN,
General Accounting Office,
Philadephia, Pa.

DEAR MR. RUDERMAN: The Heintz Division of the Kelsey-Hayes Company is a complex and diversified jobbing shop. Over the years, the Aircraft & Defense Products Department has had many jobs, both of long and short duration, requiring all types of equipment and many varied processes. Since the Heintz Division is not a prime contractor and is bidding on a very competitive basis as a means of giving the Government the best possible cost, the Heintz Division can not, at any time, forecast or commit any particular unit or group of equipment to any specified utilization. In general, the Heintz Division maintains a facility that is flexible and equipment usage that past experience tells is a good, useful, and competitive resource to the prime contractors who, in turn, can supply the Government with quality products at competitive prices.

By nature of this type of operation, there are some problems in scheduling since many jobs require specialized set-ups and specialized tooling. Due to the many and varied reasons forthcoming from the customer, these jobs are in a continual state of flux; i.e., engineering changes, testing, supply problems, etc. As this indicates, the Heintz Division is at the beck and call of its customers and this leaves very little room for definite determination of machine utilization over a prolonged period of time. A good job is done by scheduling equipment in such manner as to limit the cost to any particular job. Long set-ups and specialized set-ups are changed as infrequently as possible; i.e., low utilization but in the interest of efficiency and cost this is the proper method of operating. Short set-ups and simple set-ups are grouped together and these are made as often as possible. This results in a higher utilization of that particular equipment.

Another area of equipment usage is that of repair and correction of machine tools, fixtures, dies, etc. This equipment is used as "support" to the actual production equipment and, as such, utilization is not recorded.

Still another area which utilizes consigned equipment is the Research & Development Department. This particular Department does prototype and development work which, again, is impossible to record. The usage is almost continuous and a considerable amount of the time is used in specialized setting-up, checking of processes and results, and the establishment of new processes. There is no machine assignment, but rather a continual group-decision process as to the operations to be performed, the equipment on which the work is to be done, when it is to be scheduled, etc., as each new detail is brought through the line.

At the same time there is this facet of the operations that contributes considerably to down-time on all equipment. This is the area of maintenance and waiting for approval of parts running across the equipment. This, too, is not recorded.

As evidenced by this information, the Heintz Division can meet general usage requirements on the various classifications of equipment and can establish an average monthly usage as follows:

	Hours per month average
"Cutmasters" and "Man-u-trols"	50
Seam and Spotwelders	20
Radial drills	50
Milling machines	50
Drilling machines	30
Presses	[1] 25
Lathes	30
Miscellaneous	[2] ?

[1] High set-up, slow operational time.
[2] "Support" equipment.

Spotwelders and seamwelders are normally used on specialized set-ups and from experience it has been found they move considerably faster than the equipment supplying the parts to the welders. Since the set-ups are difficult and it is necessary to maintain an absolute assurance of good welding, the equipment shows less utilization than would be expected.

This same condition exists in the other areas of small equipment, such as, lathes, drills, etc. The equipment is used mainly for support and in-process lines which are dependent on the major equipment for parts supply and speed of operation.

Attached is a listing of various pieces of equipment with notations describing their particular job assignments and/or condition.

The Management of the Heintz Division believes that the Government has realized many benefits from the usage of the facilities located here and welcomes the opportunity to discuss your study with any interested Government offices.

Very truly yours,

C. Y. MEYER, Jr.,
Vice President—Manufacturing.

HEINTZ DIVISION, KELSEY-HAYES CO.,
June 22, 1967.

Subject: Contract AF 33 (657) 15658.

Mr. HARRY ORTH,
Contracting Officer, Defense Contract, Administration Services Region, Philadelphia, Pa.

DEAR MR. ORTH: We are in receipt of your letter of June 21, 1967, with reference to the payment of rental for the support equipment on the subject contract from March 1961 through July 1966. Accordingly, we are enclosing our check payable to the Treasurer of the United States in the amount of $5,000.00. This is in settlement of all past due rental on this support equipment during this period.

We appreciate your cooperation in finalizing this matter.

Very truly yours,

JOSEPH F. MCMAHON,
Controller.

DEFENSE SUPPLY AGENCY,
DEFENSE CONTRACT ADMINISTRATION SERVICES REGION,
June 21, 1967.

HEINTZ DIVISION, KELSEY-HAYES CO.,
Philadelphia, Pa.

(Attention: Mr. Joseph F. McMahon, Controller.)

GENTLEMEN: Reference is made to your letter dated June 16, 1967, offering $5,000.00 in settlement of all past rental on support equipment under Contract AF 33(600)42330 during the period March 1961 through July 1966.

Your offer has been reviewed and has been determined as being fair and reasonable. It further is accepted as complete settlement of all past rental due on the support equipment during the period involved.

Accordingly, it is requested that your check payable to the Treasurer of the United States in the amount of $5,000.00 be forwarded without delay.

Sincerely yours,

HARRY W. ORTH,
Administrative Contracting Officer.

BLADES MANUFACTURING CORP.,
Rector, Ark., December 15, 1967.

Re (B-140389) Report to the Congress—Need for improvements in controls over Government-owned Property in Contractors' plants.

U.S. GENERAL ACCOUNTING OFFICE,
Defense Division,
Washington, D.C.

(Attention: C. M. Bailey, Deputy Director, Defense Division.)

GENTLEMEN: In compliance with your request of November 29, Blades Manufacturing Corporation is pleased to submit its comment to that provision of the Report to the Congress on the need for improvements in controls over Government-owned property, which you indicated is applicable. Cited is that provision of the Report which you have referenced by marginal check, followed by Blade's comment.

"We noted instances at three other contractor locations where machines were used for commercial work without obtaining prior approval as required by facilities contracts." Report to the Congress, "Need for improvements in controls over Government-owned property in contractor's plants," p. 29, November 24, 1967.

Under the terms of Blades' present facility contract, the Contractor is entitled to 25% commercial use of Government-owned machinery during any rental period after obtaining authority from ACO. In order to so utilize such machinery an appropriate rental fee must be paid to the Government.

Blades Manufacturing Corporation can assure you that should the occasion arise in the future, whereby Blades finds it necessary to utilize Government-owned machinery for commercial use, authority to so use such machinery will be requested from the ACO. If authority is granted for Blades to utilize Government-owned machinery, such machinery will not be used more than the period of time which is allotted by the ACO for commercial use. Furthermore, the appropriate rental fee will be paid.

Respectfully,

HARRY C. BON, Jr.

THE UNIVERSITY OF CHICAGO,
OFFICE OF THE VICE PRESIDENT FOR BUSINESS AND FINANCE,
Chicago, Ill., December 11, 1967.

Mr. C. M. BAILEY,
Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR DIRECTOR BAILEY: We have reviewed the Report to the Congress forwarded to us with your letter of November 29, entitled "Need for Improvements in Controls Over Government-Owned Properties in Contractors' Plants." Our

review pertained primarily to those items identified by marginal notations as applicable to the University of Chicago. Following are our specific comments:

1. On page 60 of the report you commented that control over the taking of physical inventories was inadequate because procedures do not provide for the appropriate segregation of duties of personnel. We agree that this is a valid criticism and procedures have been revised so that required physical inventories will now be taken by persons having no responsibility for custody of the equipment.

2. On page 60 you indicated that several items of equipment were purchased in 1966 without "required screening at DIPEC." It is our feeling that failure to obtain such screening was due to misunderstandings concerning when screening was required. In any event, procedures have now been revised by the various DOD agencies to assure such screening and we are complying with these revised requirements.

3. At the bottom of page 60 and the top of page 61 is the comment that IPE purchased by universities was not reported to DIPEC. As in the previous comment, we were not aware that in failing to report certain purchases of equipment we were not complying with ASPR. Our procedures have been revised and all IPE is being reported promptly to DIPEC via the Agency.

4. On page 61 is the comment that title to several pieces of equipment was transferred to the University while DIPEC considered such equipment in short or critical supply. We are unable to effectively comment on this criticism since the determination of the need for various types of equipment by other DOD agencies can only be made by such agencies. It should be mentioned, however, that the fact that title was transferred to the University does not in any sense mean that the equipment was excess to government research being conducted by the University.

5. On page 59 is the comment that financial control accounts were not required to be maintained by universities for IPE and special test equipment, nor were they being maintained by The University of Chicago. We do not agree with this criticism. Actually, financial control accounts are being maintained for government equipment. Admittedly, these control accounts are not maintained independent of the individual responsible for the detail inventory records and, therefore, the procedure does not conform to classic internal control afforded by segregation of duties. It is, however, our belief that adequate financial control does exist over government-owned equipment. Although the establishment of an independent financial control account would, in theory, provide additional control, it is our belief that the special problems concerning the proper identification of government equipment are such as to require considerable involvement by persons closely identified with this equipment. As a result, little if any additional control would, in fact, be established. We would be pleased to discuss this matter in detail with your representatives to see whether additional control can be established in a practical manner. Insofar as we know, no equipment losses have taken place as a result of any inadequacy in financial controls.

We appreciate the opportunity of responding to this report and, if we can be of further assistance, please let us know.

Sincerely,

G. L. LEE, Jr.

SELB MANUFACTURING CO.,
Walnut Ridge, Ark., December 15, 1967.

Re (B–140389) Report to the Congress—Need for improvements in controls over Government-owned Property in Contractor's Plants.

U.S. GENERAL ACCOUNTING OFFICE,
Defense Division,
Washington, D.C.

(Attention: C. M. Bailey, Deputy Director, Defense Division.)

GENTLEMEN: In compliance with your request of November 29, Selb Manufacturing Company is pleased to submit its comments to those provisions of the Report to the Congress on the need for improvements in controls over Government-owned property, which you indicate as applicable. Cited are those specific provisions which you have referenced by marginal check followed by Selb's comments to each.

"We questioned retention of 133 items of IPE, estimated to cost $3.3 million, which had not been in use for extended periods of time. On the basis of our review

of utilization surveys conducted by Government property officials, we concluded that in many cases undue reliance had been placed on the prospect of future production creating valid needs or desirable utilization levels for the IPE reviewed as illustrated below." Report to the Congress, "*Need for Improvements in Controls Over Government-Owned Property in Contractor's Plants.*" p. 13, November 24, 1967.

Selb Manufacturing Company realizes that, at all times, the proper reports as to machine idle time were not submitted.

At the present time, Selb has an ample supply of material which requires machining under Government facility contracts. As a result, all Government-owned machines are in operation and are expected to remain so for quite some time.

Selb Manufacturing Company can assure you that, henceforth, all proper procedures will be followed as to the reporting of Government machinery which is of no more use in Selbs manufacturing operation.

"Our review established that, of the 17 contractors examined, only five contractors maintained adequately comprehensive machine-by-machine utilization data. Two of the five contractors accumulated the data by manual postings and the other three through mechanized procedures (tab card system). One of the contractors was converting from mechanized procedures to an electronic data collection system designed for manufacturing industries. Included among the applications of the electronics data collection system is 'machine and tool utilization,' and we observed that three of the remaining 12 contractors reviewed were in the process of installing similar systems at the time of our review." Id. p. 22

At the time of Government inspection of facility Contractors, Selb Manufacturing Company was in the process of converting from an over all utilization reporting system to a machine-by-machine reporting system. Due to unfamiliarity with the new system in the plant, records, at first, were not kept as accurately as perhaps they might have been. However, now that Selb's employees are more familiar with the machine-by-machine reporting system, Selb Manufacturing Company feels that such a system is much more accurate and positive than an over all reporting system. Therefore, Selb Manufacturing Company will continue to utilize comprehensive machine-by-machine data in the future to report machine usage, as recommended by the Comptroller General.

"We noted instances at three contractor locations where machines were used for commercial work without obtaining prior approval as required by the facilities contracts." Id. p. 29

Under the terms of Selb's present facility contract, the Contractor is entitled to 25% commercial use of Government-owned machinery during any rental period. In order to use Government-owned machinery, permission must be obtained from the ACO and appropriate rent must be paid to the Government.

Selb Manufacturing Company can assure you that if the occasion arises in the future, whereby Selb finds it necessary to utilize Government-owned machinery for commercial use, authority to so use such machinery will be requested from the ACO.

If authority is granted for Selb to utilize Government-owned machinery, such machinery will not be used more than the period of time which is allotted by the ACO, and appropriate rent will be paid for the use of such machinery.

"The maintenance of utilization data for Government-owned IPE, as recommended in our discussion of utilization practices, would provide the basis to more accurately compute rent on an item-by-item basis. The feasibility of maintaining use records, machine-by-machine, has been established by five contractors included in our review, and one of the contractors was computing rent in the manner in which we suggested, as detailed above. Moreover, such a procedure would eliminate discrimination in rates charged to different contractors because the credits would be uniformly computed for each item based on actual machine hours used. Broad allocations are appropriate in those cases where Government versus commercial machine usage cannot be tabulated, such as for certain common support equipment or for IPE below an established value where no utilization records are maintained. Further, the tabulation of utilization data could be expected to disclose commercial use for which approval had not been requested and thus supplement the present complete reliance on floor checks." Id.p.30

Selb Manufacturing Company concurs with the Comptroller General's conclusion that rent on Government-owned machinery should be computed on an

item-by-item basis. As was stated previously in this letter, Selb presently computes machine time used on a machine-by-machine basis and has found it quite satisfactory. Selb feels that computing rent on an item-by-item basis would prove equally satisfactory and, as the Comptroller General has stated, would eliminate discrimination in rates charged to different contractors.

"*Property Administrators' Surveillance and Approval of Systems.*—Our review showed that the property administrator had withheld approval of systems employed at five of the 19 contractors in our review. Further, we found that ASPR does not provide an incentive for the contractor to maintain an approved system." Id.p.64

Selb Manufacturing Company has implemented procedures for maintenance of Government-owned equipment and for accounting of Government property, which have been approved by the ACO. In the future Selb will continue to comply with these procedures.

Respectfully,

HARRY C. BON, Jr.

RAYTHEON CO.,
Lexington, Mass., December 14, 1967.

Mr. C. M. BAILEY,
Deputy Director, Defense Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. BAILEY: Thank you for the opportunity to review the General Accounting Office Report (B–140389) to the Congress on the subject of control of Government-owned property at contractors' plants. I have read the report taking particular note of those sections which you have identified as being applicable to Raytheon Company. As an attachment to this letter, I have included specific comments to those sections in response to your letter of November 29, 1967.

In this covering letter, I should like to set forth a few basic considerations which, from industry's viewpoint, pertain to the subject of the GAO Report. Raytheon, along with hundreds of other major suppliers to the Department of Defense, has a firm policy of conducting its defense business in accordance with the requirements of ASPR and other Government regulations. In this process it is not unusual to be faced with conflicting requirements which dictate a choice on the part of the contractor. This choice can only be made in favor of what appears to be the practical solution based on the facts available at the time the decision must be made.

As an example, we have contractual requirements to maintain a production capability of a certain quantity of HAWK missiles per month. Our capability is entirely dependent upon the availability of the special tooling and test equipment initially acquired for production of this equipment even though it is not presently being used and there is no positive assurance that it will ever be used. As we understand it, the GAO Report's recommendation is that we should declare this special equipment as surplus because of a low utilization factor. We have, however, elected to retain this equipment since we consider our contractual requirement both proper and practical. Obviously, with the world situation as it is, the Department of Defense cannot afford to destroy a quick-reaction capability for critical weapons such as the HAWK when the cost of maintaining such a capability is miniscule compared to the cost of the system itself.

It also appears to us that a more practical approach to the treatment of special test equipment within the DIPEC could be considered. We have no fault to find with the speed with which DIPEC responds to our requests for screening. We do have a problem, however, with some of the equipment we have received.

Special test equipment, by its very nature, generally receives very heavy use during the period of performance of the contract for which it was designed. It is a type of equipment which can and does wear out. We would recommend serious consideration be given to setting a limitation on the age of test equipment which is maintained by the DIPEC. The cost saving to the Government in having this kind of equipment available for reuse by contractors is often outweighed by the cost of collecting, refurbishing, storing and maintaining it before it can be considered for a new program with perhaps indefinite life requirements.

I am sure that the specific comments contained in the attachment to this letter will clarify in greater detail more of the problems faced by contractors who are

conscientiously attempting to comply with all of the requirements. We believe that we have a good property control system here at Raytheon. We are in the process of making it better, and I assure you we will continue to strive for improvement in this very important area.

I hope this reply is responsive to your request. Should you need any additional information, please feel free to contact Mr. Stephen W. Rowen, who is our Corporate Director of Government Contracts.

Sincerely,

THOMAS L. PHILLIPS.

This attachment identifies each section of the General Accounting Office Report by page and paragraph number with the Raytheon position stated directly beneath.

Raytheon maintains its control of Government property through the use of Property Administrators at each plant or laboratory. The basic policy for the administration of Government property is issued by the Corporate Director of Government Contracts in the form of a Government Property Manual. Each division implements the basic policy instructions with detailed procedures suited to the particular location.

Page 16, para. 4

(a) Raytheon Company had not screened the Defense Industrial Property and Equipment Center (DIPEC).

Partial Concurrence: The screening of DIPEC for items of special test equipment did not become a contractual requirement until early 1966. Upon receipt of the initial contracts requiring DIPEC screening, procedures were drafted to insure proper compliance with the new requirements. There was, however, an interim time when items of special test equipment were procured and screening of DIPEC had not been accomplished. We now have procedures to insure that all items of special test equipment valued at $1000 or more are being screened through DIPEC and certificates of nonavailability are received prior to the placing of any purchase orders for special test equipment.

Page 16, para. 5

(b) Raytheon Company had over 2400 items of test equipment on hand which were not presently needed but were being held for possible future use.

Nonconcurrence: The 2400 items which were stated as being held for future use were, in fact, items of test equipment which were required to maintain a specific production capability for the HAWK Program; including Basic HAWK, Self-Propelled HAWK, HAWK Improvement Program and Saudi Arabian HAWK. This requirement is contained in Contract No. DA–19–020–ORD–4030, Modifications 16 and 25. There may have been a misunderstanding concerning equipment not presently being used, but being held in reserve as spares. This equipment may have little utilization, but is necessary to maintain a pool of spares to replace equipment requiring calibration or repair. Whenever a determination is made that any item becomes excess to the needs of production and spares requirements, the proper disposition action is initiated through the local Government Property Administrator, and in turn to DIPEC is applicable.

The GAO Report states that these items were not reported to DIPEC. After a careful review, the greater percentage of items were found to be under $1000 in value and, therefore, not reportable to DIPEC.

(c) No system of use data had been maintained for industrial plant equipment.

Concurrence: We do not consider that it is the general industry practice to record and collect usage data on test equipment of this type through a formal and rigid reporting system. It has been determined that the cost associated with the initiation and maintenance of such a system would exceed the benefits derived. We will periodically review this position considering future business and the types of equipment involved.

Page 50, para. 2

(d) Policies provide for a complete inventory of special tooling at least once a year. We found that physical inventories had been taken only at the completion of contracts. Therefore, yearly inventories were not accomplished in accordance with the procedures.

Concurrence: A physical inventory of special tooling is taken at the completion or termination of a contract. However, it should be noted that production equipment and plant equipment are inventoried on a cyclical basis. We are currently undertaking a program to inventory special tooling during the Year 1968. Special tooling history cards are also maintained in accordance with ASPR requirements and IBM reports are available reflecting additional information that may be desired concerning the special tooling.

Page 50, para. 7

(e) There were occasions, however, when the prime contractor had requested the subcontractor to verify special tooling in its custody.

Concurrence: We are pleased that the GAO Report takes note of the fact that we maintain a policy of periodically requiring a physical inventory of special tooling at subcontractors' plants to be taken by the vendor and that the results of such inventory are reported to Raytheon. IBM reports are maintained to reflect the inventory verification as well as tool history records containing the subcontractor's name and the tools for which he is accountable.

Page 56, para. 2

MATERIAL

(f) Financial accounting controls not maintained.

Nonconcurrence: Raytheon Company agrees that individual stock record cards as maintained by Inventory Control personnel for material in stores do not reflect the total value of the quantity of items in the stockroom according to the data reflected on the stock record card.

There is no requirement in ASPR to include such information on stock cards, nor has Raytheon found it necessary to establish a duplicate set of accounting records in this manner. Physical movement of material from such stockrooms is recorded on material control documents by personnel within the inventory control area. The pricing of such action is performed on a controlled basis by personnel within the Controller's Department to insure that the dollars for cost purposes flow with the material from stores to the appropriate account established to collect costs for the item being manufactured and/or shipped.

Page 57, para. 2

(g) Physical inventory taking is ineffective.

Nonconcurrence: Physical inventory of Government material at the Andover Plant is accomplished on a cyclical basis by storekeepers. The stock record cards are maintained by the Inventory Control Section, and the personnel associated with this section are separate and not connected with the storekeepers who take the inventory. Raytheon also maintains a separate internal audit staff that periodically verifies physical inventories of Government material. The physical inventory procedures are so structured that one individual may not make any improper adjustments, and any adjustment required is reviewed by responsible management.

APPENDIX 5

REPORT TO THE CONGRESS OF THE UNITED STATES—IMPROVED INVENTORY CONTROLS NEEDED FOR THE DEPARTMENTS OF THE ARMY, NAVY, AND AIR FORCE AND THE DEFENSE SUPPLY AGENCY, DEPARTMENT OF DEFENSE BY THE COMPTROLLER GENERAL OF THE UNITED STATES

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., November 14, 1967.

B-146828.

To the President of the Senate and the Speaker of the House of Representatives:

The General Accounting Office has reviewed controls over depot inventories in the Department of Defense and found a need for substantial improvements. Our review was directed primarily toward examining into the accuracy of the inventory records for depot stocks held by the Departments of the Army, Navy, and Air Force and the Defense Supply Agency.

This report presents our conclusion that increased emphasis and attention is needed at all levels of management to improve the accuracy, and therefore the usefulness, of inventory stock records.

During fiscal years 1965 and 1966, stock records of selected depot inventories—averaging in value about $10.4 billion—had to be adjusted up or down an average of $2.4 billion annually in order to bring them into agreement with the physical inventory quantities.

We believe that these inaccuracies in the inventory stock records resulted from inadequate control over documentation affecting inventory records as well as over the physical assets. Such inaccuracies would, of course, adversely affect any supply system's responsiveness to requisitions for material. Only when inventory records are accurate and current can they be relied upon for determining whether requisitions can be filled or whether procurements or repair actions are necessary.

In commenting on our review, Department of Defense officials agreed, in general, with our findings and proposals for corrective actions. We were advised that each of the military services and the Defense Supply Agency had initiated specific programs to eliminate the inventory control problems discussed in this report and were installing new procedures designed to provide more accurate inventory controls. We were told that the installation of the new procedures had advanced to the point where results could be expected shortly.

We are reporting this matter to the Congress so that it may be apprised of the need for improvements in the control of depot inventories and of the actions that the Department of Defense has indicated the military services and the Defense Supply Agency have taken or planned to improve and strengthen the management controls over these inventories.

Copies of this report are being sent to the Director, Bureau of the Budget; the Secretary of Defense; the Secretaries of the Army, Navy, and Air Force; and the Director, Defense Supply Agency.

ELMER B. STAATS,
Comptroller General of the United States.

CONTENTS

Introduction.
Background.
Findings.
Need for improvements in the control of inventories.
Significant differences between stock record balances and items in depot inventories.
Exceedingly large number of special inventories.
Inaccurate stock locator records and weakness in receipt control.

Prescribed inventories not accomplished.
Army.
Navy.
Air Force.
Defense Supply Agency.
Receipt and issue documentation not adequately controlled and proper reconciliations not performed.
Physical inventory adjustments not researched.
Internal audit reports show stock record inaccuracies and related difficulties are a continuing problem.
Agency comments.
Conclusions.
Scope of Review.

APPENDIXES

I. Principal officials of the Department of Defense and the Departments of the Army, Navy, and Air Force responsible for administration of the activities discussed in this report.
II. Department of Defense CONUS depot inventory management data for fiscal years 1965 and 1966.
III. Letter dated July 21, 1967, from the Deputy for Supply and Services, Office of the Assistant Secretary of Defense (Installations and Logistics), to the General Accounting Office.

REPORT ON IMPROVED INVENTORY CONTROLS NEEDED FOR THE DEPARTMENTS OF THE ARMY, NAVY, AND AIR FORCE AND THE DEFENSE SUPPLY AGENCY, DEPARTMENT OF DEFENSE

INTRODUCTION

The General Accounting Office has performed a limited review of the effectiveness of inventory controls in the Department of Defense. Our review was directed primarily toward examining into the accuracy of the inventory records for depot stocks held by the Departments of the Army, Navy, and Air Force and the Defense Supply Agency. Also, it was concerned with the degree of compliance at selected locations, with the Departments' and the Agency's prescribed policies and procedures for maintaining stock record accuracy through scheduled physical inventory programs, and with the extent to which inadequate physical inventory practices and the associated adjustment of inventory records may have contributed to any record inaccuracies at those locations.

This review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Our field work was conducted during the period June 1966 to January 1967 at selected activities of the Departments of the Army, Navy, and Air Force and the Defense Supply Agency. Additional information concerning the scope of our review is shown on page 26.

BACKGROUND

The military departments' task of supply management is to provide materiel support to their organizations at a minimum cost. So that supply economy may be achieved, no more money should be invested in inventories than is necessary for effective support. If this objective is to be attained, accurate and current records of quantities of specific items in the inventory must be available for use in determining whether user requisitions can be satisfied and whether, on the basis of requirements computations, procurement actions are necessary. This entails controlling and accounting for an enormous number of items and an even greater number of transactions which daily affect the status of items in the inventory.

The basic authority which sets forth the policy to be followed by the Department of Defense in establishing control of and accounting for its inventory is provided for under sections 2202 and 2701 of Title 10, United States Code. Through these sections the Secretary of Defense is directed to prescribe regulations which will achieve the efficient, economical, and practical operation of an integrated supply system to meet the needs of the military departments without duplicate or overlapping operations or functions and to have records of major equipment items and stored supplies of the military departments maintained on both a quantitative and a monetary basis so far as practicable.

To accomplish this task, the Secretary of Defense has assigned the responsibility for inventory management to his Assistant Secretary for Installations and Logistics. As a part of its implementation of the above policy, the Department of Defense has directed that all items held in stock be physically inventoried not less than once each year either by full count or by statistical sampling techniques; however, exceptions are permitted for slow-moving items and other items, provided that storage conditions and lack of movement ensure adequate physical protection and accuracy of records. Also, the Department of Defense has directed that inventory records and reports be reconciled promptly on the basis of physical inventories.

Within the Department of Defense the basic record of accountability which shows by item the receipt, issue, adjustment, disposal actions, balances on hand, and other supply management data is the stock record account. The Departments now generally maintain this record of their commodities on automatic data processing equipment. Effectiveness of overall supply management is contingent upon the accuracy of stock records and financial records. In an effort to attain this accuracy, periodic physical inventories are required to be performed and the stock record balances adjusted to the actual quantities on hand.

Each of the three military departments and the Defense Supply Agency have published policies and procedures which direct the frequency for, and the procedures to be followed in, taking scheduled physical inventories of depot stocks. These procedures generally require a complete count at least annually of those items which have a high-dollar value, either because of unit cost or because of a large quantity of annual issues, and of those items requiring special attention or which are classified or pilferable. For other items the Departments, in most cases, direct that the physical inventories be accomplished by means of statistically sampling lots comprised of similar items. The results of the physical inventories by statistical sampling must meet prescribed accuracy objectives or the items sampled are subjected to a complete physical count.

The procedures of the military departments provide for special physical inventories which are one-time, unscheduled physical counts of one or more line items (1) when the stock record shows a balance on hand but the warehouse indicates no stock physically available to fill a request for the material (hereinafter referred to as warehouse denial), (2) to correct a suspected discrepancy between the recorded stock record balance and the assets on hand, and (3) on request from the inventory manager or another appropriate official. Therefore, these inventories are recognized by all the supply components of the Department of Defense to be emergency measures which are not meant to substitute for the scheduled physical inventory program.

To provide assurance that actual physical locations of stock correctly identified in the appropriate records, the commands require either a complete or a statistical sample comparison of the recorded location of stock with the physical location or vice versa. They also prescribe that prompt reconcilliations of the stock records with the physical counts be accomplished and that necessary adjustments be made to the stock records. Likewise the commands provide for suitable research to be conducted in an effort to determine causes for differences revealed by physical inventories and to make necessary procedural changes to preclude the recurrence of the problems.

Each of the military departments has established separate organizations that are responsible for the logistical mission and supply system management within the department. The principal organizational elements that carry out the functions necessary to that accomplishment are the inventory control point (ICP), stock control activity, and storage activity.

An ICP is responsible for systemwide direction and control of a number of categories of similar commodities. This responsibility includes development of worldwide quantitative and monetary inventory data. The stock control activity is responsible for maintaining inventory data on the quantity, ownership, location, etc., to determine availability of material for issue and to facilitate distribution and management of material. The storage activity is responsible for physical handling of the material incident to receipt, storage, and issue. These elements may be combined for groups of items in one organization at one location or grouped geographically in various combinations.

Inventories in the Department of Defense are valued at about $37 billion, excluding aircraft, ships, and supplies and equipment in the hands of using units. Our report pertains to approximately $10.4 billion worth of these inventories,

representing equipment and supplies held in major depots of the military departments. (See app. II.) This does not include inventories of vehicles and ammunition. The inventories included in our review are referred to as depot inventories throughout this report.

FINDINGS

Need for Improvements in the Control of Inventories

Increased emphasis and attention are needed at all management levels, in our opinion, to improve the reliability and usefulness of the inventory records for control of depot inventories within the Department of Defense. We found that substantive differences existed between stock record balances and the actual quantities of items in inventories throughout the depot supply systems.

The depot supply activities in the Department of Defense adjusted inventory records up or down an average of $2.4 billion annually in fiscal years 1965 and 1966, in order to bring the stock record balances into agreement with physical inventory quantities. The depot inventory for these 2 years averaged about $10.4 billion. The ratio of annual gross adjustment to total inventory for fiscal years 1965 and 1966 was approximately 29 and 18 percent, respectively.[1] The existence of this degree of inaccuracy and unreliability in the inventory records is not, in our opinion, conducive to the maintenance of effective and economical supply support.

The frequent and voluminous adjustments made to the stock records by the supply activities in an effort to correct the records were due, in large part, to an exceedingly large number of unscheduled special inventories. These special inventories, which were conducted primarily because of the lack of reliability of the records, frequently restricted the supply activities' capability to perform prescribed scheduled physical inventories. We found that, with the exception of the Air Force, the regularly scheduled physical inventories frequently were not taken and that, when taken, the results frequently revealed inaccurate stock records to an extent not considered acceptable by the supply activities' own standards.

Many factors have contributed to the existence of limited control over inventories. One of the primary factors, in our opinion, was the magnitude of inaccurate stock locator cards at the inventory locations. This not only had an adverse effect on supply actions but generated the need for conducting many of the special inventories. Other factors, which we feel contributed to inadequate inventory control, as reflected by the significant amount of inventory adjustments, were that:

1. Physical inventories were frequently made without proper control of documentation for receipts and issues occurring during the period of the inventory.
2. Proper reconciliation between the physical inventory count and the stock records was often not made at the completion of these inventories and causes of the imbalances were not determined.
3. Prescribed inventory control procedures were not always followed by supply personnel.

Details of the more significant conditions noted during our review are discussed in the following sections.

Significant differences between stock record balances and items in depot inventories

During our review we found that significant differences existed between stock record balances and actual quantities of items in depot inventories. This is demonstrated by the high ratio of gross dollar adjustments to the average annual inventory. In fiscal years 1965 and 1966 this ratio ranged from about 13 percent to 60 percent for Department of Defense (DOD) wholesale supply services. The percentages for each of the DOD services are shown in appendix II.

At the two Army depots included in our review, we found that significant imbalances existed between the accountable stock record balances maintained

[1] One of the major factors contributing to this decline in percentage of gross adjustment was the Army Aviation Materiel Command's (AVCOM) reduction of gross adjustments from $817 million in fiscal year 1965 to $145 million in 1966. The gross adjustment in 1965 resulted in large part from complete inventories conducted at two depots that stored AVCOM items. Similar complete inventories were not conducted in 1966.

at inventory control points and the depot stocks physically on hand. Between December 1965 and September 1966 these two depots took scheduled physical inventories of 26 lots by prescribed statistical sampling methods. An inventory lot generally comprises a number of items of the same Federal supply class. Of the 26 lots, 20 failed to meet the prescribed accuracy objective. For these 20 lots, 7 to 40 percent of the items sampled did not agree with the stock record balances. The overall average error rate for the 20 lots was about 15 percent.

The Naval Supply Systems Command monitors the system-wide accuracy of Navy stock records through quarterly reports of physical inventory performance which are submitted by Navy stock points. For fiscal years 1965 and 1966, these reports showed that an average overall stock record error rate of about 21 percent was experienced by all Navy stock points. However, the Navy's actual system-wide stock record error rate may be significantly higher than this reported 21-percent rate since this statistic included the number of Defense Supply Agency (DSA) items that were inventoried but excluded those which required adjustment.

For example, at one supply center included in our review, the quarterly reports of physical inventory performance for fiscal years 1965 and 1966 showed that about 28 percent of the Navy line items inventoried required stock record adjustments. The quarterly reports showed that stock record adjustments, totaling $33 million, were required for about 145,000 Navy items of the total 507,000 items physically inventoried in fiscal years 1965 and 1966.

We found that 268,000 DSA-owned items at this Navy stock point had been included in the total number of inventoried line items. Any adjustments required for these items were made by DSA and were not included in the 145,000 adjustments made by the Navy. Elimination of the DSA line items from the computation of the percentage of inventoried Navy items requiring stock record adjustments would then show that stock record adjustments were required for about 61 percent of the Navy line items inventoried at this supply center. On the basis of this result, we believe that the total reported error rate for the Navy does not present a true picture of existing conditions.

During our review at the DSA supply activities, we found that in fiscal year 1966 one of the Defense depots conducted scheduled statistical sample physical inventories of 42 lots representing 541,012 line items managed by five Defense Supply Centers. The results of these inventories showed that 22, or 52 percent, of the lots sampled failed to meet the statistically acceptable accuracy criteria.

Exceedingly large number of special inventories

DOD supply activities, in an effort to locate stocks required for accomplishment of their supply support mission, depend to a great extent on an exceedingly large number of special inventories to resolve suspected differences between stock record balances and items on hand. In our opinion, the widespread use of such inventories, in lieu of improved inventory control practices, is costly and ineffective. Furthermore, the excessive workload associated with taking these special inventories frequently restricts accomplishment of scheduled systematic physical inventories.

Scheduled physical inventories, unlike special inventories, provide for systematic selection and scheduling of items for physical inventory on the basis of priorities established according to the characteristics of the items, such as dollar value, criticality, or classified sensitivity. The objective of regularly scheduled physical inventories is to achieve and maintain an acceptable degree of accuracy for each item in store rather than just to give attention to those item balances that are suspect or in an emergency situation.

The data furnished to us by the Army Materiel Command indicate that its depots, which are responsible for 514,000 line items of depot stocks, conducted over 900,000 special inventories between January 1965 and June 1966. From this it appeared that, in addition to regularly scheduled physical inventories, it was necessary to count each item an average of 1.7 times during the 18-month period. However, some items were counted many times. For example, one depot conducted, within a 30-day period, five or more special inventories for each of 92 items.

For fiscal year 1966, the Air Force Logistics Command indicated that its five active Air Materiel Areas (AMA) had conducted special inventories of 277,254 line items. This number of special inventories are equal to about 30 percent of the total items in their inventories. At the two Navy supply centers included

in our review, we found that, in fiscal years 1965 and 1966, approximately 90 percent of the inventory effort was concentrated on special inventories.

On the basis of our observations, we believe that a large number of these special inventories were generated by warehouse denials. For example, at one of the Navy supply centers included in our review, we found that about 37 percent of the 436,000 special inventories conducted in fiscal years 1965 and 1966 were generated because of warehouse denials. At one of the Air Force AMAs, we found that, for calendar years 1965 and 1966, approximately 19 percent of its 109,000 special inventories were necessary because of warehouse denials.

In their reports and in discussions with us, the officials of the supply management commands of the Army and the Navy cited the workload associated with the taking of special inventories as a reason for not taking their prescribed scheduled physical inventories. However, information obtained from the Air Force indicated that the AMAs conducted, with few exceptions, all of their scheduled inventories.

Inaccurate stock locator records and weakness in receipt control

The magnitude of inaccurate stock locator records as well as weaknesses in receipt control had, in our opinion, an adverse effect on supply actions and generated the need for conducting many special inventories.

In order that the warehouse personnel may be directed to the correct location to obtain material needed to fill requisitions, locator records are maintained by the depots to show item identification and warehouse location. Errors exist when there is a locator record for a particular item but the item is not found at that location or when there is no locator record for an item found at a particular location.

During the period September 1965 through November 1966, Army ICPs averaged over 15,500 warehouse denials a month. Our review indicated that inaccuracies in, or the absence of, stock locator records for specific items at Army depots contributed to this large number of warehouse denials. Army personnel analyzed 3,475 of these denials that were processed during the 4-month period ended in September 1966 by the two depots included in our review. This analysis showed that 35 percent of the denials were the result of inaccurate or missing stock locator records.

We concluded that, at the Army depots included in our review, adequate controls did not exist to provide reasonable assurance that (1) assigned warehouse locations for storage of incoming material receipts were being recorded in the computerized locator records and (2) incoming stocks were being stored in designated warehouse locations.

At these depots (1) a stock locator division is responsible for assigning warehouse storage locations for incoming materiel receipts, (2) a data processing division is responsible for input of assigned stock locations into computerized locator records, and (3) a storage division is responsible for storage of stocks in designated warehouse locations. We found that no centralized control existed over the interrelated functions of these divisions to provide assurance that materials were being stored in designated storage locations and that the storage locations were being entered in the computerized locator records.

The Navy found that a systemwide error rate of about 13 percent existed in stock locator records as a result of location audits performed at stock points from July 1964 through June 1966. On an average annual basis, the location audits revealed that, of the 6 million audited stock locations, about 778,000 were discrepant. The discrepancies revealed by the location audits included (1) material in storage but not shown on stock locator and/or stock records and (2) actual storage location of material in disagreement with the recorded storage location.

The two Navy supply centers included in our review, in our opinion, did not have effective controls over unbroken lot receipts [1] to ensure that materials were being properly stored and processed to accountable records within the prescribed 5-day period.

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[1] Materials belonging to the same commodity class, which are logged in at a central receiving point but for which receipt and storage documentation is furnished to receipt control only after the material has been stored.

We found that, if proof of storage was not furnished by the storage division within a reasonable period of time, the receipt control procedures at these supply centers did not provide for follow-up action. Without the signed warehouse copy of the receipt document, the receipt control division at these supply centers could not, under existing procedures, process this type of material receipt to the stock record accounts.

At one Navy location, we tested the receipt processing time required for 54 receipts of unbroken lots which were logged in at the central receiving warehouse during the period February 1966 to July 1966. We found that the processing time required for 38, or 70 percent, of these receipts ranged from 6 to 72 days with an average processing time of 18 days. We found also that three material receipts, valued at about $34,000, had been in storage for varying periods, ranging from 76 to 200 days, but had not been recorded on the accountable records. After we brought this matter to the attention of officials, the three material receipts were processed to the accountable records.

During the 3-month ended September 1966, the Air Force AMAs conducted special inventories on about 72,000 items as a result of preinventory location surveys which showed that no recorded stock balances existed for about 51,000 items in storage and that stock locator records had not been established for another 21,000 items in storage. In this regard, at one of the AMAs included in our review, we found that location surveys and follow-up special inventories conducted during the period January 1, 1965, to June 30, 1966, resulted in the location of $37 million worth of unrecorded assets.

In an effort to improve controls over the proper recording and storage of assets, the Air Force Logistics Command developed a debit suspense receipt system during fiscal years 1965 and 1966. Under this system, the AMAs will post material receipts to stock records prior to storing the material in an assigned warehouse location; however, the system provides for an automated suspensing and matching of posted receipt documents with documents evidencing proof of storage. If an automated match-up is not obtained within 5 days, a computerized printout of unmatched receipt documents is obtained and follow-up action, including a special inventory if necessary, is taken. Thereafter, the unmatched debit suspense documents are automatically aged and printed out periodically until stored receipts are located.

The debit suspense system was introduced at the Ogden AMA in July 1966, and full implementation of the system at all the AMAs is scheduled for January 1968. The debit suspense system, if properly implemented, should improve stock record accuracy and supply effectiveness by reducing the incidence of recorded assets in storage which cannot be located.

Our review of inventory adjustments of $5,000 or more that were processed from November 1966 to January 1967 by two Defense supply centers showed that they could not locate stock shown on stock records for 101 items having a value of $1.9 million for periods averaging 2 months. As a result of the temporary losses of stock for 16 of the 101 items, approximately 100 high-priority requisitions for stock, valued at about $106,000, were backordered[1] for an average period of 17 days. The maximum time prescribed by DOD for filling high-priority requisitions is 3 days. We noted that 21 of these requisitions were for support to Southeast Asia and that they were in a backorder status for periods ranging from 3 to 51 days. The majority of these temporary losses of stock were generally attributable to inadequate receipt control and storage locator records at activities storing DSA-owned items.

Prescribed inventories not accomplished

During fiscal years 1965 and 1966, the DOD supply activities, except for those of the Department of the Air Force, generally did not accomplish the regular periodic inventories prescribed by their own directives. In addition, we observed inventory practices during our review which raised questions as to whether the data reported on physical inventories taken by the supply activities accu-

[1] Backorders represent requisitions that could not be filled within prescribed time periods by the supply depot and, therefore, were suspended awaiting availability of the requisitioned item.

rately portrayed the extent and result of their inventory activity. Our findings and observations are presented below by supply service.

Army

The overall data for the period February 1965 to June 1966 submitted for the 20 Army depots showed that 55 percent took no complete inventories, 45 percent took no sample inventories, and 25 percent performed no location record audits. The reasons given for these failures to conduct scheduled physical inventories were (1) utilization of total inventory resources for special inventories, (2) conversion to new or revised major logistical systems, and (3) the workload influx caused by the Southeast Asia buildup had a severe impact on the inventory programs.

Navy

Statistical data prepared by the Naval Supply Systems Command showed that 66 percent of the line items at Navy supply activities were physically inventoried in fiscal year 1965 and 88 percent in fiscal year 1966. These percentages were computed by using both special inventories and scheduled inventories and relating the total to the number of line items in the inventory. We believe that this is not a satisfactory means of measuring the effeciveness of a physical inventory program because the number of special inventories taken does not necessarily represent physical inventories of different line items. As indicated on page 9, the same line items are frequently counted many times through special inventories.

At the Navy locations included in our review, which were the two supply centers that stored the greatest number of items, we found that special inventories accounted for approximately 90 percent of the inventory effort. On the basis of their approved inventory programs, these activities were required to perform scheduled inventories annually on approximately 920,000 line items in fiscal years 1965 and 1966. However, during these fiscal years, scheduled inventories were taken on less than 6 percent of the items scheduled for physical inventory.

Air Force

Our review in the Air Force showed that the supply activities generally accomplished the prescribed physical inventories and location surveys. During fiscal years 1965 and 1966, they reported average overall stock record accuracy rates ranging from 86.7 percent to 99.7 percent.

However, our review at selected supply activities indicated that the reported high rates of stock record accuracy for certain categories of stock may have been overstated. Although the line items scheduled for regular physical inventory were selected on the basis of statistical sampling, action taken after the items were selected but before the scheduled inventories were taken raise some doubts as to the validity of the results as a basis for projecting to the universe.

For example, in August 1966 one of the supply activities conducted a statistical physical inventory of B–52 aircraft spares. The sample consisted of 75 items. No major stock variances were revealed, and an accuracy rate of 100 percent was computed for the lot. We found that 37 of the 75 sample items had been special inventoried about 1 week after the sample selection and about 2 weeks before the scheduled inventory. As a result, the stock records were adjusted for major stock variances. If these adjustments had not been processed immediately before the scheduled sample inventory, the results of the scheduled sample inventory would have reflected major stock variances for 10 of the 75 sample items.

Defense Supply Agency

Available DSA data showed that its supply activities had about 1.9 million active line items on hand. During fiscal years 1965 and 1966, approximately 40 and 9 percent, respectively, of the DSA active items were physically inventoried by complete or statistical sampling methods. In addition, the data indicated that the DSA supply activities accomplished less than 50 percent of the required location audits.

DSA officials indicated that one of the reasons for the substantial decrease from 1965 to 1966 in the number of line items physically inventoried was the

need for increased support to Southeast Asia. They indicated also that the failure to accomplish the majority of the location audits was due in large part to the implementation of a new depot system known as MOWASP (Mechanization of Warehousing and Shipment Procedures).

Under MOWASP all Defense supply centers and depots will utilize standardized computer systems and uniform programs. This system is being designed to improve warehousing operations and stock locator accuracy by mechanization of various warehouse functions, including computerized assignment of warehouse stock locations for material receipts, previously performed manually. Also, DSA Headquarters officials informed us that they recognized the need for better inventory performance reporting in order to better monitor and evaluate the inventory program. They also indicated that revisions were under development which they believed would give them the means to attain more effective control over the physical inventory program.

Receipt and issue documentation not adequately controlled and proper reconciliations not performed

Our review revealed that physical inventories were frequently made without proper control of documentation for receipts and issues occurring during the inventory cycle. The inventory cycle is the time period from establishment of the recorded balances for the line items to be included in the physical inventory through the actual count and summarization of those line items to the reconciliation of the recorded balances with the physical quantities. Also we found that, in a number of instances, personnel failed to perform proper reconciliations of the stock record balances with the physical stock position as of the physical inventory cutoff date.

All DOD supply activities follow the practice of taking open physical inventories; that is, receipt and issue of material continues during the inventory cycle. Therefore, it is necessary to identify and control the documents for transactions occurring during the inventory cycle. Also, it is necessary to perform a reconciliation of the physical counts with the stock records that will ensure the same effect from any interim transactions on both the recorded balances and the determination of the physical stock positions as of the cutoff date. Adjustment must be made to the records for any differences between the recorded balances and the physical stock positions that remain at the completion of the reconciliation. If the foregoing procedures are accomplished properly, the stock records should then show the physical stock position as of the inventory cutoff date.

During our review of Army supply activities, we tested the adjustments that one ICP made to 26 of its stock records for major variances between the recorded balances and the physical stock position as of the inventory cutoff date. We found that 19 percent of the records were adjusted incorrectly because personnel failed to adequately control the documentation for transactions occurring during the inventory cycle and failed to properly consider these transactions in performing reconciliations.

At two other Army ICPs, our tests showed a number of cases where major stock variances between the stock records and the physical inventory counts were researched inadequately and reconciled improperly. These activities allegedly reconciled the stock records with the physical inventory counts for 71 major variances, amounting to about $532,000, that were revealed by physical inventories taken and reported to the ICPs by one depot. We found that, in performing the reconciliations, personnel failed to properly take into consideration the effect of transactions that occurred during the inventory cycle. This resulted in erroneous reconciliations for 18 percent of the 71 major variances.

Personnel at two DSA depots did not follow the prescribed procedures for control of documentation in the performance of physical inventories taken in 1965 and 1966. We examined into the control that one DSA depot exercised over the documents for transactions that occurred during its physical inventory cycles. As a result of physical inventories conducted by the depot, adjustments totaling about $540,000 were made to the records for 550 items.

Our review indicated that the depot reported inaccurate quantities for about 14 percent of the 550 items which resulted in invalid adjustments totaling about

$130,000. We found that these invalid adjustments resulted from the depot's failure to adequately control the documentation for transactions occurring during the inventory cycle and to properly consider these transactions in arriving at a physical stock position as of the inventory cutoff date.

We believe that adequate control of the documentation for transactions occurring during the inventory cycle could have eliminated a significant part of the erroneous adjustments to the stock records. In our opinion, adequate research of the major adjustments could have shown these errors, made their correction possible, and reduced their recurrence.

Physical inventory adjustments not researched

We found that suitable research of adjustments to the stock records for major differences disclosed by physical inventories was frequently not accomplished by the DOD supply activities. Although each supply command's criteria vary slightly, the commands have prescribed procedures for research of major adjustments that are designed to determine causes for the differences and to make provisions for eliminating them or reducing their recurrence.

We found that two Army ICPs processed inventory adjustments for about $197 million in 1966 and failed to research a substantial number of the adjustments representing major stock variances. At another Army ICP, we found that eight of 17 alleged reconciliations were considered proper and not in need of research on the basis of a comparison of a second physical inventory count with the stock record as adjusted by the first physical inventory count.

For example, on August 18, 1966, a depot inventory group physically counted 57 units of a particular item (FSN 1420–629–2626). The ICP's stock record for this item showed a zero balance as of the inventory cutoff date. On August 27, 1966, without performing any research, the ICP adjusted its stock record for the item to show an on-hand quantity of 57 units. The stock record then agreed with the count reported by the depot.

The Army requires a second physical count and research for all major variances. Therefore, on September 1, 1966, the depot made another physical count of the item and again reported an on-hand quantity of 57 units. The ICP personnel compared the reported results of the second physical count, 57 units, with the stock record balance which, as a result of adjustments made to record the first physical count, showed 57 units. They determined that, since the second physical count and the stock record balance agreed no research was necessary.

We found that, at one of the Navy supply activities, a procedure had been established that provided for postaudits and follow-up corrective action on all inventory adjustments valued at $2,000 or more. However, we found that the procedure had been of little value because no follow-up corrective action had been taken.

During fiscal year 1966 postaudits were performed on 1,923 inventory adjustments which met the $2,000 or more criteria. We found that no analysis had been made of the results of the fiscal year 1966 postaudits and that the results of these audits had not been reported to any organizational element above the group responsible for the postaudits. We found also that no corrective measures had been taken to eliminate or minimize the causes of recurring inventory errors identified by the postaudits. After we brought this situation to the attention of officials at the supply center, they informed us that, in the future, postaudit results would be turned over to a quality assurance group for review and follow-up action.

We found that, at one DSA supply center, approximately 33,700 stock records were adjusted in fiscal years 1965 and 1966 to reflect physical inventory gains and losses totaling about $93 million, or a net inventory gain of approximately $43 million. However, subsequent investigations of these adjustments showed that many of them were incorrect. After the correcting entries were made, the net inventory gain of $43 million was reduced to $1.8 million.

On the basis of our review, we believe that the investigations of physical inventory adjustments, when made, generally were not conducted in sufficient depth to establish the basic causes for the adjustments. In those instances where a single transaction or a group of transactions appeared to account for all or a major portion of the physical inventory adjustment, it was usually assumed

that incorrect transaction entries were the reason for the discrepancy. The investigative practices observed at one center are illustrated by the following example.

Water chlorination kits (FSN 6850-270-6225)

In June 1966 the center personnel concluded their investigation of a physical loss adjustment of 8,341 units of a water chlorination kit having a total value of about $28,360. This loss adjustment had been posted to the stock accounts in January 1966. The investigation developed the following information.

Month adjustment posted to stock records	Reason for adjustment	Quantity increase or decrease (—)
1965:		
May	Physical inventory	11,829
September	Not given	640
1966:		
January	Physical inventory	—8,341
March	Physical inventory (special)	5,201
April	Not stated	1,300
June	Physical inventory (special)	—9,404
Net increase		1,225

On the basis of the above data, the investigative personnel concluded that no further investigation or corrective action was necessary inasmuch as the series of adjustments appeared to be offsetting.

In other cases we reviewed, we could find no evidence that the investigations attempted to establish the basic causes for the physical inventory adjustments. In our opinion the investigative practices are not in accord with DSA procedures and are not conducive to improvement of stock record accuracy.

Internal audit reports show stock record inaccuracies and related difficulties as a continuing problem

We reviewed 35 reports issued between January 1964 and June 1966 by the internal audit groups of the DOD organizations. These reports indicated that differences between stock records and items on hand were a continuing problem. Also they frequently called attention to failures to—

1. Conduct prescribed physical inventories;
2. Control documentation for transactions occurring during the inventory cycle;
3. Properly reconcile stock records with the physical stock position as of the inventory cutoff date; and
4. Properly adjust stock records for differences.

Furthermore, they noted problems caused by—

1. Erroneous locator records;
2. Poor counting;
3. Selection of nonrepresentative samples for statistical inventorying; and
4. Lack of ownership identification for items owned by two or more managers but stored at one location.

In the majority of instances the internal audit recommendations for improving the accuracy of the records or solving the inventory control problems were directed to stricter adherence to the prescribed procedures.

In our opinion, the audit coverage, except for the Air Force, was adequate in scope and frequency of review. During the period reviewed, the Air Force auditors had issued only one report on one phase of inventory control at the depot level. We believe that the area is sufficiently important to warrant greater attention.

In fiscal years 1965 and 1966, the Navy internal auditors issued two Navy-wide reports that showed an overall 28 percent difference between the physical inventories and the stock records at 18 Navy and three Marine Corps stock points. However, these reports failed to deal with the causes for such conditions. We believe that in-depth reviews of previously identified problem areas should be considered by the internal audit groups.

Agency comments

We brought our findings to the attention of the Secretary of Defense on May 3, 1967, and proposed that the military departments and the Defense Supply Agency be directed to take the necessary steps to concentrate management attention on the factors that have contributed to the present conditions and to achieve more positive enforcement of the existing policies and procedures relative to the maintenance of an acceptable degree of stock record accuracy for depot inventories.

We proposed further that the Secretary of Defense establish a group, composed of representatives from the military departments and the Defense Supply Agency, to study the problems of inventory control in depth with an objective of resolving the broad basic causes for these problems and to make recommendations that will correct the conditions uniformly throughout the Department of Defense.

At the Secretary's request, the Deputy for Supply and Services, Office of the Assistant Secretary of Defense (Installations and Logistics), commented on our findings and proposals by letter dated July 21, 1967 (see app. III), and stated that the Department of Defense concurred, in general with our findings. He advised us that current management actions, including concentration of management attention on the factors contributing to the present conditions and increased emphasis on positive enforcement of existing policies and procedures, now under way within each of the military services and DSA are expected to effectively reduce the problems associated with maintenance of stock record accuracy for depot inventories.

The Deputy for Supply and Services commented that each of the military services and DSA had initiated specific programs to eliminate the types of inventory control problems discussed in this report and were in the process of installing new procedures which were aimed at more accurate inventory control. We were advised that the installation of the new procedures had advanced to the point where fruitful results could be anticipated within a relatively short period of time. We were advised also that the need for establishment of a special inventory study group would be reconsidered and, if necessary, organized after an evaluation of the results was obtained from the new procedures.

Conclusions

We believe that the increased emphasis which DOD has stated that the military services and DSA are placing on more positive enforcement of the existing policies and procedures for control of depot inventories should, if effectively pursued on a continuing basis, result in greater stock record accuracy and increased supply effectiveness. As a part of our continuing interest in the supply management activities of the Department of Defense, we intend to give further attention to the need for improvement in the control of depot inventories and to test the effectiveness of the new inventory programs and procedures that are currently being implemented by the military services and DSA.

On the basis of other studies we have made of inventory controls and supply system responsiveness, we believe that, in addition to the specifics cited in this report, there are certain broad basic factors which have a significant bearing on the effectiveness of inventory controls in the Department of Defense. For example, we believe that the organizational structure of the supply systems in some cases may contribute substantially to the difficulties encountered in control of inventories.

The responsibility for physical receipt, storage, and issue of stocks of the same item is frequently decentralized to several storage activities. The management and accounting responsibility for these same stocks is centralized at another supply activity which has no direct authority or control over the practices of the storage activities. Thus, it is difficult to establish responsibility for errors or loss of control because no single organization has the direct authority, responsibility, or perhaps motivation to reconcile differences and ensure closer control.

For the immediate future, we intend to concentrate our efforts on the organizational structure, alignment of responsibilities and authority, and numbers and types of personnel. We also intend to examine into the policies, procedures,

and practices used by the military services and DSA relative to the receipt and storage of material, and into the processing of related transaction documents affecting the inventory records. In connection with this work, we intend to consider the organizational structure and methods used in commercial enterprises to determine if there are any techniques that may have application to the solution of inventory control problems in the Department of Defense.

SCOPE OF REVIEW

In response to the May 1966 report on the Economic Impact of Federal Procurement issued by the Subcommittee on Economy in Government of the Joint Economic Committee in which it indicated continued interest in the adequacy of inventory controls in the DOD, we initiated a review of this matter at selected locations in June 1966.

Our work included review and analysis, as deemed necessary, of overall reported or accumulated figures—quantitative and monetary, when available—for fiscal years 1965 and 1966 that were furnished to us by the military departments and by the DSA. These figures included total depot inventories, receipts and issues, adjustments resulting from physical inventories, and material availability. We also reviewed reports of scheduled and accomplished physical inventories, when available, and reports of audits conducted by the military departments' and DSA's internal audit organizations.

At the selected locations, our work included examination of the procedures and practices for control of receipts and issues of material, as well as observations of the taking of some physical inventories. We also reviewed the control exercised over documentation for transactions that occurred during the inventory cycle and tested the associated reconciliations of the stock records with the physical stock position as of the inventory cutoff date. We performed limited tests of the research of the adjustments on the part of the military departments that resulted from physical inventories. This prescribed research is intended to determine causes and to result in improvements to procedures or practices, whichever may be necessary.

Our review was conducted at the following locations in the military departments and DSA.

Department of the Army

Army Materiel Command, Headquarters, Washington, D.C.
Army Aviation Materiel Command, St. Louis, Missouri
Army Missile Command, Huntsville, Alabama
Army-Tank-Automotive Center, Warren, Michigan
Army Weapons Command, Rock Island, Illinois
Red River Army Depot, Texarkana, Texas
Sharpe Army Depot, Lathrop, California

Department of the Navy

Naval Supply Systems Command, Headquarters, Washington, D.C.
Aviation Supply Office, Philadelphia, Pennsylvania
Norfolk Naval Supply Center, Norfolk, Virginia
Oakland Naval Supply Center, Oakland, California

Department of the Air Force

Air Force Logistics Command, Headquarters, Dayton, Ohio
Ogden Air Materiel Area, Ogden, Utah
Oklahoma Air Materiel Area, Oklahoma City, Oklahoma

Defense Supply Agency

Defense Supply Agency, Headquarters, Alexandria, Virginia
Defense Electronics Supply Center, Dayton, Ohio
Defense General Supply Center, Richmond, Virginia
Defense Industrial Supply Center, Philadelphia, Pennsylvania
Ogden Defense Depot, Ogden, Utah
Richmond Defense Depot, Richmond, Virginia

APPENDIXES

APPENDIX I

PRINCIPAL OFFICIALS OF THE DEPARTMENT OF DEFENSE AND THE DEPARTMENTS OF ARMY, NAVY, AND AIR FORCE RESPONSIBLE FOR ADMINISTRATION OF THE 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	June 1967.
Paul H. Nitze	July 1967	Present.
Assistant Secretary of Defense (Installations and Logistics):		
Thomas D. Morris	January 1961	December 1964.
Paul R. Ignatius	December 1964	August 1967.
Thomas D. Morris	September 1967	Present.
Director, Defense Supply Agency:		
Vice Adm. Joseph M. Lyle	July 1964	June 1967.
Lt. Gen. Earl C. Hedlund	July 1967	Present.
Department of the Navy:		
Secretary of the Navy:		
Paul H. Nitze	November 1963	June 1967.
Robert H. B. Baldwin (acting)	July 1967	August 1967.
Charles F. Baird (acting)	August 1967	September 1967.
Paul R. Ignatius	September 1967	Present.
Under Secretary of the Navy:		
Paul B. Fay, Jr	February 1961	January 1965.
Kenneth E. BeLieu	February 1965	June 1965.
Robert H. B. Baldwin	July 1965	June 1967.
Charles F. Baird (acting)	July 1967	Present.
Assistant Secretary of the Navy (Installations and Logistics):		
Kenneth E. BeLieu	February 1961	February 1965.
Graeme C. Bannerman	February 1965	Present.
Chief of Naval Operations: Adm. David L. McDonald	August 1963	Do.
Commander, Naval Supply Systems Command: [1]		
Rear Adm. John W. Crumpacker	May 1961	April 1965.
Rear Adm. Herschel J. Goldberg	May 1965	July 1967.
Rear Adm. Bernhard H. Bieri, Jr	August 1967	Present.
Department of the Army:		
Secretary of the Army:		
Stephen Ailes	January 1964	July 1965.
Stanley R. Resor	July 1965	Present.
Under Secretary of the Army:		
Paul R. Ignatius	March 1964	December 1964.
Vacant	December 1964	March 1965.
Stanley R. Resor	March 1965	July 1965.
David E. McGiffert	July 1965	Present.
Assistant Secretary of the Army (Installations and Logistics):		
Daniel M. Luevano	July 1964	October 1965.
Dr. Robert A. Brooks	October 1965	Present.
Deputy Chief of Staff for Logistics:		
Lt. Gen. R. W. Colglazier, Jr	July 1959	July 1964.
Lt. Gen. Lawrence J. Lincoln	August 1964	Present.
Army Materiel Command: Gen. Frank S. Besson, Jr	July 1962	Do.
Department of the Air Force:		
Secretary of the Air Force:		
Eugene M. Zuckert	January 1961	September 1965.
Dr. Harold Brown	October 1965	Present.
Under Secretary of the Air Force:		
Dr. Brockway McMillan	June 1963	September 1965.
Norman S. Paul	October 1965	October 1965.
Townsend Hoopes	October 1967	Present.
Assistant Secretary of the Air Force (Installations and Logistics) (formerly Materiel): Robert H. Charles	November 1963	Do.
Commander, Air Force Logistics Command:		
Gen. Mark E. Bradley, Jr	July 1962	August 1965.
Gen. Kenneth B. Hobson	August 1965	July 1967.
Gen. Thomas P. Gerrity	August 1967	Present.

[1] Formerly the Bureau of Supplies and Accounts, reorganized in May 1966.

APPENDIX II

DEPARTMENT OF DEFENSE CONUS DEPOT INVENTORY MANAGEMENT DATA FOR FISCAL YEARS 1965 AND 1966

	1965					1966				
	Air Force	Navy	Army	Defense Supply Agency	DOD total	Air Force	Navy	Army	Defense Supply Agency	DOD total
	Dollar value in millions									
Average annual inventory	$3,810	$3,105	$1,455	$2,104	$10,474	$3,743	$3 014	$1,594	$1,985	$10,426
Receipts	1,308	536	510	1,870	4,224	1,758	607	933	3,023	6,321
Issues	2,645	873	515	1,968	6,001	1,887	1,186	1,294	3,010	7,377
Physical inventory adjustments:										
Gain	603	223	438	206	1,470	406	204	229	162	1,001
Loss	−752	−202	−432	−184	−1,570	−314	−195	−146	−180	−835
Net	−149	21	6	22	−100	92	9	83	−18	166
Gross	1,355	425	870	390	3,040	720	399	375	342	1,836
Percent of gross physical adjustment to average annual inventory	35.56	13.69	59.79	18.54	29.02	19.24	12.85	23.53	17.23	17.61
	Line items, actual [1]									
Average annual inventory	$956,483	$827,985	$497,435	$2,350,700	$4,632,603	$930,783	$824,626	$531,425	$2,405,050	$4,691,884
Receipts	750,106	2,648,208	(2)	2,157,700	5,556,014	1,051,458	2,681,461	5,111,602	2,651,300	11,495,821
Issues	3,472,667	6,082,546	(2)	15,081,100	24,636,313	4,912,618	6,317,010	4,661,453	18,774,300	34,665,381

[1] A comparison cannot be drawn between the number of line item receipts and issues because generally receipts are made in bulk form which is recorded as one line item receipt, while shipments are generally made by breaking down this bulk form into smaller line item issues to be shipped to the individual using activities.

[2] This data not provided by AMC for fiscal year 1965.

Note: Inventory management data was supplied to us by the Department of the Army (Army Materiel Command), Navy (Naval Supply Systems Command), Air Force (Air Force Logistics Command), and the Defense Supply Agency. The data supplied by the Army Materiel Command (AMC) for fiscal year 1965 covered only the period Feb. 1, 1965, to June 30, 1965.

APPENDIX III

ASSISTANT SECRETARY OF DEFENSE,
Washington, D.C., July 21, 1967.

Mr. WILLIAM A. NEWMAN, Jr.,
Director, Defense Division,
General Accounting Office,
Washington, D.C.

DEAR MR. NEWMAN: Reference is made to your letter of May 3, 1967 which forwarded for review and comment a draft report on Control of Depot Inventories in the Department of Defense (DoD) (OSD Case #2605).

The draft report is based on a limited review of the effectiveness of inventory controls in the DoD, particularly with those pertaining to the accuracy of depot inventory records, and to the degree of compliance with prescribed policy and procedural directives addressed to the maintenance of stock record accuracy.

The General Accounting Office (GAO) concluded from its review that substantive differences existed between stock record balances and the actual quantities of items in inventory. Those imbalances were generally attributable to the failure to: (1) establish and maintain accurate locator cards, (2) conduct regularly scheduled physical inventories, (3) adequately control documentation representing movement of stock during the physical inventory cycle, (4) adequately perform or validate reconciliations of the stock record with the physical inventory stock positions prior to posting adjustments, and (5) perform post-adjustment research to isolate causes for the significant discrepancies and to take appropriate corrective action.

Based on the overall conclusion that needed improvements must come through the concentration of management attention on the factors that have contributed to the present conditions, the report recommends that the Military Departments and the Defense Supply Agency (DSA) be directed to take necessary steps to achieve more positive enforcement of existing policies and procedures, and that a group be established to study the problems of inventory control in depth.

Generally, the types of deficiencies cited in the report are valid. However, actions now under way within each of the Military Services and the Defense Supply Agency should result in significant improvements.

The effectiveness of inventory controls at all levels is a matter of continuing concern to the DoD. The introduction of computers into the management system and the consequent transfer of accountable records from local control to centralized ADP equipment have introduced some new dimensions into the management process. While many cost and effectiveness advantages have been achieved as a result of these management innovations, the remote control of stocks on hand as well as specific warehouse locations, created transitional problems that always result from conceptual changes in basic procedures. Coupled with this was the advent of hostilities in Vietnam as well as the need for more highly competent personnel assigned to the inventory control task. Both of these latter factors further complicated the many transitional problems that were already apparent.

These problems were recognized, but the pressures to maintain a continuing flow of high priority essential military supplies to Vietnam often precluded the orderly process of converting from one system to another. However, each of the Military Services and DSA initiated specific programs to eliminate these deficiencies. For example, the Army initiated a six-phase program in September 1966. Three of these phases were completed by the end of December 1966 but not in sufficient time to be reflected in the draft report prepared by your staff. The major phase, which involves the establishment of new inventory procedures, will be phased in between May and October 1967. Likewise, the Navy, Air Force and DSA are in the process of installing new procedures which are aimed at more accurate inventory control.

The draft report recommends that the Secretary of Defense take necessary steps to direct the Military Departments and DSA to concentrate management attention on the factors that have contributed to the present conditions and to achieve more positive enforcement of existing policies and procedures. The Military Departments and DSA are now doing this and it is anticipated that current management actions will effectively reduce the problems associated with maintaining accurate physical inventories. This office will continue to review the progress being made under the programs now under way to assure the

development of inventory control procedures that will appropriately reflect an acceptable degree of accuracy.

The draft report also recommends the establishment of a special group to study this problem in depth. It is believed advisable at this time to continue with the installation of the new procedures now under way by the Military Services and DSA since they have advanced to the point where fruitful results can be anticipated within a relatively short period of time. After evaluation of the results obtained from these new procedures, the need for establishment of the special group will be reconsidered and, if necessary, such a group will be organized.

In the meantime, a positive exchange of views between the GAO and DoD with respect to this program as well as the effectiveness of the procedures now being installed by the Military Services and DSA would be welcomed and such an exchange is encouraged. A follow-on survey by GAO after the procedures have been in effect for a reasonable period of time might also serve a useful purpose.

Sincerely,

PAUL H. RILEY,
Deputy Assistant Secretary of Defense (Supply and Service).

APPENDIX 6

List of Independent Computer Peripheral Equipment Manufacturers and Glossary of Terms

1. Data Disc, Inc., 1275 California Ave., Palo Alto, Calif. 94304.
   Small fixed and interchangeable Disc memories with associated electronic systems.
2. Data Products Corp., 8535 Warner Drive, Culver City, Calif. 90230.
   Medium and large random access disc files memories with associated electronic systems.
3. Digital Development Corp., 5575 Kearney Villa Road, San Diego, Calif. 92123.
   Disc/Drum (Drisk) memories with associated electronic systems.
4. Magna-Head Division, General Instrument Corp., 13040 S. Cerise Ave., Hawthorne, Calif. 90250.
   Small, medium and large drum and core memories with associated electronic systems.
5. Librascope Group, Components Division, General Precision Inc., Subsidiary of General Precision Corp., 1100 Frances Court, Glendale, Calif. 91201.
   Small, medium capacity Disc memory systems. Large capacity Disc file memory systems.
6. Vermont Research Corp., Precision Park, North Springfield, Vermont 05150.
   Small, medium and large Drum memory systems.
7. Western Magnetics, Division of GJM, Inc., 1733 Flower Street, Glendale, Calif. 91201.
   Small, medium and large drum memory systems. Event recording drums (analog).
8. Potter Instrument Co., Inc., 151 Sunnyside Boulevard, Plainview, New York 11803.
   Medium capacity random access memory systems.
9. Computer Memories Corp., 13432 Wyandotte Street, North Hollywood, Calif.
   Small and medium capacity disc memory systems.
10. Applied Magnetics Corp., Computer Memories Division, 75 Robin Hill Road, Goleta, Calif. 93017.
    Small and medium capacity disc memory systems.
11. Memorex Corp., 1180 Shulman Avenue, Santa Clara, Calif. 95052.
    IBM compatible disc-drivers and disc pack memory systems.
12. Caelus Memories, Inc., San Jose, Calif.
    Disc pack memories.
13. Mac Panel Co., High Point, N.C.
    Disc Pack memories.
14. Electronic Memories, 12621 Chadron Avenue, Hawthorne, Calif. 90250.
    Core Memory Systems.
15. Hughes Aircraft Company.
    Small military drum systems.
16. Anelex Corp. (out of memory business), 150 Causeway Street Boston, Mass. 02114.
    Used to produce small disc file memory systems.
17. Fabri-Tek, Inc., 5901 S. County Road, Minneapolis, Minn. 55118.
    Core Memory Systems.
18. S. Himmelstein & Company, 2500 Estes Avenue, Elk Grove Village, Ill. 60007.
    Magnetic tape systems: Small drum memory systems.
19. LFE, Inc., Electronics Division, Waltham, Mass. 02154.
    Delay-Line memory systems.
20. Dacol Division, Hersey-Sparling Meter Co., 210 W. 131st. Los Angeles, Calif. 90061.
    Magnetic tape memory systems.

21. Tally Corp., 1310 Mercer Street, Seattle, Washington 98109.
Magnetic tape memory systems.
22. Anderson Laboratories, Inc., 1280 Blue Hills Avenue, Bloomfield, Conn. 06002.
Delay line memory systems.
23. Computer Devices Corp., 63 Austin Boulevard, Commack, New York 11725.
Delay line memory systems.
24. Optimized Devices, Inc., 220 Marble Avenue, Pleasantville, New York.
Small Disc Memory systems.
25. Decision Control, Inc., 1590 Monrovia Avenue, Newport Beach, Calif.
Core memory systems.
26. Microsonics, Inc., Subsidiary of Sangamo Electric Co., 60 Winter Street, Weymouth, Mass. 02188.
Delay line memory systems.
27. Fairchild Semiconductor, 313 Fairchild Drive, Mountain View, Calif.
Core memory systems.
28. Itek Corp., 10 Maguire Road, Lexington, Mass.
Photo-disc memory systems.
29. Simons Precision Products, Computer Product Division, Fairhaven, Vt.
Core memory systems.
30. Astrodata, Inc., 240 E. Palois Road, Anaheim, Calif.
Small and medium capacity drum memory systems.
31. Advanced Memory Systems, Inc., 1718 Barrington Avenue, Los Angeles, Calif. 90025.
Small drum memory systems.
32. California Computer Products, Inc., 305 Mueller Avenue, Anaheim, Calif.
Digital Plotter systems, Magnetic Tape memory systems.
33. Cognitronics Corp., 549 Pleasantville, Briarcliff Manor, New York.
Analog memory systems, Small digital drum memory systems.
34. Datamark, Inc., 2000 Shames Drive, Westbury, L.I., New York.
High speed printers.
35. Litton Systems, Inc., Division of Litton Industries, 5500 Canago Avenue, Woodland Hills, Calif.
Core memory systems.
36. Lockheed Electronics Co., Division of Lockheed Aircraft Corp., 6201 E. Randolph Street, Los Angeles, Calif. 90022.
Core memory systems.
37. Indiance General, Electronics Division/Memory Products, Keasbey, New Jersey.
Core memory systems.
38. Hughes Aerospace Group, Guidance & Controls Division, Hughes Aircraft Company, Culver City, Calif.
Small and medium airborne drum memory systems.
39. Ampex Corp., 401 Broadway, Redwood City, Calif.
Core memory systems.
40. Electron Ohio, Inc., 1278 W. 9th Street, Cleveland, Ohio 44113.
Small drum memory system.
41. Precision Instrument Co., 3170 Porter Drive, Palo Alto, Calif.
Magnetic tape memory systems.
42. Datametrics Corp., 8217 Lankershim Blvd., North Hollywood, Calif.
Small disc memory systems.
43. Soroban Engineering Inc., Melbourne, Florida 32902.
High speed printers, paper tape punches.
44. Thin Film Inc., 961 E. Slauson Avenue, Los Angeles, Calif. 90011.
Disc packs.
45. Dura Magnetics, Inc., 5355 Whiteford Road, Sylvania, Ohio.
Small disc systems.
46. Benson-Lehner Corp., 14761 Califa Street, Van Nuys, Calif.
Small disc systems.
47. Bryant Computer Products, 850 Ladd Road, Walled Lake, Michigan 48088.
Small, medium and large drum memory systems, Large Disc File memory systems.
48. AMP, Inc., Harrisburg, Pennsylvania.
Card Readers.

49. Peripherals, Inc., Phoenix, Arizona.
Disc Testers.
50. Franklin Electronics, Inc., E. Fourth Street, Bridgeport, Pa. 19405.
High speed digital printers.

Glossary of Terms

Reference: "Words of The Computer Age" by Newsweek.
"Glossary for Automatic Data Processing" by Datamation.

The following are an attempt to put into layman terms various phrases which are used in the computer industry so that the average person could understand them:

Binary

This is a numbering system in which only two stable states are possible; e.g., something is either up or down; on or off; in or out there is never any in between. This system is extremely useful and easy to use in a electronic system where either we have current flowing or not flowing in an element within the system.

Bit

This is actually an abbreviation of the words binary digit. Bi from binary and the "t" from digit. The existence or the absence of a pulse or a bit in a group of pulses becomes a code that can be recognized by the computer and turned into an intelligent language.

Byte

A byte is a series of eight (8) bits. This particular quantity is very useful in a computer language in order that certain characters or symbols may be represented by the computer so that the computer can recognize them.

Character

A character usually consists of six (6) bits; e.g., a character from a typewriter, such as the letter "a", the letter "b" or one of the symbols for punctuation or for that matter one of the numerical symbols can be represented in binary language by a series of pulses. In reality, it is only necessary to have six (6) bits of information in order to have 64 different characters or symbols represented by any combination of the bits (an eight (8) bit byte can represent up to 256 different types of characters or symbols).

Check/Parity Bit

In many instances it is necessary to check that a character or byte has been transmitted properly and this is done by having *check bits* or *parity bits* which will determine if the proper number of bits have been transferred; that is, if the bits that makeup a character or byte are even then another bit could be added to make them odd thereby referring to odd parity or odd number of check bits which allows the computer to very quickly determine if an error has been made in the transmission of the information between one area in the processor to another area in the processor.

Main Frame

This is the area of the computer which does the majority of the work; that is, the actual addition, subtraction or any other functions which are necessary are done in what is termed the main frame. It is sometimes referred to as the CPU or central processing unit. It is that portion of a computer exclusive of the input/output and peripheral devices.

Main Frame Memory

This portion of the memory is usually a core memory which consists of a series of small round magnetic cores which are inter-wired together and then put into various size planes. These cores store the data that is being processed much like the wheels in an adding machine which store that particular number that is inserted until everything is added together and these wheels rotate. In this particular case data is stored in an electronic sense, magnetically, and then the numbers are added or divided or subtracted or whatever the particular requirement is. The main feature of this core data storage unit is that it is extremely fast since it determines the speed of the computer.

Auxiliary Memory

This is an external storage device which is associated with the computer and which is not usually a core memory as previously described. It is rather a permanent or semi-permanent type storage where the information is stored for long periods of time, such as payroll information, accounting information, inventory control information. It is possible to go back into this main store and retrieve the information; do some work on it, possibly a payroll for example, and then restore the same information back into this mass storage device. The mass store can consists of rotating magnetic devices, magnetic strips or even photographic film type devices. These are strictly permanent or semi-permanent stores.

Peripheral Equipment

This is any piece of equipment external to the main frame; e.g., it could be a typewriter in which information can be typed into the computer and if the typewriter is so constructed information can be typed automatically from the computer. This is commonly known as an input/output device. Another such type device would be a card reader; that is, a unit that can read punched cards, such as those that are key punched. These can be read directly into the computer and by the same token it is possible for the computer to punch cards out if such a device is attached. It is also an input/output device. Another type device which is considered only an output device is referred to as a line printer. This can print; e.g., pay checks, inventory control lists, etc. at a very high rate of speed although it is much slower than the computer can operate at. In other words, these will print-out on an average of a thousand lines per minute as opposed to a typewriter which is capable of possibly 150 characters per minute. A mass storage device is considered a computer peripheral, (this has been discussed above) however, it requires an interface to the computer in order for it to be affective. A data terminal is considered an I/O (input/output) device. This will allow somebody remotely located to interrogate the computer and to receive information back. This is used in what is called the time-sharing systems; that is, where a lot of people are sharing the same computer and it is not wholly one person.

Electronic Interface

This is an interface determined by an electronic voltage levels and signals which determine exactly where the connections are being made for the input/output devices or the various inter-connections between the peripheral equipment and the main frame.

Software

This word is contrasted to hardware. The software is in effect all of the paperwork that is necessary in order that the computer can operate. In other words, a computer programer must outline in extreme detail all of the steps or functions which the computer must go through in order to perform a certain operation. This operation is referred to as a program. The program itself is referred to as software. Now this can be in a form of punched cards which are inputed into the computer; a punched paper tape which can be inputed into the computer or even a magnetic tape which has been programed which in turn will operate the computer. The term software usually refers to the complete programing and routines which are necessary in order to use the computer's capabilities to the fullest extent. Various other terms which are used in conjunction with software are compilers, assemblers, narraters, etc. There are assemblers which will change from one computer language to another computer language since many times computers do not operate with the same coding structure. The words FORTRAN, ALGOL and COBOL are methods of programing the computer and many times you want to convert from FORTRAN to ALGOL because the computer will recognize ALGOL but not FORTRAN, therefore, an assembler or an emulator, or a compiler is necessary.

Hardware

This word refers to the physical equipment. It refers to the main frame, input/output devices, in other words, to the computer itself, to the physical units as opposed to the word software which is really the operating controls for the computer.

Program

This is a term used to describe the step-by-step procedures which the computer must take in order to solve a particular problem. The computer in itself can only do what it is directed to do. It can only answer a question "yes" or "no" and by a process of elimination through program control it can come up to the most logical or most correct answer. In order to make each of these steps it is necessary that they be programed into the computer. The reason why the computer is so effective, of course, is because it can determine these answers at extremely high speeds and thereby spill out this information very rapidly much much faster than what a person could do.

Computer System

A computer system would be considered as a complete computer environment which would include the central processor or main frame, all of the peripherals, all of the programs necessary to solve all of the problems that are brought to this particular computer. It includes the hardware, software, the people, the facility. It is all inclusive of everything associated with a particular computer.

System

This term would not necessarily have the connotation that the term computer system has. It would possibly be one small portion of the overall computer system; e.g., the assembly of procedures or processes or methods which would be used to run the computer is sometimes called an operating system. A system that controls the overall operation of the computers and determines priorities of certain input/output devices is referred to as an executive system. This would determine whether or not it should print-out the checks for example or whether it should read-in additional data prior to printing out the checks. These priorities are established as part of the executive system, therefore, the term system can be very very widely used and without an adjective describing the particular system it does not become a full and meaningful word in the computer language.

APPENDIX 7

One Hundred Companies and Their Subsidiary Corporations Listed According to Net Value of Military Prime Contract Awards

Fiscal year 1967 (July 1966 to June 1967)

The 100 companies which, together with their subsidiaries, received the largest dollar volume of military prime contracts of $10,000 or more in FY 1967 accounted for 65.5% of the United States total. This rate was 1.7 percentage points above the 63.8% received by the top 100 companies in FY 1966. The increase in the 100 company percentage was due to a sharp upswing in aircraft procurement which rose from $7.5 billion in FY 1966 to $9.7 billion in FY 1967. Aircraft awards generally are concentrated in a relatively small number of companies which have the resources and knowhow to undertake such complex projects.

Military prime contract awards of $10,000 or more to all United States companies for work in the U.S. and overseas totalled $39,219.4 million, or $5,686.8 million more than in FY 1966. Because of this sizable increase, it required $46 million in awards for a company to be listed in FY 1967 compared with $40 million in FY 1966. The largest company in FY 1967 received $2,123.6 million, whereas the largest in FY 1966 received $1,531.0 million.

The table below shows that the first 5 companies received 3.2% more in FY 1967 than in FY 1966, and that the first 25 companies received 1.5% more.

PERCENT OF U.S. TOTAL

Companies	Fiscal year						
	1961	1962	1963	1964	1965	1966	1967
1st	6.5	5.6	5.9	5.8	7.1	4.6	5.4
2d	5.2	4.7	5.2	5.4	4.9	3.5	4.7
3d	5.2	4.4	4.1	4.6	3.5	3.4	4.6
4th	4.1	4.0	4.0	4.1	3.4	3.4	3.3
5th	3.8	3.8	4.0	3.9	3.1	2.7	2.8
1 to 5	24.8	22.5	23.2	23.8	22.0	17.6	20.8
6 to 10	11.8	11.1	10.9	12.0	10.2	9.0	8.8
11 to 25	18.2	17.2	17.8	17.1	16.0	16.4	14.9
1 to 25	54.8	50.8	51.9	52.9	48.2	43.0	44.5
26 to 50	11.0	12.6	13.7	12.9	13.0	12.1	11.6
51 to 75	5.5	6.0	5.5	5.1	5.2	5.4	6.1
76 to 100	2.9	2.9	2.8	2.5	2.5	3.3	3.3
1 to 100	74.2	72.3	73.9	73.4	68.9	63.8	65.5

The FY 1967 list of the top 100 companies contains 18 companies which did not appear on the list for FY 1966. Of these, two appear between positions 26 and 50; four between 51 and 75, and the remaining twelve between positions 76 and 100.

Companies listed in fiscal year 1967 but not in fiscal year 1966

Airlift International, Inc.
Cessna Aircraft Co.
Cities Service Co.
Continental Airlines, Inc.
Dillingham Overseas Corp. & H. B. Zachry Co.
Federal Cartridge Corp.
Gulf Oil Corp.
Hughes Tool Co.
Mason & Hanger-Silas Mason Co.

Companies listed in fiscal year 1967 but not in fiscal year 1966—Continued
Maxson Electronics Corp.
Morrison-Knudsen Co.
Northwest Airlines, Inc.
Ogden Corp.
Pacific Architects & Engineers, Inc.
Smith Investment Co.
Tumpane Co., Inc.
Vinnell Corp.
White Motor Corp.

Companies listed in fiscal year 1966 but not in fiscal year 1967

American Electric, Inc.
Borg-Warner Corp.
Bowman-McLaughlin-York, Inc.
Burlington Industries, Inc.
Burroughs Corp.
Caterpillar Tractor Co.
Clark Equipment Co.
Colt Industries, Inc.
Continental Oil Co.
Control Data Corp.
General Time Corp.
Hayes International Corp.
Hupp Corp.
National Presto Industries, Inc.
United States Steel Corp.
Universal American Corp.
Vitro Corp. of America

In addition to this turnover the following changes affecting companies on the FY 1966 list were noted: McDonnell Aircraft Corp. and Douglas Aircraft Co. merged to become the McDonnell Douglas Corp.; United States Rubber Co. changed its name to Uniroyal Inc.; and Norris Thermador Corp. became Norris Industries Inc.

Although the contract work of many companies on the list involves more than one procurement category, each company has been assigned in the table below to the procurement category that accounts for its largest dollar volume of awards. On this basis, "Missile" companies decreased from 13 in FY 1966 to 7 in FY 1967, while "Service" companies increased from 5 to 10. If the McDonnell Douglas merger is taken into consideration, the aircraft companies increased by 2 instead of by 1 as shown in the table.

Procurement category	Number of companies		Change
	Fiscal year 1966	Fiscal year 1967	
Aircraft	19	20	+1
Missiles	13	7	−6
Ships	3	4	+1
Tanks (automotive)	9	7	−2
Weapons	1	1	
Ammunition	20	19	−1
Electronics	18	19	+1
Services	5	10	+5
Construction	1	2	+1
Petroleum	6	7	+1
Textiles and clothing	2	1	−1
Construction equipment	2	0	−2
Building supplies	1	1	
All other supplies and equipment	0	2	+2

As indicated above the number of companies assigned to "Missiles" declined substantially; however, this decrease does not signify a reduction in dollar awards in the missiles category, since awards totaled more than $4 billion in both FY 1966 and FY 1967. Seven companies were assigned to this category in both years. Of the remaining 6 companies assigned to "Missiles" last year but not this year, 5 made the 100 company list this year assigned to other categories.

The year to year increase in the number of companies assigned to "Services" is indicative of the general rise in the dollar volume of wards in this category. Awards amounted to $3.0 billion in FY 1967 compared with $2.2 billion in FY 1966. This year, 5 air transport companies made the list compared with only two last year. Other additions were involved in operation and maintenance of government facilities and engineering services.

The four non-profit contractors (see Index) listed for FY 1967 are the same as last year. These non-profit contractors, for the most part, provide research, development, and training services in the missile-space and electronics programs.

Five companies received prime contract awards of more than $1 billion each in FY 1967 compared with four companies in FY 1966. Lockheed Aircraft Corp. slipped from the number one position which it held for the five preceding years, and was third after McDonnell Douglas and General Dynamics. The five leading companies and a brief description of their more important work are as follows:

McDonnell Douglas Corp. heads the lost with $2,124.6 million or 5.4% of the total. Last year, prior to merger, the two companies in combination, totaled 3.0%. The aircraft contracts of this company include the F–4 Phantom series of fighter and reconnaissance aircraft, the A–4/TA–4 Jet Attack/Trainer Aircraft, and aircraft modification, overhaul and repair.

General Dynamics Corp. moved into second place on the list, receiving awards totaling $1.831.9 million which represented 4.7% of the fiscal year 1967 total. The fiscal year 1966 percentage for this company was 3.4%. The company received contracts for aircraft, missiles and ships. Aircraft contracts include the F–111 fighter aircraft. Contracts awarded for ships were for alterations, conversions, maintenance and repair as well as for new construction of small craft and submarines. Missiles included components as well as systems.

Lockheed Aircraft Corp. received the same percentage of total awards this year as last year, 4.6%; however, its dollar volume increased by $276.2 million. Lockheed's principal aircraft contracts include the C–5A Jet Transport, the C–141A Starlifter Jet Cargo Transport, the C–130 Hercules Turboprop Jet Transport and the P–3 Orion Patrol Bomber. Missile and satellite activity includes the Agena, Polaris and Poseidon.

General Eelectric Co., whose contracts totaled $1,289.8 million, 3.3% of total, ranks 4th. This compares with $1,187.0 million or 3.5% of total in fiscal year 1966, which was sufficient for second place in that year. Aircraft engines were an important part of this company's production and development effort. Ordnance contracts were for various types of guns and guidance and control systems for missiles. This company also received substantial contracts for electronics equipment and nuclear propulsion systems for ships.

United Aircraft Corp. received contracts amouting to $1,097.1 million, 2.8% of total and is in 5th place. This compares with $1,138.7 million and 3.4% for fiscal year 1966 when they were ranked 3rd. The prime contract work of the company is in the production of aircraft engines and engine spare parts. Contracts for aircraft were for the production of helicopters.

Index of 100 parent companies which with their subsidiaries received the largest dollar volume of military prime contract awards in fiscal year 1967

Rank	Parent Company
74.	Aerospace Corp. (N)
83.	Airlift International, Inc.
63.	American Machine & Foundry Co.
88.	American Manufacturing Co. of Texas.
8.	American Telephone & Telegraph Co.
52.	Asiatic Petroleum Corp.
86.	Atlantic Research Corp.
16.	Avco Corp.
23.	Bendix Corp.
82.	Bethlehem Steel Corp.
6.	Boeing Co.
85.	Cessna Aircraft Co.
69.	Chamberlain Corp.
40.	Chrysler Corp.
97.	Cities Service Co.
32.	Collins Radio Co.
78.	Condec Corp.
76.	Continental Airlines, Inc.
66.	Curtiss-Wright Corp.
44.	Day & Zimmerman, Inc.
68.	Dillingham Overseas Corp., & H. B. Zachry Co. (JV)
75.	Dow Chemical Co.
37.	du Pont (E. I.) de Nemours & Co.
57.	Eastman Kodak Co.
80.	Emerson Electric Co.
39.	F M C Corp.
65.	Fairchild Hiller Corp.
72.	Federal Cartridge Corp.
81.	Firestone Tire & Rubber Co.
70.	Flying Tiger Line, Inc.
18.	Ford Motor Co.
2.	General Dynamics Corp.
4.	General Electric Co.
9.	General Motors Corp.
48.	General Precision Equipment Corp.
45.	General Telephone & Electronics Corp.
26.	General Tire & Rubber Co.
41.	Goodyear Tire & Rubber Co.
12.	Grumman Aircraft Engineering Corp.
94.	Gulf Oil Corp.
54.	Harvey Aluminum, Inc.
33.	Hercules, Inc.
20.	Honeywell, Inc.
17.	Hughes Aircraft Co.
84.	Hughes Tool Co.
34.	International Business Machine Corp.
71.	International Harvester Co.
28.	International Telephone & Telegraph Corp.
73.	Johns Hopkins University (N)
22.	Kaiser Industries Corp.
60.	Lear Siegler, Inc.
10.	Ling-Temco-Vought, Inc.
36.	Litton Industries, Inc.
3.	Lockheed Aircraft Corp.
61.	Magnavox Co.
24.	Martin Marietta Corp.
58.	Mason & Hanger-Silas Mason Co.
62.	Massachusetts Institute of Technology (N)
100.	Maxson Electronics Corp.
1.	McDonnell Douglas Corp.
56.	Mobil Oil Corp.
46.	Morrison-Knudsen Co.
96.	Motorola, Inc.
35.	Newport News Shipbuilding & Dry Dock Co.
47.	Norris Industries, Inc.
7.	North American Aviation, Inc.
21.	Northrop Corp.
93.	Northwest Airlines, Inc.
29.	Ogden Corp.
42.	Olin Mathieson Chemical Corp.
59.	Pacific Architects & Engineers, Inc.
55.	Pan American World Airways, Inc.
27.	Radio Corp. of America
14.	Raymond-Morrison-Brown-Jones (JV)
19.	Raytheon Co.
25.	Ryan Aeronautical Co.
50.	Sanders Associates, Inc.
53.	Signal Oil & Gas Co.
95.	Smith Investment Co.
13.	Sperry Rand Corp.
43.	Standard Oil Co. (California)
30.	Standard Oil Co. (New Jersey)
89.	Stevens (J. P.) & Co., Inc.
87.	Sverdrup & Parcel, Inc.
92.	System Development Corp. (N)
51.	T R W, Inc.
67.	Teledyne, Inc.
49.	Texaco, Inc.
64.	Texas Instruments, Inc.
11.	Textron, Inc.
38.	Thiokol Chemical Corp.
98.	Tumpane Co., Inc.
99.	Union Carbide Corp.
31.	Uniroyal, Inc.
5.	United Aircraft Corp.
90.	Vinnell Corp.
79.	Western Union Telegraph Co.
91.	Westinghouse Air Brake Co.
15.	Westinghouse Electric Corp.
77.	White Motor Corp.

(N) —Non-Profit Contractors
(JV)—Joint Venture

100 COMPANIES AND THEIR SUBSIDIARIES LISTED ACCORDING TO NET VALUE OF MILITARY PRIME CONTRACT AWARDS, FISCAL YEAR 1967 (JULY 1, 1966, TO JUNE 30, 1967)

Rank	Companies	Millions of dollars	Percent of U.S. total	Cumulative percent of U.S. total
	U.S. total [1]	39,219.4	100.0	100.0
	Total, 100 companies and their subsidiaries [2]	25,693.1	65.5	65.5
1.	McDonnell Douglas Corp	2,111.6	.....	.....
	Conductron Corp	5.3	.....	.....
	Hycon Manufacturing Co	5.0	.....	.....
	Tridea Electronics Co	2.7	.....	.....
	Total	2,124.6	5.4	5.4
2.	General Dynamics Corp	1,818.7	.....	.....
	Stromberg-Carlson Corp	12.8	.....	.....
	United Electric Coal Co	.4	.....	.....
	Total	1,831.9	4.7	10.1
3.	Lockheed Aircraft Corp	1,799.8	.....	.....
	Lockheed Shipbuilding & Construction Co	7.4	.....	.....
	Total	1,807.2	4.6	14.7
4.	General Electric Co	1,289.8	3.3	18.0
5.	United Aircraft Corp	1,097.1	2.8	20.8
6.	Boeing Co	911.7	2.3	23.1
7.	North American Aviation, Inc	688.8	1.8	24.9
8.	American Telephone & Telegraph Co	158.9	.....	.....
	Bell Telephone Co. of Pennsylvania	[3]	.....	.....
	Chesapeake & Potomac Telephone Cos	11.9	.....	.....
	Moutain States Telephone & Telegraph Co	1.7	.....	.....
	New England Telephone & Telegraph Co	.6	.....	.....
	New Jersey Bell Telephone Co	.5	.....	.....
	New York Telephone Co	.1	.....	.....
	Northwestern Bell Telephone Co	.2	.....	.....
	Ohio Bell Telephone Co	.9	.....	.....
	Pacific Northwest Bell Telephone Co	.2	.....	.....
	Pacific Telephone & Telegraph Co	.6	.....	.....
	Southern Bell Telephone & Telegraph Co	2.6	.....	.....
	Southwestern Bell Telephone Co	1.0	.....	.....
	Western Electric Co	493.8	.....	.....
	Total	673.0	1.7	26.6
9.	General Motors Corp	625.0	.....	.....
	Frigidaire Sales Corp	.1	.....	.....
	Total	625.1	1.6	28.2
10.	Ling-Temco-Vought, Inc	91.0	.....	.....
	Continental Electronics Manufacturing Co	4.4	.....	.....
	Continental Electronics Systems, Inc	[3]	.....	.....
	Kentron Hawaii, Ltd	12.0	.....	.....
	LTV Aerospace Corp	310.7	.....	.....
	LTV Electrosystems, Inc	103.4	.....	.....
	LTV Ling Altec, Inc	.9	.....	.....
	Okonite Co. (the)	3.4	.....	.....
	Wilson & Co	8.9	.....	.....
	Total	534.7	1.4	29.6
11.	Textron, Inc	16.6	.....	.....
	Accessory Products Corp	.1	.....	.....
	Bell Aerospace Corp	478.2	.....	.....
	Bostitch, Inc	[3]	.....	.....
	Dalmo Victor Co	[3]	.....	.....
	Durham Manufacturing Co	[3]	.....	.....
	Maico Electronics	[3]	.....	.....
	Speidel Corp	.1	.....	.....
	Textron Electronics, Inc	1.2	.....	.....
	Textron Industries, Inc	[3]	.....	.....
	Townsend Co	.2	.....	.....
	Total	496.6	1.3	30.9
12.	Grumman Aircraft Engineering Corp	487.7	1.2	32.1
13.	Sperry Rand Corp	484.1	1.2	333.
14.	Raymond International, Inc.; Morrison-Knudsen Co., Inc.; Brown & Root, Inc.; and J. A. Jones Construction Co	462.5	1.2	34.5

See footnotes at end of table.

100 COMPANIES AND THEIR SUBSIDIARIES LISTED ACCORDING TO NET VALUE OF MILITARY PRIME CONTRACT AWARDS, FISCAL YEAR 1967 (JULY 1, 1966, TO JUNE 30, 1967)—Continued

Rank	Companies	Millions of dollars	Percent of U.S. total	Cumulative percent of U.S. total
15.	Westinghouse Electric Corp	442.6		
	Deco Electronics, Inc	3.7		
	Thermo King Corp	6.8		
	Total	453.1	1.2	35.7
16.	Avco Corp	448.6	1.1	36.8
17.	Hughes Aircraft Co	419.5	1.1	37.9
18.	Ford Motor Co	87.4		
	Philco-Ford Corp	316.4		
	Total	403.8	1.0	38.9
19.	Raytheon Co	384.1		
	Amana Refrigeration, Inc	(3)		
	D. C. Heath & Co	(3)		
	Edex Corp	(3)		
	Machlett Laboratories, Inc	18.5		
	Micro State Electronics Corp	.2		
	Raytheon Learning Systems Co	(3)		
	Seismograph Service Corp	.3		
	Total	403.3	1.0	39.9
20.	Honeywell, Inc	313.7	.8	40.7
21.	Northrop Corp	208.5		
	Hallicrafters Co	17.9		
	Northrop Carolina, Inc	10.9		
	Page Communications Engineers, Inc	69.1		
	Total	306.4	.8	41.5
22.	Kaiser Industries Corp	5.5		
	Kaiser Aerospace & Electronics Corp	3.5		
	Kaiser Jeep Corp	145.8		
	Kaiser Steel Corp	18.1		
	National Steel & Shipbuilding Co	132.8		
	Total	305.7	.8	42.3
23.	Bendix Corp	289.3		
	Bendix Field Engineering Corp	4.7		
	Bendix-Westinghouse Automotive Air Brake Co	.7		
	Dage Electric Co., Inc	(3)		
	Fram Corp	.7		
	Microwave Devices, Inc	.1		
	Mosaic Fabrications, Inc	.5		
	P. & D. Manufacturing Co., Inc	.1		
	Sheffield Corp	(3)		
	Total	296.1	.8	43.1
24.	Martin Marietta Corp	274.9		
	Bunker-Ramo Corp	15.3		
	Total	290.2	.7	43.8
25.	Ryan Aeronautical Co	118.9		
	Continental Aviation & Engineering Corp	26.0		
	Continental Motors Corp	136.5		
	Wisconsin Motor Corp	8.7		
	Total	290.1	.7	44.5
26.	General Tire & Rubber Co	17.3		
	Aerojet Delft Corp	.9		
	Aerojet General Corp	224.5		
	Batesville Manufacturing Co	25.1		
	Fleetwood Corp	.1		
	Frontier Airlines, Inc	(3)		
	General Tire International Co	.7		
	Space General Corp	4.4		
	Total	273.1	.7	45.2

See footnotes at end of table.

100 COMPANIES AND THEIR SUBSIDIARIES LISTED ACCORDING TO NET VALUE OF MILITARY PRIME CONTRACT AWARDS, FISCAL YEAR 1967 (JULY 1, 1966, TO JUNE 30, 1967)—Continued

Rank	Companies	Millions of dollars	Percent of U.S. total	Cumulative percent of U.S. total
27.	Radio Corp. of America	268.0		
	National Broadcasting Co., Inc	(3)		
	RCA Institutes, Inc	(3)		
	RCA Defense Electronics Corp	.4		
	Total	268.4	0.7	45.9
28.	International Telephone & Telephone Corp	149.7		
	Barton Instrument Corp	.1		
	Documat, Inc	.1		
	Federal Electric Corp	66.3		
	ITT Gilfillan, Inc	36.1		
	ITT Technical Services, Inc	.8		
	ITT Terryphone Corp	1.1		
	Jennings Radio Manufacturing Corp	.6		
	Puerto Rico Telephone Co	.4		
	Total	255.2	.7	46.6
29.	Ogden Corp	0		
	Avondale Shipyards, Inc	227.5		
	Eimco Corp	.2		
	International Terminal Operating Co., Inc	3.5		
	Ogden Technology Laboratories, Inc	.1		
	SMS Instruments, Inc	1.4		
	Tillie Lewis Foods, Inc	3.3		
	Wilson Foods, Inc	.7		
	Total	236.7	.6	47.2
30.	Standard Oil Co. (New Jersey)	0		
	American Cryogenics, Inc	.8		
	Esso International, Inc	144.3		
	Esso Research & Engineering Co	.7		
	Esso Standard Eastern, Inc	.1		
	Humble Oil & Refining Co	89.2		
	Total	235.1	.6	47.8
31.	Uniroyal, Inc	217.3		
	Uniroyal International Corp	(3)		
	Total	217.3	.6	48.4
32.	Collins Radio Co	201.6	.5	48.9
33.	Hercules, Inc	193.5		
	Haveg Industries, Inc	1.7		
	Total	195.2	.5	49.4
34.	International Business Machines Corp	194.6		
	Service Bureau Corp	.2		
	Science Research Associates	.1		
	Total	194.9	.5	49.9
35.	Newport News Shipbuilding & Dry Dock Co	188.5	.5	50.4
36.	Litton Industries, Inc	17.7		
	Aero Service Corp	(3)		
	Airtron, Inc	(3)		
	Clifton Precision Products Co., Inc	(3)		
	Ingalls Shipbuilding Corp	12.0		
	Kestor Solder Co	(3)		
	Kimball Systems, Inc	(3)		
	Litton Precision Products, Inc	7.5		
	Litton Systems, Inc	142.7		
	Monroe Calculating Machine Co	(3)		
	Monroe International, Inc	.2		
	Profexray, Inc	(3)		
	Total	180.3	.5	50.9
37.	du Pont (E. I.) de Nemours & Co	23.3		
	Remington Arms, Inc	156.3		
	Total	179.6	.5	51.4
38.	Thiokol Chemical Corp	172.7	.4	51.8

See footnotes at end of table.

100 COMPANIES AND THEIR SUBSIDIARIES LISTED ACCORDING TO NET VALUE OF MILITARY PRIME CONTRACT AWARDS, FISCAL YEAR 1967 (JULY 1, 1966, TO JUNE 30, 1967)—Continued

Rank	Companies	Millions of dollars	Percent of U.S. total	Cumulative percent of U.S. total
39.	F M C Corp	161.2	.....	.....
	Ferguson (Harry J.) Co	.2	.....	.....
	Gunderson Bros. Engineering Corp	8.3	.....	.....
	Total	169.7	0.4	52.2
40.	Chrysler Corp	164.3	.....	.....
	Chrysler International SA	.4	.....	.....
	Chrysler Outboard Corp	(3)	.....	.....
	Total	164.7	.4	52.6
41.	Goodyear Tire & Rubber Co	60.3	.....	.....
	Goodyear Aerospace Corp	89.3	.....	.....
	Goodyear International Corp	.2	.....	.....
	Kelly-Springfield Tire Co	.1	.....	.....
	Motor Wheel Corp	4.6	.....	.....
	Total	154.5	.4	53.0
42.	Olin Mathieson Chemical Corp	154.3	.4	53.4
43.	Standard Oil Co. (California)	86.4	.....	.....
	Caltex Oil Products Co.[5]	48.3	.....	.....
	Chevron Asphalt Co	.1	.....	.....
	Chevron Chemical Co	.9	.....	.....
	Chevron Oil Co	1.9	.....	.....
	Chevron Shipping Co	.6	.....	.....
	Community Oil Co., Inc	.3	.....	.....
	Pacific Oil Co	.1	.....	.....
	Standard Oil Co. (Kentucky)	12.0	.....	.....
	Standard Oil Co. of Texas	2.2	.....	.....
	Total	152.8	.4	53.8
44.	Day & Zimmerman, Inc	142.2	.4	54.2
45.	General Telephone & Electronics Corp	0	.....	.....
	Automatic Electric Co	5.9	.....	.....
	Automatic Electric Sales Corp	1.0	.....	.....
	General Telephone Co. of the Southwest	.1	.....	.....
	General Telephone Directory Co	.1	.....	.....
	General Telephone & Electronics Laboratories, Inc	.1	.....	.....
	Lenkurt Electric Co., Inc	11.1	.....	.....
	Sylvania Electric Products, Inc	120.2	.....	.....
	Total	138.5	.4	54.6
46.	Morrison-Knudsen Co	2.5	.....	.....
	Ferguson H. K. Co	.4	.....	.....
	National Steel & Shipbuilding Co.[4]	132.8	.....	.....
	Total	135.7	.3	54.9
47.	Norris Industries, Inc	127.3	.....	.....
	Fyr-Fyter Co	.3	.....	.....
	Total	127.6	.3	55.2
48.	General Precision Equipment Corp	0	.....	.....
	American Meter Controls	(3)	.....	.....
	Controls Co. of America	.6	.....	.....
	General Precision, Inc	112.8	.....	.....
	General Precision Decca Systems, Inc	.5	.....	.....
	Graflex, Inc	1.2	.....	.....
	Strong Electric Corp	1.6	.....	.....
	Tele-Signal Corp	4.7	.....	.....
	Vapor Corp	2.8	.....	.....
	Total	124.2	.3	55.5
49.	Texaco, Inc	24.2	.....	.....
	Caltex Oil Products Co [5]	48.3	.....	.....
	Jefferson Chemical Co	.6	.....	.....
	Texaco Caribbean, Inc	(3)	.....	.....
	Texaco Experiment, Inc	.8	.....	.....
	Texaco Export, Inc	45.5	.....	.....
	Texaco Puerto Rico, Inc	3.7	.....	.....
	Texaco Trinidad, Inc	(3)	.....	.....
	White Fuel Co., Inc	1.1	.....	.....
	Total	124.2	.3	55.8

See footnotes at end of table.

100 COMPANIES AND THEIR SUBSIDIARIES LISTED ACCORDING TO NET VALUE OF MILITARY PRIME CONTRACT AWARDS, FISCAL YEAR 1967 (JULY 1, 1966, TO JUNE 30, 1967)—Continued

Rank	Companies	Millions of dollars	Percent of U.S. total	Cumulative percent of U.S. total
50.	Sanders Associates, Inc	124.0	0.3	56.1
51.	T R W, Inc	120.5	.3	56.4
52.	Asiatic Petroleum Corp	117.2	.3	56.7
53.	Signal Oil & Gas Co	7.7	--------	----------
	Garrett Corp	104.9	--------	----------
	Petroleum Heat & Power Co	.1	--------	----------
	Southland Oil Corp	2.4	--------	----------
	Space Petroleum Corp	1.7	--------	----------
	Total	116.8	.3	57.0
54.	Harvey Aluminum, Inc	116.5	.3	57.3
55.	Pan American World Airways, Inc	115.1	.3	57.6
56.	Mobil Oil Corp	109.3	.3	57.9
57.	Eastman Kodak Co	108.4	--------	----------
	Eastman Kodak Stores, Inc	.3	--------	----------
	Total	108.7	.3	58.2
58.	Mason & Hanger-Silas Mason Co	108.4	.3	58.5
59.	Pacific Architects & Engineers, Inc	106.9	.3	58.8
60.	Lear Siegler, Inc	87.8	--------	----------
	American Avitron, Inc	.1	--------	----------
	Astek Instrument Corp	.5	--------	----------
	Hokanson (C.G.) Co., Inc	.1	--------	----------
	L S I Service Corp	11.6	--------	----------
	T. I. C. Engineers, Inc	.1	--------	----------
	Transport Dynamics, Inc	.6	--------	----------
	Total	100.8	.3	59.1
61.	Magnavox Co	98.5	.3	59.4
62.	Massachusetts Institute of Technology	94.9	.2	59.6
63.	American Machine & Foundry Co	93.2	--------	----------
	AMF Beaird, Inc	(3)	--------	----------
	AMF Tuboscope, Inc	.1	--------	----------
	Cuno Engineering Corp	.5	--------	----------
	Voit (W. J.) Rubber Corp	.3	--------	----------
	Total	94.1	.2	59.8
64.	Texas Instruments, Inc	93.4	--------	----------
	Metal & Controls, Inc	.3	--------	----------
	Total	93.7	.2	60.0
65.	Fairchild Hiller Corp	93.4	--------	----------
	Burns Aero Seat Co	.1	--------	----------
	Total	93.5	.2	60.2
66.	Curtiss-Wright Corp	90.8	.2	60.4
67.	Teledyne, Inc	87.8	.2	60.6
68.	Dillingham Overseas Corp. and H. B. Zachry Co	87.6	.2	60.8
69.	Chamberlain Corp	74.0	.2	61.0
70.	Flying Tiger Line, Inc	73.4	.2	61.2
71.	International Harvester Co	72.7	.2	61.4
72.	Federal Cartridge Corp	72.4	.2	61.6
73.	Johns Hopkins University	71.1	.2	61.8
74.	Aerospace Corp	70.8	.2	62.0
75.	Dow Chemical Co	65.5	--------	----------
	Dow Corning Corp	1.5	--------	----------
	Total	67.0	.2	62.2
76.	Continental Airlines, Inc	65.7	.2	62.4
77.	White Motor Corp	48.1	--------	----------
	Hercules Engines, Inc	15.6	--------	----------
	Minneapolis-Moline, Inc	.9	--------	----------
	Oliver Corp	.1	--------	----------
	Total	64.7	.2	62.6

See footnotes at end of table.

100 COMPANIES AND THEIR SUBSIDIARIES LISTED ACCORDING TO NET VALUE OF MILITARY PRIME CONTRACT AWARDS, FISCAL YEAR 1967 (JULY 1, 1966, TO JUNE 30, 1967)—Continued

Rank	Companies	Millions of dollars	Percent of U.S. total	Cumulative percent of U.S. total
78.	Condec Corp	61.9		
	Consolidated Controls Corp	1.1		
	Total	63.0	0.2	62.8
79.	Western Union Telegraph Co	62.4	.2	63.0
80.	Emerson Electronic Co	56.9		
	Pace, Inc	.5		
	Rantec Corp	.1		
	Supreme Products Corp	4.7		
	Total	62.2	.2	63.2
81.	Firestone Tire & Rubber Co	61.0		
	Dayton Tire & Rubber Co	.3		
	Total	61.3	.2	63.4
82.	Bethlehem Steel Corp	54.3		
	Bethlehem Steel Export Corp	3.7		
	Calmar Steamship Corp	2.3		
	Total	60.3	.2	63.6
83.	Airlift International, Inc	59.0	.2	63.8
84.	Hughes Tool Co	58.6	.1	63.9
85.	Cessna Aircraft Co	52.1		
	Aircraft Radio Corp	4.6		
	Total	56.7	.1	64.0
86.	Atlantic Research Corp	56.3		
	Northeastern Engineering, Inc	.2		
	Total	56.5	.1	64.1
87.	Sverdrup & Parcel, Inc	.9		
	A R O, Inc	55.6		
	Total	56.5	.1	64.2
88.	American Manufacturing Co. of Texas	54.9	.1	64.3
89.	Stevens (J. P.) & Co., Inc	53.4	.1	64.4
90.	Vinnell Corp	53.1	.1	64.5
91.	Westinghouse Air Brake Co	14.1		
	Failing (George E.) Co	.3		
	Le Tourneau-Westinghouse Co	2.7		
	Melpar, Inc	15.4		
	Wilcox Electric Co., Inc	19.4		
	Total	51.9	.1	64.6
92.	System Development Corp	50.4	.1	64.7
93.	Northwest Airlines, Inc	50.3	.1	64.8
94.	Gulf Oil Corp	49.8		
	Industrial Asphalt, Inc	.1		
	Total	49.9	.1	64.9
95.	Smith Investment Co	0		
	Smith, A. O., Corp	48.5		
	Total	48.5	.1	65.0
96.	Motorola, Inc	42.7		
	Motorola Communications & Electronics, Inc	5.0		
	Motorola Overseas Corp	.1		
	Total	47.8	.1	65.1

See footnotes at end of table.

100 COMPANIES AND THEIR SUBSIDIARIES LISTED ACCORDING TO NET VALUE OF MILITARY PRIME CONTRACT AWARDS, FISCAL YEAR 1967 (JULY 1, 1966, TO JUNE 30, 1967)—Continued

Rank	Companies	Millions of dollars	Percent of U.S. total	Cumulative percent of U.S. total
97.	Cities Service Co	0	.....	.....
	Cities Service Gas Co	.5	.....	.....
	Cities Service Oil Co	39.4	.....	.....
	Cities Service Tankers Corp	7.6	.....	.....
	Total	47.5	0.1	65.2
98.	Tumpane Co., Inc	46.9	.1	65.3
99.	Union Carbide Corp	44.5	.....	.....
	Englander Co., Inc	1.0	.....	.....
	Korad Corp	.7	.....	.....
	Ocean Systems, Inc	.6	.....	.....
	Total	46.8	.1	64.5
100.	Maxson Electronics Corp	45.9	.....	.....
	Hopkins Engineering Co	.1	.....	.....
	Total	46.0	.1	65.5

[1] Net value of new procurement actions minus cancellations, terminations, and other credit transactions. The data include debit and credit procurement actions of $10,000 or more, under military supply, service and construction contracts for work in the United States, plus awards to listed companies and other U.S. companies for work overseas.

Procurement actions include definitive contracts, the obligated portions of letter contracts, purchase orders, job orders, task orders, delivery orders, and any other orders against existing contracts. The data do not include that part of indefinite quantity contracts that have not been translated into specific orders on business firms, nor do they include purchase commitments or pending cancellations that have not yet become mutually binding agreements between the Government and the company.

[2] The assignment of subsidiaries to parent companies is based on stockownership of 50 percent or more by the parent company, as indicated by data published in standard industrial reference sources. The company totals do not include contracts made by other U.S. Government agencies and financed with Department of Defense funds, or contracts awarded in foreign nations through their respective governments. The company names and corporate structures are those in effect as of June 30, 1966. Only those subsidiaries are shown for which procurement actions have been reported.

[3] Less than $50,000.

[4] Stockownership is equally divided between Kaiser Industries Corp. and Morrison-Knudsen Co.; half of the total military awards is shown under each of the parent companies.

[4] Stockownership is equally divided between Standard Oil Co. of California and Texaco, Inc.; half of the total of military awards is shown under each of the parent companies.

APPENDIX 8

STATEMENT OF NATIONAL AEROSPACE ASSOCIATION ON CIVIL SERVICE COMMISSION OPINION

NATIONAL AEROSPACE SERVICE ASSOCIATION,
Washington, D.C., November 28, 1967.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Economy in Government,
The Joint Economic Committee,
Washington, D.C.

DEAR SENATOR PROXMIRE: National AeroSpace Services Association (NASSA) will appreciate inclusion of the attached information in the record of your current hearings.

This provides the position of this industry on the recent Civil Service Commission General Counsel opinion to which Mr. Staats referred in his testimony yesterday.

With kindest regards, I am,
Sincerely,

HARRY S. BAER, *Executive Director.*

PRIVATE INDUSTRY THREATENED BY CIVIL SERVICE OPINION

NASSA NEWS RELEASE NO. 67–10, NOVEMBER 15, 1967

A Civil Service Commission (CSC) legal opinion could have serious impact on private industry's role in performing services under contract for the government, National AeroSpace Services Association (NASSA) warned today.

The opinion itself, authored by CSC General Counsel Leo M. Pellerzi, is not industry's primary concern, NASSA noted, but there is apprehension about how it will be interpreted and implemented. Although it applies mainly to a select few service contracts of National Aeronautics and Space Administration (NASA), its vast comprehensiveness and detail "read like a blueprint for a socialistic state," one NASSA member company president stated.

A 25-year-old national trade association of companies engaged in aerospace services, both commercially and under government contract, NASSA has just completed a survey among its 37 member companies to obtain industry reaction to the Pellerzi Opinion. Strong feelings expressed emphasize that Pellerzi's views present "a highly biased impression that all service contractors are guys in black hats," as one NASSA member who heads a small business doing aircraft maintenance for the Air Force put it.

Recent articles on the Pellerzi Opinion substantiate such concern as some writers failed to limit their coverage to the legal issues concerning the NASA contracts in question. This is due to some extent to the manner in which the Pellerzi material is presented. For example, a Washington newspaper columnist wrote the opinion "is intended to apply, also to all similar contracts throughout government" and predicted that "up to 250,000 employees" would be added to the federal payroll "as replacements for (more costly) contractor personnel." Such statements, NASSA contends, are not based on fact.

Although directed at the Space Agency, the CSC ruling " leaves too much room for interpretation that could force service-type functions in house on a broad basis," another members commented. He feels Pellerzi "dwells on many insignificant factors" in his justification of when a service contract is illegal without providing standards to measure the magnitude of their relative importance. This gives the opinion "vast imbalance," he added.

This contention and NASSA's position gained support from the General Accounting Office (GAO). Although Comptroller General Elmer B. Staats concurs

with the Pellerzi Opinion, GAO is cautious not to overstep boundaries on the primary issue—CSC's charge that the Space Agency contracts are "illegal." In his letter of November 1 to CSC Chairman John W. Macy, Jr., Staats stated GAO concurrence is based on a 1965 legal decision that certain technical support services contracts are "illegal" because, in essence, the contracts supplied people in a function not unlike that of a personnel agency. NASSA members have not been disturbed by this decision as their most valuable contribution under a service contract is their management role—the key to economy and efficiency achievable under the contract concept. The government buys management in its contracts with NASSA member companies.

The Comptrollers General's letter makes an effort to clarify "considerable misunderstanding among government agencies" which has resulted from "a number of generalizations" contained in Pellerzi's paper, GAO legal authorities advised NASSA. (NASSA was the only industry group to contact GAO before completion of Staats' letter of concurrence.) GAO will continue to view "contractor control and supervision" as the main element which determines that a service contract is beyond the purview of the illegality ruling; therefore, not in jeopardy of termination and conversion.

Because the CSC document can be read two ways, it poses peril to industry. Without additional balancing comment, it will "stimulate conversion of contracts to an in-house basis irregardless of the basic illegality issue," says a component overhaul contractor, "and it will deter future contract awards. It is bound to raise doubt about service contracting across the board in the minds of many procurement officials with whom we deal. The in-house route is likely to get the nod, despite higher cost, because the Pellerzi Opinion has created such an imbalance which, taken out of legal context, provides the strongest of endorsement that services should be done almost exclusively by government workers. I am gravely concerned of its potential broad application and our industry will need substantial protection to survive the pressures of the strong groups who will overplay and misinterpret not only the Pellerzi ruling but also the Staats letter to suit their objective of advancing government's tremendous growth—ironically, at a time when both the Executive and Legislative Branches are under pressure to reduce government personnel and cut costs."

A vice president of a NASSA member company engaged in aircraft maintenance under contract for the Army expressed concern for the nation's economy were contract services tranferred en masse to government employees with "resultant loss of tax money from free enterprise activities."

The president of one of the country's largest aircraft engine overhaul companies doing business both under government contract and commercially for airlines and industry mentioned private enterprise's role "to help develop under-developed areas throughout the country and train not only the unemployed but the underemployed." He further commented that "the law which has brought on the illegality issue " should be challenged judicially if it is not serving the best interests of the country, which seems to be the case. We can offer proof that industry does the job better, quicker, and cheaper."

NATIONAL AEROSPACE SERVICES ASSOCIATION

MEMBER COMPANIES

Aero Corp., Lake City, Florida.
Aero Maintenance Radio, Inc., Miami Springs, Florida.
Aerodex, Inc., Miami, Florida.
Air Carrier Engine Service, Inc., Miami, Florida.
Air International, Miami, Florida.
Aircraft Plating, Inc., Miami, Florida.
Aircraft Turbine Service, Inc., Westbury, (L.I.), New York.
Airponents, Inc., Lawrence, (L.I.), New York.
Airtech Service, Inc., Miami, Florida.
Central American Airways, Louisville, Kentucky.
Consolidated American Services, Inc., Los Angeles, California.
Dallas Airmotive, Inc., Dallas, Texas.
Dynalectron Corp., Washington, D.C.
Fairchild Hiller Aircraft Service Div., St. Augustine, Florida.

Gary Aircraft Corp., San Antonio, Texas.
General Dynamics Corp., Fort Worth, Texas.
Hawthorne Aviation, Charleston, South Carolina.
Hayes International Corp., Birmingham, Alabama.
Hylan School of Aeronautics, Rochester, New York.
International Aerospace Services, Inc., Charleston AFB, South Carolina.
Lockheed Aircraft Service Co., Ontario, California.
LSI Service Corp., Santa Monica, California.
LTV Electrosystems, Inc., Greenville, Texas.
Maytag Aircraft Corp., Colorado Springs, Colorado.
National Aircraft Sales, Inc., Dallas, Texas.
Page Aircraft Maintenance, Inc., Lawton, Oklahoma.
Ross Aviation, Inc., Fort Rucker, Alabama.
Serv-Air, Inc., Vance AFB, Oklahoma.
Southern Airways Co., Atlanta, Georgia.
Southern Airways of Texas, Inc., Fort Wolters, Texas.
Southwest Airmotive Co., Dallas, Texas.
Spartan Aircraft Co., Tulsa, Oklahoma.
United Aircraft Corp. (Hamilton Standard Div.), East Granby, Connecticut.

ASSOCIATE MEMBER COMPANIES

Aero Engineering & Manufacturing Co., Glendale, California.
Cee Bee Chemical Co., Inc., Downey, California.
Charlotte Aircraft Corp., Charlotte, North Carolina.
Pennsalt Chemicals Corp., Philadelphia, Pennsylvania.

National AeroSpace Services Association

CODE OF PRINCIPLES

1. To advance and encourage economical, efficient, and ethical development and operation of all aerospace services (the term "aerospace" constituting both aviation-aeronautical and missile-space oriented activities) among companies engaged in various aerospace service-type activities—both commercially and under contract for the government—such as overhaul, maintenance, and modification; flight and technical training; into-plane refueling; base management functions; and other aerospace services accomplished throughout the United States and abroad under the free enterprise system which is the essence of the U.S. principle of government.

2. To cooperate with agencies of the federal, state, and local government and with private organizations to the end that all the above-named aerospace facilities best suited to the national need may be maintained under civilian management and supervision in all instances in whch aerospace servces industry can accomplish a requirement more economically and efficiently within the framework of maintaining the strongest possible national defense.

3. To contribute to the improvement of methods and techniques of civilian contracting and the use thereof by all branches of the armed services and other agencies of the federal, state, and local government—particular emphasis being given such special projects as the Department of Defense Contractor Cost Reduction Program, Zero Defects Program, and other such affirmative programs designed to reduce defense procurement costs and operating expenditures.

4. To assist and to cooperate with executive agencies of government and the Congress in improving methods and techniques of contracting for aerospace services, discouraging such action in individual procurement cases that could bring discredit upon the concept and practice of civilian contracting.

5. To formulate uniform, safe, efficient, and modern techniques in all phases of aerospace training—emphasizing the continued improvement in the safety of flight—and to promote and assist in development and installation of all technological improvements in equipment to aid aerospace navigation and guidance techniques to increase efficiency and to enhance safety of flight.

6. To foster better public understanding of present and potential contributions to the national welfare by greater civilian participation in various phases of aerospace services for the government.

7. To confederate in one organization all those having a mutual interest in furthering the objectives as set forth in this code; to encourage cooperative

relations, including exchange of data and information among the member companies; and to limit membership to those who will maintain and conduct all operations in such manner as to reflect credit as to individual business ethics, responsibilities, and sound standards and as to reflect credit on the organization of National AeroSpace Services Association.

NATIONAL AEROSPACE SERVICES ASSOCIATION

PURPOSE—FUNCTION—HISTORY

National AeroSpace Services Association (NASSA) is a national trade association representing, as a group, companies which are engaged in various aviation and space service-type activities. In behalf of this industry, NASSA maintains direct contact with the Pentagon, Congress, Federal Aviation Agency, National Aeronautics and Space Administration, Small Business Administration, and other government agencies on matters of specific interest and importance to the NASSA membership. NASSA's work is directed at enhancing a favorable business climate for the aerospace services industry—both commercially and under contract with the government. One of its continuing missions—use of civil enterprise for such aerospace services which industry can accomplish more economically and efficiently within the framework of maintaining the strongest possible national security.

Among the varied aerospace services accomplished by NASSA member companies are the following:

Airframe and engine maintenance, modification, overhaul, and repair.

Missile maintenance and support services, such as range instrumentation, collection of missile in flight data, and training support.

Aircraft flight and technical training.

Maintenance, modification, overhaul, and repair of aerospace electronics equipment.

Into-plane refueling.

Air base management and housekeeping functions.

Fixed-base operations, aviation sales and supply, and other aerospace services for commercial industry and the government under contract.

As focal point of the aerospace services industry, NASSA brings together into a national trade association companies with common interests and goals which are of benefit to this specific industry. A primary objective is to advance the use of the contract concept with the Armed Services and other government agencies. This stimulates additional business for the entire industry.

NASSA works with the Armed Forces on policy and procurement matters. It annually holds symposiums with the services which provide an ideal forum for exchange of information between military officials and contractors. Key officials from the Armed Forces, Congress, and the Federal Aviation Agency address the association at its Annual Meeting, held in the spring each year in Washington. Special committees are formed for pertinent tasks when required. NASSA strives continually to keep its membership alert to contract opportunities. It has an efficient system of reporting all matters of interest to member companies.

NASSA was incorporated as a non-profit trade association on December 9, 1942, as Aeronautical Training Society. Its organization was stimulated and approved by Gen H. H. (Hap) Arnold to serve the Army Air Corps during World War II as an association of contract primary flight training schools. Some 60 of these civilian-operated schools trained nearly 200,000 cadets in the World War II effort.

Aeronautical Training Society performed a similar function during the Korean Conflict. From 1952 through 1960, more than 40,000 Air Force pilots received their primary flight training at contract schools. Thousands of pilots from friendly foreign nations were also trained under contract at these schools. On April 29, 1960, it merged with The Aircraft Service Association, which had been established during the Korean War to serve major companies engaged in aircraft overhaul and maintenance. The new organization was called National Aeronautical Services Association.

The association's name underwent slight change on April 10, 1963, when it became known as National AeroSpace Services Association.

APPENDIX 9

STATEMENTS ON "BUY AMERICAN" ACT POLICY

SCHERR-TUMICO, INC.,
St. James, Minn., November 24, 1967.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee of the Senate Finance Committee,
Washington, D.C.

DEAR SENATOR PROXMIRE: We are manufacturers of precision hand tools and measuring instruments. The precision hand tool business has been the main stay of our growth, and while we are twenty-five years old, we are still a small business employing approximately 400 people.

Foreign competition has made deep inroads into our business and has retarded our growth to the point where we wonder whether or not we shall be in business ten years from now. Immediately following World War II, the European type of vernier caliper, which is in demand in this country in large quantities, we found we had to purchase from Germany, because our labor rates would not permit us to be competitive.

Since 1950, the Japanese have increased their quality so that their instruments are equal to ours. Their prices are so much below those of American manufacturers that their exports to this country are increasing tremendously to the point where now American made precision tools purchased in this country are but a small part of the total market here. A wholly owned subsidiary of Mitutoyo in Tokyo, Japan, is an American corporation called the MTI Corporation of New York, which is their sales and distributing firm for the American market. Because of their labor rates, they started after World War II and have become the world's largest manufacturer of precision hand measuring tools.

From the figures we have been able to obtain, so far in the first nine months of this calendar year, the General Services Administration purchased $475,000 worth of micrometers from the Mitutoyo sales outlet here. The 12% differential allowed under the Buy American Act is unrealistic in the light of the difference in the wage rates in Japan and those in the United States. The Defense Department uses a figure of 50%, which makes all the difference as to who gets the award. Why, in the hand tool field, are we granted only a 12% differential when our wage rates are at least two and one half to four times those of the Japanese? Japanese workmen pay no income taxes to help bolster our Treasury.

There are very few American companies left in the precision tool field. Lufkin Rule Company was forced to cease the manufacture of precision hand measuring tools in November of 1966, after having been in the business for almost one hundred years. It is rumored that Millers Falls has discontinued the manufacture of micrometers. With minor exceptions, this leaves the L. S. Starrett Company at Athol, Massachusetts, Brown & Sharpe Manufacturing Company at Providence, Rhode Island, and this corporation as the only manufacturers of precision hand measuring tools in this country. The Government purchases that went to Mitutoyo would have been extremely welcome in this business during the past year and would have been a means of bolstering this corporation's fortunes and assuring our people of continued employment.

It is alarming to note the devastating effect foreign competition has had on this industry, particularly when the United States buys the major portion of these tools from foreign suppliers.

It is my understanding that the Tool Industry Trade Association have gone on record in pointing out the impact that such purchases from foreign manufacturers is having on the American tool economy.

I made a trip to Japan last April to study the situation and received actual figures from our Embassy there as to the dollar and unit shipments of precision hand tools to the United States. I was appalled by the annual growth each year of their exports of these products to this country.

The duty imposed on these imports is very small. There should at least be some limitation factor as to the volume and increase of these imports before it is too late to save our own hand tool industry. The least that could be done is to increase the 12% differential which now exists in the Buy American Act to the 50% as used by the Defense Department.

Your interest in this problem and some remedial action on the part of your Committee will be most appreciated by all who are attempting to maintain the American way of life and still meet competition in our own country.

Very truly yours,

HOWARD M. JAMES, *President and Chairman.*

SERVICE TOOLS INSTITUTE,
New York, N.Y., November 29, 1967.

Subject: Improper Application of Buy American Act in Government Purchasing.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR PROXMIRE: Representing the domestic manufacturers of hand tools, including those in the State of Wisconsin, we would again like to bring to your attention the inconsistent hand tool buying policies of the General Services Administration and the Department of Defense under the Buy American Act.

As you know, in the case of GSA, only a 6 percent tool buying differential in favor of domestic manufacturers is permitted, while in the case of the Department of Defense a 50 percent differential in favor of domestic manufacturers is allowed. Because of this disparate policy, foreign bidders are continuing to obtain many awards from GSA with its 6 percent differential, which would not be possible if the procurement were made by DOD. Obviously, if this policy continues the already substantial loss of business by hand tool manufacturers will continue to rise and the USA balance of payments will worsen further.

Since we wrote you on April 12, 1967, the GATT International Trade Negotiations have been concluded at Geneva, with the result that USA import duties on hand tools have been reduced by 50 percent. Under the circumstances, it can be clearly seen that imports of low-wage cost foreign tools, particularly those from Japan, are bound to increase at a faster rate than ever before.

Accordingly, it is most important to the life of this industry and jobs of employees in our domestic hand tool plants that the tool buying differential of the GSA be no lower than the 50 percent currently allowed by the Department of Defense. We respectfully request and urge, therefore, that you and your Committee make every possible effort to have the Bureau of the Budget permit the GSA to adopt this 50 percent tool buying differential currently allowed by the Department of Defense.

This appeal is respectfully submitted on behalf of the domestic hand tool manufacturing companies whose names appear on the attached list.

Also, we respectfully request that this letter be entered in the record of the Hearings now being conducted by the Sub-Committee on Economy in Government of the Joint Economic Committee.

Yours sincerely,

GEORGE P. BYRNE, Jr., *Secretary.*

LIST OF SERVICE TOOLS MANUFACTURERS

A. & E. Manufacturing Co., Racine, Wis.
Advertising Metal Display Co., Rem Line Division, Chicago, Ill.
Apco Mossberg Co., Attleboro, Mass.
Apex Machine & Tool Co., Dayton, Ohio.
Armstrong Bros. Tool Co., Chicago, Ill.
Baltimore Tool Works, Baltimore, Md.
Bergman Tool Manufacturing Co., Inc., Buffalo, N.Y.
Boker Manufacturing Co., Subsidiary of New Britain Machine Co., Maplewood, N.J.
The Bridgeport Hardware Manufacturing Division, Crescent Niagara Corp., Bridgeport, Conn.

C. & G. Wheel Puller Co., Inc., Scio, N.Y.
Cameron Manufacturing Corp., Emporium, Pa.
Channellock, Inc., Meadville, Pa.
Cleco Division, Reed International, Inc., Houston, Tex.
Cornwell Quality Tools Co., Mogadore, Ohio.
Crescent Niagara Corp., Buffalo, N.Y.
Crescent Tool Division, Crescent Niagara Corp., Jamestown, N.Y.
Diamond Tool & Horseshoe Co., Duluth, Minn.
Dowley Manufacturing, Inc., Spring Harbor, Mich.
C. Drew & Co., nIc., Kingston, Mass.
Duplex Manufacturing Corp., Fort Smith, Ark.
Duro Metal Products Co., Chicago, Ill.
Fairmount Tool and Forging, Division of Houdaille Industries, Inc., Cleveland, Ohio.
Fleet Tool Corp., Schiller Park, Ill.
The Forsberg Manufacturing Co., Bridgeport, Conn.
Jo-Line Tools, Inc., South Gate, Calif.
Ken Tool Manufacturing Co., Akron, Ohio.
Kennedy Manufacturing Co., Van Wert, Ohio.
Mathias Klein & Sons, Chicago, Ill.
McKaig-Hatch, Division of Tasa Coal Co., Buffalo, N.Y.
Metal Box & Cabinet Corp., Chicago, Ill.
Midwest Tood & Cutlery Co., Inc., Sturgis, Mich.
Milbar Corp., Cleveland, Ohio.
Millers Falls Co., Greenfield, Mass.
Moore Drop Forging Co., Springfield, Mass.
New Britain Machine Co., New Britain, Conn.
Nupla Manufacturing Co., Los Angeles, Calif.
C. S. Osborne Co., Harrison, N.J.
Owatonna Tool Co., Owatonna, Minn.
P. & C. Tool Co., Portland, Ore.
Park Manufacturing Co., Grant Park, Ill.
Parker Manufacturing Co., Worcester, Mass.
Petersen Manufacturing Co., Inc., De Witt, Nebr.
H. K. Porter, Inc., Somerville, Mass.
Proto Tool Co., Los Angeles, Calif.
The Quality Tools Corp., New Wilmington, Pa.
Reed & Prince Manufacturing Co., Worcester, Mass.
S–K Wayne Tool Co., Subsidiary of Symington-Wayne Corp., Chicago, Ill.
Snap-On Tools Corp., Kenosha, Wisc.
Stanley Tools, Division of the Stanley Works, New Britain, Conn.
Stevens Walden, Inc., Worcester, Mass.
Stream Line Tools, Inc., Conover, N.C.
P. A. Sturtevant Co., Addison, Ill.
Superior Tool Co., Cleveland, Ohio.
Thorsen Manufacturing Co., Oakland, Calif.
Torque Controls, Inc., South El Monte, Calif.
Union Steel Chest Corp., LeRoy, N.Y.
Upson Bros., Inc., Rochester, N.Y.
Utica Tool Company, Inc., Orangeburg, S.C.
Vaco Products Co., Chicago, Ill.
Vaughan & Bushnell Manufacturing Co., Hebron, Ill.
Vlchek Tool Co., Cleveland, Ohio.
Waterloo Industries, Inc., Waterloo, Iowa.
Wilde Tool Co., Inc., Hiawatha, Kans.
J. H. Williams & Co., Buffalo, N.Y.
J. Wiss & Sons Co., Newark, N.J.
Wright Tool & Forge Co., Barberton, Ohio.
Xcelite, Inc., Orchard Park, N.Y.

(The following material was submitted by Deputy Director Hughes:)

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., January 30, 1968.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee, Congress of the United States, Washington, D.C.

(Attention: Mr. Ray Ward.)

DEAR MR. CHAIRMAN: Mr. Ray Ward, of your staff, has asked for additional information regarding two matters which came up during the course of my testimony before the Committee.

With regard to the first (hand tools—Buy American policy), enclosed is copy of a letter to Senator Brooke following up on earlier correspondence and telephone calls, and confirming discussions with a member of his staff. At the hearings of the Joint Committee I indicated that I would report to the Committee on the follow-up with Senator Brooke that the Committee requested. I had neglected to do so.

With regard to the second (Government-owned equipment in contractor plants), enclosed is a copy of a tabulation returned with the transcript when it was sent us for editing. We believe the tabulation responsive to your inquiry in the description on page 394 of the transcript. (See p. 554.)

Sincerely,

PHILLIP S. HUGHES,
Deputy Director.

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., January 27, 1968.

Hon. EDWARD W. BROOKE,
U.S. Senate, Washington, D.C.

DEAR SENATOR BROOKE: This is in response to correspondence and telephone calls from you and members of your staff concerning the Bureau of the Budget's application of the Buy American Act in the purchase of handtools by the General Services Administration and the Department of Defense. As you know, I have also met with Mr. Riemer of your staff on the matter.

As the result of an attempt to provide a more efficient and economical government-wide system of procurement, GSA has been given primary responsibility for purchasing handtools for use by all government agencies. DOD and GSA entered into a consolidated purchasing agreement in 1964 in order to eliminate overlapping and duplication within the Government's supply system. Under this agreement, procurement and management control for 52 classes of commodities, including handtools, were transferred to GSA. DOD was given procurement responsibility for all agencies for 98 classes of commodities. The division of procurement responsibility for specific commodities was determined on the basis of the end use of the commodity. GSA was given the procurement responsibility for those items used through the Federal Government or which were commercial in nature. DOD was assigned those items which were essential to military operations.

Total purchases of handtools by GSA were about $107.5 million in fiscal year 1967, foreign procurement amounted to $2.7 million (about 2.5%). Recent analysis by GSA indicates that foreign procurement of handtools would have been significant in FY 1967 (about $1.5 million) even under the application of the DOD 50% differential. As you can see, GSA procurement of foreign handtools is a small part of GSA total handtool procurement and has not been the cause of a dislocation of the American handtool industry. GSA purchase of foreign handtools is also a small part of the value of handtools imported into the U.S.

Furthermore, the difference between effective preference afforded domestic firms under the 6% GSA differential and the 50% DOD differential is not as great as it would first appear. Because the 6% differential is applied to the foreign offered price, *including duties*, while the 50% differential is applied to the offered price *excluding duties*, the difference in the effective preference afforded domestic bidders under the two differentials will be smaller the higher the duties. The average rate of duties on handtools purchased by the GSA is about 23%; thus, using the 6% rule gives domestic bidders 30% effective preference, compared to 50% preference under the DOD 50% rule.

In our continuing review of Buy American practices, higher budgetary costs must be weighed against possible balance of payments savings associated with the application of price differentials in evaluating bids on foreign and domestic products. We must consider also the implication of any change in the differentials on our efforts to reduce trade barriers and on the procurement practices of foreign governments. Defense regulations specify that its existing procurement practice is a temporary measure which will be eliminated when the balance of payments problem is less pressing. While this policy differs from that of civilian agencies, we do not believe the standards now applied by the Department of Defense or other agencies should be changed.

Sincerely,

PHILLIP S. HUGHES,
Deputy Director.

DOD MACHINE TOOL PURCHASES

[In millions of dollars]

	Fiscal year				
	1963	1964	1965	1966	1967
Total	$57.3	$51.2	$45.8	$110.5	$90.1
Ammunition machine tools	----------	----------	3.3	36.3	26.3
Balance	----------	----------	42.5	74.2	63.8

It will be noted that approximately 33 percent and 29 percent of Government purchased machine tools in FY 1966 and FY 1967, respectively, went for the support of the ammunition program which is principally a Government-owned, contractor-operated activity devoted full-time to producing for military needs. Related, but not included in the ammunition machine tool totals, are machine tools which have been purchased for the gun and gun tube programs. Most of these tools are also used exclusively in Government-owned activities.

MPORTS OF MECHANICS' HAND SERVICE TOOLS COMPARED WITH U.S. MANUFACTURERS' SHIPMENTS IN THE DOMESTIC MARKET, ANNUAL TOTAL VOLUMES, IN DOLLAR VALUE

Years and months	U.S. manufacturers' domestic shipments	Percent	Imports into United States	Percent	Total domestic market in United States
1948	$74,512,086	99.8	$169,320	0.2	$74,681,406
1949	60,462,104	99.7	153,780	.3	60,615,884
1950	77,917,482	99.5	411,864	.5	78,329,346
1951	99,130,508	98.9	1,085,172	1.1	100,215,680
1952	96,404,704	98.7	1,278,540	1.3	97,683,244
1953	96,461,867	97.9	2,098,464	2.1	98,560,331
1954	80,560,947	97.2	2,313,396	2.8	82,874,343
1955	93,536,405	96.3	3,560,136	3.7	97,096,541
1956	105,288,665	96.8	3,452,184	3.2	108,740,849
1957	107,225,021	96.3	4,169,460	3.7	111,394,481
1958	106,104,502	95.3	5,234,388	4.7	111,338,890
1959	118,828,160	94.4	7,101,792	5.6	125,929,952
1960	113,429,275	93.5	7,857,720	6.5	121,286,995
1961	116,256,085	94.0	7,462,488	6.0	123,718,573
1962	132,436,090	94.3	7,950,852	5.7	140,386,942
1963	142,053,479	94.3	8,609,403	5.7	150,662,882
1964	158,443,648	94.6	9,003,272	5.4	167,446,920
1965	185,479,573	94.4	10,934,780	5.6	196,414,353
1966	208,103,791	93.7	13,940,479	6.3	222,044,270
1967					
January	15,530,284	91.9	1,363,143	8.1	16,893,427
February	17,632,271	95.0	929,124	5.0	18,561,395
March	19,534,740	92.8	1,508,738	7.2	21,043,478
April	16,957,806	94.0	1,074,101	6.0	18,031,907
May	17,535,402	92.5	1,430,063	7.5	18,965,465
June	18,743,026	93.4	1,323,121	6.6	20,066,147
July	14,200,451	90.7	1,452,471	9.3	15,652,922
August	17,191,593	90.9	1,727,072	9.1	18,918,665

Source: Imports data from U.S. Department of Commerce.

TABULATION SHOWING COMPARISON OF MECHANICS' HAND SERVICE TOOLS IMPORTS WITH U.S. MANUFACTURERS' SALES IN THE U.S. MARKET—DATA ON MONTHLY AVERAGE VOLUME BASIS

[Dollar amounts in thousands

	Annual averages		Monthly average 1st 8 months, 1967	Percent change
	1965	1966		
STI's shipments into domestic U.S. market	$15,457	$17,342	$17,166	−1.0
Imports into United States	911	1,162	1,350	+16.2
Total, domestic market in United States	16,368	18,504	18,516	+.1
Imports of total market (percent)	5.6	6.3	7.3	

COMPARISON, 1ST 8 MONTHS OF 1967 WITH SAME PERIOD IN 1966

[Dollar amounts in thousands]

	Monthly average rate, 1st 8 months, each year		Percent change
	1966	1967	
STI's shipments into domestic market	$16,609	$17,166	+3.4
Imports into United States	1,162	1,350	+16.2
Total, domestic market in United States	17,771	18,516	+4.2
Imports of total market (percent)	6.5	7.3	

IMPORTS—MONTHLY AVERAGE RATE COMPARISON OF SOME HANDTOOL PRODUCTS—FROM U.S. DEPARTMENT OF COMMERCE

[Dollar amounts in thousands]

	1965	1966	1st 8 months, 1967	1967, plus or minus 1966 percent change
(a) Slip-joint pliers	$83,079	$117,685	$102,751	−12.7
(b) Pliers, nippers, pincers, etc	165,659	202,616	244,909	+20.9
(d) Tin snips and parts	4,248	3,214	3,699	+15.1
(f) Bolt and chain cutters and metal cutting shears	12,359	15,056	15,466	+2.7
(g) Pipe wrenches and spanners	60,867	93,803	90,999	−3.0
(h) Pipe tools, pipe wrenches, etc	285,565	350,189	418,285	+19.5
(i) Hammers, etc	55,219	68,156	63,024	−7.1
(k) Chisels and other cutting tools	37,239	39,071	44,586	+14.4
(l) Screwdrivers	73,395	77,736	83,536	+7.5
(n) Interchangeable tools, not metal cutting	81,460	140,906	219,470	+55.8

APPENDIX 10

COMPTROLLER GENERAL'S OPINION ON AUTHORITY OF ADMINISTRATOR OF GSA RE PURCHASE, LEASE, MAINTENANCE, OPERATION OF ADPE

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., November 21, 1967.

B-151204.
B-157587.

Hon. LAWSON B. KNOTT, Jr.,
Administrator, General Services Administration.

DEAR MR. KNOTT: By letter of July 11, 1967, you requested our opinion with respect to the authority of the Administrator of General Services under the provisions of Pub. L. 89-306, 79 Stat. 1127, which amended the Federal Property and Administrative Services Act of 1949 to provide for the economic and efficient purchase, lease, maintenance operation, and utilization of automatic data processing equipment by Federal departments and agencies.

The complete text of Public Law 89-306 reads as follows:

"'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 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 provisio 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.'"

Your letter includes a summary of actions which have been taken to date by the Bureau of the Budget and the General Services Administration in getting underway implementation of the concepts inherent in section 111. GSA has prepared draft regulations designed to achieve what are believed to be the objectives of that section—to establish a single purchaser for all general purpose ADPE used by Federal agencies. You point out that the draft of these Government-wide regulations is based upon the interpretation that section 111 provides GSA with exclusive authority to procure all general purpose ADPE for use by Federal agencies but that the regulations will not include procedures or controls which could be interpreted as interfering with determinations of requirements for or use of ADPE by Federal agencies.

With a view to expediting and facilitating the orderly functioning of the procurement processes in the acquisition of ADPE, you request a decision on the question of the extent to which other Federal agencies may have independent authority to procure ADPE. Specifically you ask:

"* * * whether, on the one hand, other agencies are legally required to obtain a delegation of procurement authority from GSA or use GSA as the agency to purchase their general-purpose ADPE, or whether, on the other hand, agencies may acquire ADPE without regard to any actions which might be taken by GSA pursuant to section 111."

Your inquiry is prompted by the fact that although subsections 111 (a) and (b) (1) of the act state that the Administrator shall provide ADPE for use by Federal agencies, they do not in so many words foreclose other agencies from acting without regard to your actions or regulations in the procurement of ADPE. Also, subsection (g) states that GSA is not to interfere with agency rights to select types and configurations of equipment needed. You point out that since selection of types and configurations of equipment is so closely related and interwoven wtih the actual acquisition, subsection (g) might be interpreted as implying authorization to agencies to acquire ADPE. Because the plain meaning associated with "types" in the ADPE field is that of a particular brand name, authority to select types might be considered tantamount to purchase of the equipment.

It is your belief, however, that the right, reserved to using agencies under section (g), to select types of equipment needed refers only to agency determinations regarding what equipment is to be purchased and does not encompass the procurement itself on such equipment.

The language of the act and its legislative history make it clear, in our opinion, that it was the legislative intent to place GSA in the position of acting, subject to direction and control by the President and the Bureau of the Budget, as the Government's single purchaser for all general purpose ADPE estimated to cover about 90 percent of the Government's requirements. At the same time it was recognized that full implementation of this single purchaser concept would necessarily require a considerable period of adjustments. The legislative history shows that the delegation authority provided in subsection (b) (2) was to be resorted to during the period the Administrator would be developing the necessary procedures toward assuming his exclusive jurisdiction in the ADPE area. See the lengthy treatment afforded the concepts underlying the act, as set forth in Senate Report No. 938, dated October 22, 1965; House Report No. 802, dated August 17, 1965; and Hearings before a subcommittee of the house Government Operations Committee on H.R. 4845, March 30, 31 and April 7, 1965.

Subsections 111 (a) and (b) (1) quoted above clearly place authority in the Administrator of General Services and direct him to "provide for the economic and efficient purchase, lease, and maintenance of automatic data processing equipment by Federal Agencies." Any question as to whether such authority and direction were intended to be exclusive is dispelled, it seems to us, by the provisions of subsection (b) (2) and of (e).

Subsection (b) (2) authorizes the Administrator to delegate his functions where he deems it necessary or desirable to do so. Such authority to delegate would not be necessary if the functions involved were not intended to be placed in GSA exclusively.

Subsection (e) eliminates for purposes of section 111 the exemptions granted certain agencies by sections 201(a) (4) and 602(d) of the Property Act with respect to the procurement of personal property generally. When the Property Act was passed in 1949, it was recognized at that time that, due to the peculiar missions of various agencies, complete compliance with uniform procedures might interfere with their operations; therefore certain agencies were granted exemptions in sections 201(a) (4) and 602(d). Subsection 111(e) takes away these exemptions in the administrations of section 111.

We recognize that responsibilities related to determining ADPE requirements, selecting types and configurations and the use to be made of such equipment are divided by a fine line from responsibilities related to actual purchase of the equipment desired. Subsection (g) provides that Administrator of General Services shall not interfer with determinations made by agencies in these areas. But whatever problems may arise between the various agencies and the exercise of GSA's procurement authority, subsection (g) specifically provides for their resolution by the Bureau of the Budget and the President. Again, it hardly seems necessary to spell out a form for settling differences between GSA and the agencies, if GSA's authority were not otherwise intended to be exclusive.

The only evidence which might be interpreted as supporting the independent right of other agencies to procure ADPE, is found in subsection 111(c) and (d) which establish the ADP revolving fund. It could be argued that the authority given to GSA in subsections (a) and (b) (1) is to be invoked only in connection with fund activities, and until there is some affirmative action on the part of GSA to make a fund procurement on behalf of, and at the request of an agency, that agency would be free to continue procuring on its own. We believe, however that this argument is severly weakened by the provision for delegation of author-

ity in subsection (b)(2). If the only exclusive authority the Administrator had been given was authority to purchase ADPE through the revolving fund, there would be no particular need to give him power to delegate procurement authority.

We have carefully reviewed the legislative history of Pub. L. 80–306 and find that it clearly supports the construction reached upon examination of the language of the act itself. Accordingly, you are advised that we concur in your construction of section 111 of the Federal Property and Administrative Services Act of 1949, as amended by Pub. L. 89–306, as providing exclusive authority to GSA to procure all general-purpose ADPE and related supplies and equipment for use by other Federal agencies.

Sincerely yours,

ELMER B. STAATS,
Comptroller General of the United States.

APPENDIX 11

PROCUREMENT INFORMATION FURNISHED BY SENATOR DOMINICK

U.S. MILITARY PROCUREMENT[1] PRACTICES NEED INVESTIGATION

Mr. DOMINICK. Mr. President, reports which have reached me concerning some recent military procurement practices indicate that there is a real cause for concern over the equity, inefficiency, and even perhaps the honesty of some of these practices. In one specific instance, I have asked the Senate Committee on Government Operations to conduct a preliminary investigation to determine whether the facts in that case warrant a full-scale investigation and public hearings on military procurement practices.

In this case, my constituent, Custom Packaging Co., a small business in Aurora, Colo., received less than equitable treatment, to say the least, in its efforts to do business with the Army. The facts in this case are as follows:

Working on its own initiative and expense over a considerable period of time, Custom Packaging Co. developed the concept of a lightweight, shoulder-borne flame weapon with a 2,000- to 3,000-yard range capability. In August 1965, they contacted Army officials at Edgewood Arsenal, Aberdeen, Md. The Army showed a great deal of interest and, after considerable discussion, a demonstration was arranged. The demonstration took place at Edgewood Arsenal on February 14, 1966.

Assurances were given to Custom Packaging Co. by the Army that the company's technological innovations would be fully protected against disclosures to or use by unauthorized persons. Two of the significant innovations introduced by the company were in the basic lightweight design and in the propellant that was used.

Following the demonstration at Edgewood Arsenal, the Army agreed that Custom Packaging Co. should prepare a color sound on film showing the weapon firing nine or 10 rounds. The Army also asked the company to prepare a proposal setting forth the company's capability to produce the weapon, estimates of time and cost factors, and statistics on how much time and money had already been spent by the company on the program.

Custom Packaging Co. submitted the requested film and proposal to the Army on April 15, 1966.

During the summer of 1966, the Marine Corps displayed interest in a preliminary test program with this weapon. Subsequently, on October 16, 1966, Edgewood Arsenal circulated "Requests for Proposals" on a flame weapon system, soliciting quotations from several vendors, including Customs Packaging Co. The invitation called for proposals for research and development, production of 20 weapons and 2,000 units of ammunition. The language of the Edgewood Arsenal description of the weapon and requirements was virtually word for word identical with the "unsolicited" proposal submitted by Custom Packaging Co. on April 15, 1966, at the request of the Army.

On November 16, 1966, Custom Packaging Co. submitted its bid for a fixed price contract in the amount of $167,608. Northrop Nortronics of Anaheim, Calif., a subsidiary of Northrop Aviation, submitted its bid on a cost-plus-incentive fee basis in the amount of $387,000. Seven other bidders submitted quotations ranging from $269,000 to a high bid of $404,000, all on a cost-plus-fixed fee basis. A comparison of the bids of Custom Packaging and Northrop Nortronics shows that the engineering estimates were very nearly the same, but Custom Packaging's bid reflected lower labor rates and lower overhead costs, as well as lower subcomponent costs. Nortronics' bid proposed use of more expensive off-the-shelf, or subcontracted components. Subsequently, by telegram dated January 26, 1967, the Edgewood Arsenal Contracting Office advised Custom Packaging Co. that the award was expected to be made on Monday, February 6, 1967. Thereafter, in

[1] Reprinted from Congressional Record, 90th Cong., 1st sess., Sept. 19, 1967.

a peculiarly unusual procedure, Edgewood Arsenal announced the award of this contract, not on February 6, but on Friday, February 3, 1967, and designated Northrop Nortronics as the successful bidder in spite of the fact that the Northrop bid was more than double the amount bid by Custom Packaging.

Why was this award announced 3 days early? It appears to have been a deliberate attempt to justify an "urgent" classification for this procurement and thereby circumvent Armed Services Procurement Regulation 2-407.9 which generally prohibits an award being made if a timely protest has been filed, except where it has been determined that the award is urgently required.

Now, was there an overriding urgency to justify this award? In my opinion, there was not. In response to my question, Dr. Russel D. O'Neal, Assistant Secretary of the Army for Research and Development, told me that there was no planned production of this weapon systems.

The Army then contended that Custom Packaging Co. had not filed a timely protest to the award. This too was disproven. Mr. Eugene Bates, the president of Custom Packaging Co. had the foresight to process his protest on February 3, 1967, through the Denver Regional Office of the Small Business Administration, who substantiated the fact that both telephonic and telegraphic protests had been sent to the General Accounting Office on that date by Custom Packaging Co.

Mr. President, I interpolate to state that here is a classic example of a small business company trying to do something which will be of help to the whole country, and being cut out completely by giving the bid, at twice the cost, to another company which had never had any experience in the field whatsoever.

Mr. President, it now appears that this is not an isolated case. Other small business firms are having the same kind of difficulty in attempting to compete with the big business manufacturers doing business with the various military departments. Recently the Army Electronics Command, 225 South 18th Street, Philadelphia, Pa., awarded to the Radio Corp. of America a contract for $10,087,431, despite the fact that the Army had on file a bid by a small business concern which was $884,856 lower than RCA's award. This appears to be only the most recent of a long series of slaps at the taxpayers' pocketbook in Army dealings with RCA for this portable, walkie-talkie type radio transmitter-receiver. Let us look at the record from the beginning.

In May 1954, the Department of the Army, Fort Monmouth, N.J., initiated a contract with RCA, Camden, N.J., for the development of this portable radio set which was given the nomenclature AN/PRC-25. Under this contract the Army paid to RCA a total sum of $2,214,857. In October 1961, this radio set was ordered into production when the Army awarded contract No. 89511 on a sole source noncompetitive basis to RCA for a total amount of $20,482,143.68. This covered 8,248 units of this radio at a per unit price of $2,156.91. Of this total $20.5 million, $17,790,000 covered the radio set. The balance of $2,692,143.68 covered ancillary items. These items included manufacturing drawings.

On May 24, 1963, invitations to bid were issued on the second production requirement. This was actually the first competitive bidding allowed on this radio set. Mind you, this was almost a year and a half later. It covered 3,822 units of the AN/PRC-25 radio, plus 1,650 units of the major component, the RT-505 receiver-transmitter. The contract was awarded to the lowest bidder, RCA, at a unit price of $843.37 for the AN/PRC-25. This was $1,313.54 per unit less than the Army had paid for this same radio set to this same firm under the earlier noncompetitive negotiations in October 1961. On February 7, 1964, which was less than a year later the Army again invited bids for the AN/PRC-25 radio. RCA again reduced its unit price; this time to only $736 per unit. Despite the latest reduction, however, on this occasion RCA was unsuccessful in obtaining the award. It went to a manufacturer in Huntington, Ind., who quoted a still lower price.

In March 1965, the Army decided to improve the AN/PRC-25 radio set. It negotiated noncompetitive, sole-source contract No. 01292 with RCA to cover this work. The total cost of this contract was $694,593.

In April 1965, a third round of bidding took place. This was on the original version, not the improved one. RCA again reduced the price; this time quoting $625 per unit for the AN/PRC-25 radio set in an unsuccessful attempt to acquire this award which was made at even lower prices to the Indiana manufacturer, with a set-aside quantity being awarded to a Massachusetts firm.

Four months later, on August 13, 1965, the Army awarded a noncompetitive contract to RCA for 4,158 units of this same AN/PRC-25 radio set at an average

price of $951 per unit. This was done despite the fact that the Army records of only 4 months earlier showed RCA's competitive bid as having been only $625 per unit for the identical equipment.

The improved version of the AN/PRC–25 radio was assigned a new nomenclature. It became the AN/PRC–77. Customarily, the first production contract for any such item is negotiated with the company which did the research and development work. Therefore, in accordance with custom, on June 26, 1966, the Army awarded contract No. 10410 on a noncompetitive, sole-source basis to RCA. It covered 5,737 units of the newly designated AN/PRC–77 at a unit price of $1,222.34.

This contract was for the total amount of $7,619,000. It included $54,834 for production drawings of this AN/PRC–77 radio set.

This contract stipulated delivery of these production drawings by March 31, 1967. Bear this in mind, because this is an important provision in this contract. March 31, 1967, was when the drawings had to be furnished to the Army and the Government as a whole.

Back on June 22, 1966, prior to the June 26 contract award, the Army justified the noncompetitive award of contract No. 10410 on the basis that:

"Drawings, mechanical gauges, and electrical test fixtures are being procured to preclude sole-source on subsequent procurements."

This same statement was repeated on the Army's determination and findings dated December 2, 1966, to justify a subsequent increase in the number of units under this contract. The statement was signed by Maj. Clyde V. Craighead, contracting officer.

In February 1967, the plot seemed to thicken. On February 27, the U.S. Army Electronics Command, Philadelphia, Pa., issued negotiation DAABO5–67–R–1176. This was issued—in secret—as a sole-source, noncompetitive action with RCA. It had a closing date of March 9, 1967. This negotiation proposed a multiyear procurement of radio set AN/PRC–77 and RT–841. The latter item was the major component of the radio transmitter-receiver.

Under date of March 7, 1967, a small manufacturer, Decitron Electronics Corp., 841 Essex Street, Brooklyn, N.Y., submitted a letter-bid to the U.S. Army Electronics Command in Philadelphia. The bid made reference to negotiation DAABO5–67–R–1176, to which I have just referred. It quoted a price of $893.75 per unit for the AN/PRC–77 and a price of $793.75 per unit for the RT–841.

The bid stated that the unit prices quoted actually included all ancillary items of provisions documentation, selection worksheets, initial tool and test equipment lists, and so forth. The Decitron bid even went so far as to suggest to the Army Electronics Command that if the Army doubted Decitron's ability to fulfill the contract, the matter could be referred to the Small Business Administration for a certificate of competency.

Under date of April 5, 1967, the Army Electronics Command, of Philadelphia, in a letter signed by Maj. Clyde B. Craighead, rejected Decitron's bid on the basis of "urgency of delivery and lack of manufacturing drawings." The drawings referred to were the self-same drawings required for delivery by March 31, 1967, under RCA's contract No. 10410. That was 5 days earlier than the date of this letter.

This was the same RCA contract that was previously justified on a sole-source basis for the purpose of obtaining the specific drawings required to avoid the necessity for subsequent sole-source procurement.

On April 28, 1967, the Army awarded contract No. DAABO5–67–C–0170 to RCA covering 10,500 units of the AN/PRC–77 at a price of $937.16 per unit. The total amount of this RCA contract, which included ancillary items, was $10,087,431. This was $884,856 higher than the bid submitted by Decitron.

On June 7, 1967, the Army announced this contract in the Department of Commerce Business Daily—PSA 4326, page 15, column 4. Curiously enough, the Army's announcement stated that the award was only for 3,300 units of the AN/PRC–77 and for 900 units of the RT–841 for a total price of only $4,094,745. The fact of the matter was that this contract was actually in excess of $10 million. On May 31, 1967, this contract—DAABO5–67–C–0170—was increased by modification No. 1, to cover an additional 1,298 units of the AN/PRC–77 for an additional cost of $1,234,684. Further, the Department of Commerce Business Daily later announced another modification, dated August 16, 1967. This one added another $5,992,686 to the total amount of this contract.

The PRESIDING OFFICER. The time of the Senator from Colorado has expired.

Mr. DOMINICK. Mr. President, I ask unanimous consent that I may proceed for an additional 5 minutes.

Mr. BYRD of West Virginia. Mr. President, reserving the right to object, we had hoped to have a little time remaining for the transaction of routine morning business. We have at least one Senator in the Chamber who wishes to take advantage of that time.

I wonder if the Senator might finish his speech in 3 minutes.

Mr. DOMINICK. I will do my best.

The PRESIDING OFFICER. Without objection, the Senator from Colorado is recognized for an additional 3 minutes.

Mr. DOMINICK. Mr. President, it is absolutely inconceivable that this last modification could possibly be justified on the basis of urgency of delivery. The delivery of these units is for a multiyear requirement with options that could allow delivery to span 4 years. Nor could it be justified on the basis of lack of production drawings. After all, the Army, for the American taxpayers, had already given RCA $54,834 to purchase these drawings in the original production contract of June 26, 1966.

Mr. President, the inequities, inefficiencies, and apparent mismanagement in this case, seemed so glaring to me that I sought additional information as to the capability of the Decitron Co. I secured a listing of 36 contracts under which this company had performed for the Department of Defense. Since the majority of these contracts for radio equipment had been awarded by the Navy, I asked the Navy to review its files and advise me whether there had been any history of failure by this company to perform, or any instance in which this company might have been suspected of underbidding and of subsequently applying for extraordinary financial relief under Public Law 85–804. The Navy reported to me that this company had not failed in the performance of any of its contracts for the Navy, and that there was no evidence that the company had sought extraordinary financial relief under Public Law 85–804.

Mr. President, what has made this case even more highly suspect has been the apparent attempts to keep information concerning it from the public. For example: On April 29, 1967, Mr. Robert R. Siegrist, a fully accredited, Washington-based, reporter-commentator with the Mutual Broadcasting System, and a highly respected member of the broadcast community, presented his credentials to the Army and asked some pertinent questions about the transactions of contract DA–36–039–AMC–10410(E), together with all amendments, and a copy of the determination and findings used to justify this award, and also advice as to what disposition was made of the drawings furnished under that contract.

Three and a half weeks later, on May 24, he received a simple acknowledgment from the Department of the Army advising that replies were being prepared to each of his questions. Under date of July 10, 1967, more than 2 months after his initial request, he received a further response from the Army. It advised him that the information he had requested could only be provided if he prepaid a cost of $120.75. That advice was given to a reporter.

Numerous telephone calls in the ensuing 10 days failed to produce results. Finally, after a telephone call to the Assistant Secretary of Defense for Public Affairs, the Honorable Phil G. Goulding, a letter dated July 21 was forthcoming from Gen. Lloyd D. Ramsey, Acting Chief of Public Information, advising that the material would be furnished without cost.

Thus, fully 3 months after this material should have been public information, it was finally made available to the newsmen. But, lo and behold, in response to the question concerning other bidders under this contract, the Army contended that RCA was the only bidder, completely concealing the bid of March 7, 1967, by Decitron.

Mr. President, the factors in this case seem to raise very serious questions as to the relationship existing between the Department of the Army procurement officials and the Radio Corp. of America. I think we should ask the question as to whether any specific benefits have been derived by any one in the Army or elsewhere as a consequence of this peculiar procedure. Why was the significantly lower bid by Decitron, the small electronics firm, rejected under the claim that drawings did not exist when in fact they not only did exist, but the original production contract of June 26, 1966, had specifically required RCA to deliver such drawings for competitive biddings on subsequent procurement? Bear in mind that this was the original contract under which RCA was paid $54,834 on a noncompetitive basis to produce these manufacturing drawings and deliver them by March 31, 1967. Therefore, these drawings were the property of the taxpayers of the United States.

There appears to be a similar pattern in both of the instances I have cited today, and I am certain there must be others. I suggest that Congress may be well advised at this time to begin an indepth investigation into our military procurement procedures. We owe it to our taxpayers that every step be taken by those spending the taxpayers' funds to insure highest efficiency at the lowest cost. And we owe it to the small businessman that he be treated equitably and fairly in his dealings with Federal procurement officials. There seems to be growing reason to question whether either is being done in many cases coming to light at present.

Unnecessary Costs in Procurement of Radar Sets [1]

Mr. Dominick. Mr. President, on September 19, I delivered a speech concerning two different Army procurements, one of which involved the AN/PRC–25 and AN/PRC–77 radio sets awarded to Radio Corporation of America in a multiyear procurment which the Army attempted to justify on the basis of lack of manufacturing drawings and also because of a supposed urgency for delivery. This award was made to RCA in spite of the fact that a small business firm had on file a bid which was lower by almost $1 million for this identical equipment.

The claim by the Army regarding the lack of manufacturing drawings appears as specious as the urgency of delivery claim is fallacious. I have been reliably informed that the drawings do exist and that delivery of these radio sets 2 years from now is not urgent.

Mr. President, on September 21, 1967, I received a letter from the Office of the Assistant Secretary of the Army signed by the Honorable Robert A. Brooks, which actually states that drawings are not available and, I quote:

"RCA was awarded a contract in June 1966 to produce the initial production quantities while further design changes and improvements were being affected."

Mr. Brooks goes on to state that:

"As a matter of fact, due to design changes resulting from concurrent field tests, the final procurement package will not be available until early December, 1967."

In other words, Mr. President, what Mr. Brooks is saying is that the Army is engaged in a development program running parallel with two production contracts which exceed $20 million for portable walkie-talkie radio sets.

This is the exact same practice that has been investigated by the General Accounting Office on radar set AN/PPS–4 and radiacmeter IM–108/PPD involving millions upon millions of dollars wasted by the Army in producing electronic equipment in quantity before the design was frozen.

In the case of the IM–108/PD radiacmeter, five separate and distinct contracts were awarded for 59,776 units, resulting in a waste of the taxpayers funds of a total of $2.9 million for defective equipment. Moreover, in its decision rendered on this case, the General Accounting Office recommended that the engineers in charge of that fiasco be fired, and they were in fact removed from the Government payroll only long enough for the national press to give its attention to more important matters. Whereupon, the Army quietly reinstated these same men, using as an excuse the fact that they had admitted they were wrong and promised not to do it again. This is incredible, but true.

Mr. President, I ask unanimous consent that the reports from the Comptroller General Nos. B–146834 and B–146906 be printed in the Record.

There being no objection, the reports were ordered to be printed in the Record, as follows:

"Unnecessary Costs Incurred in Sole-Source Procurement of Portable Radar Sets, Department of the Army

"(Report to the Congress of the United States by the Comptroller General of the United States, October 1964)

"To the Speaker of the House of Representatives and the President pro tempore of the Senate:

"Our review of sole-source procurements by the Department of the Army disclosed that the Government had incurred unnecessary costs of more than $2.2

[1] Reprinted from Congressional Record, 90th Cong., 1st sess., Sept. 28, 1967.

million in the sole-source procurement of 502 AN/PPS–4 portable radar sets. These unnecessary costs were incurred because agency officials procured the radar sets without waiting until known deficiencies in the sets had been corrected and technical data suitable for use in competitive procurement had become available. The deficiencies known prior to procurement were that the radar sets were not consistently accurate in determining the range of a target, were unable to detect a target satisfactorily, and were cumbersome to operate. After the contract for the sole-source procurement was awarded, it was necessary to stop production for 15 months while modifications were being made to correct these deficiencies. This delay unnecessarily increased the cost of the corrected units by $356,220. In addition, we estimated that, on the basis of competitive prices obtained in a subsequent procurement, unnecessary costs of about $1.86 million had been incurred because these sets had been procured without competition. In fact the successful bidder's price under the competitive procurement was more than 55 percent below the price paid to the sole-source producer.

"The Acting Assistant Secretary of the Army (Installations and Logistics) agreed with the facts presented in the report and advised us that the report would be brought to the attention of procuring commands. He also indicated that, subsequent to the procurement in question, more extensive controls were instituted regarding procurement of new equipment that included the requirement that a summary of all objections to a proposed procurement be submitted to higher authority. This summary is to include engineer- and service-test results.

"The Acting Assistant Secretary also stated that disciplinary action was not believed to be warranted because the decisions with respect to this procurement were made in accordance with the then accepted policy and that, when considered in light of the then prevailing policy, the facts presented were considered proper justification for these decisions. Officials in the Office of the Assistant Secretary of the Army (Installations and Logistics) subsequently advised us that, at the time of this procurement, there was an absence of guidance and control over the procurement of new equipment, generally, but that the Army's policy was that development and production of an item could be effectively accomplished simultaneously. Procuring officials in this instance, however, had been aware of the user and engineer objections prior to awarding this contract but had requested approval from higher authority for the award without disclosing this information. We believe, therefore, that these actions should be noted in the personnel records of responsible officials, for consideration in the future promotions, reassignments, and other personal actions.

"The management weaknesses disclosed in this report have occurred in the past and have been identified in other General Accounting Office reports. We reported on the Department of the Army's procurement of defective radiation-measuring instruments (B–146834, dated December 17, 1963). Under 5 contracts for this equipment the Army spent $3.8 million even though it knew prior to each contract that the equipment was defective. We recently reported also on the noncompetitive procurement of military ¾-ton trucks (B–146921, dated August 12, 1964). By procuring these vehicles without competition, the Army incurred unnecessary costs estimated at $12.1 million even though it could have obtained the information sufficient for competitive procurement purposes. As stated in this report and in previous reports, action has been taken by the Department of the Army to promulgate policies and regulations controlling the procurement of new equipment and to intensify its efforts to promptly obtain technical data for competitive procurement purposes. We will evaluate the effectiveness of these actions in future reviews.

"Copies of this report are being sent to the President of the United States, the Secretary of Defense, and the Secretary of the Army.

"JOSEPH CAMPBELL,
"Comptroller General of the United States."

"INTRODUCTION

"The General Accounting Office has made a review of the procurement of AN/PPS–4 portable radar sets by the Department of the Army. The purpose of our review was to inquire into the reasonableness of the award of a contract for these sets to Sperry Gyroscope Company (Sperry), Great Neck, Long Island, New York, on a sole-source basis. This review was initiated in connection with a request dated May 13, 1963, from Congressman George H. Mahon on behalf of the Subcommittee on Defense, Committee on Appropriations, House of Representa-

tives, that the General Accounting Office make a review of electronics equipment with particular emphasis on sole-source procurements. This review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67). The scope of our review is shown on page 15 of this report.

"BACKGROUND

"The general policy of the Department of Defense, as set forth in the Armed Services Procurement Regulation (ASPR), section 1–300.1, provides that all procurements, whether by formal advertising or by negotiation, shall be made on a competitive basis to the maximum practicable extent. The responsibility for implementing these provisions is assigned to each military department. The Department of the Army has assigned this responsibility to each major subcommand of the United States Army Materiel Command (AMC).

"The United States Army Electronics Command, a major subcommand of AMC, was established in August 1962 and assumed most of the logistic functions previously performed by the Office of the Chief Signal Officer, United States Army. This command has the responsibility for the research, design, development, testing, and supply management of electronic equipment.

"In a recent reorganization of the major agencies within the Electronics Command, the United States Army Electronics Materiel Agency (referred to in this report as the Materiel Agency) and the United States Army Electronics Materiel Support Agency (referred to in this report as the Support Agency) have been replaced by various directorates. The responsibility for the procurements discussed in this report now rests with the Philadelphia Division of the Procurement and Production Directorate, United States Army Electronics Command.

"The duties formerly performed by the Materiel and Support Agencies and presently being performed by the newly established directorates include computation of requirements, control of inventories, award and administration of contracts, provision of engineering specifications for procurement of electronic equipment, performance or monitoring of preproduction testing and qualification, and approval of equipment.

"In order to determine whether newly developed equipment is acceptable for Army use, the Department of Defense procedures require the cognizant military department to test such equipment prior to authorizing a contractor to commence production. These tests are generally referred to as service tests. The purpose of the tests is to determine the physical and operational characteristics, organizational maintenance requirements, and whether the equipment will be accurate, durable, and reliable when subjected to use by troops in the field.

"The AN/PPS–4, developed by Sperry, is a silent, lightweight, portable, forward-area, combat-surveillance radar set used by infantry troops. This set is capable of detecting and locating moving targets and certain fixed targets under conditions of poor visibility. The Army procured 10 radar sets in June 1955 for experimental tests and evaluations. In August 1956 the Army procured eight additional sets with various modifications for further testing. The service tests of the developmental and preproduction models were conducted for the Electronics Command by the United States Continental Army Command (USCONARC) under actual field conditions. Subsequent to the Army reorganization in August 1962, the United States Army Test and Evaluation Command was given the responsibility for performing service tests on newly developed equipment.

"Since June 1958, a total of 1,437 radar sets and related items have been procured by the Materiel Agency for about $10.9 million.

"A list of principal management officials of the Department of Defense and the Department of the Army responsible for the administration of activities discussed in this report is shown as appendix I.

"FINDING AND CONCLUSIONS

"Unnecessary costs incurred in the sole-source procurement of portable radar sets

"The Government has incurred unnecessary costs of more than $2.2 million in the sole-source procurement of 502 AN/PPS–4 portable radar sets by the Department of the Army. These unnecessary costs were incurred because agency officials procured the radar sets without waiting until known deficiencies in the sets had been corrected and technical data suitable for use in competitive procurement had become available. The deficiencies known prior to procurement were that the

radar sets were not consistently accurate in determining the range of a target, were unable to detect a target satisfactorily, and were cumbersome to operate. After the contract for the sole-source procurement was awarded, it was necessary to stop production for 15 months while modifications were being made to correct these deficiencies. This delay unnecessarily increased the cost of the corrected units by $356,220. In addition, we estimated that, on the basis of competitive prices obtained in a subsequent procurement, unnecessary costs of about $1.86 million had been incurred because these sets had been procured without competition. In fact the successful bidder's price under the competitive procurement was more than 55 percent below the price paid to the sole-source producer.

"Initial award and service-test results

"In June 1958 fixed-price redeterminable contract DA–36–039–SC–76361 was awarded by the Materiel Agency to Sperry Gyroscope Company on a sole-source basis at a cost to the Government of $3,474,962, for the production of 462 vacuum-tube radar sets. The vacuum-tube model, suitable for Army use only as interim equipment. did not satisfactorily meet the Army's need because of its excessive weight and noise. This interim equipment was procured to furnish field units with combat-surveillance capabilities at a time when field units had no other equipment that could perform its function. This contract was awarded without the benefit of competition, and the Army justified the sole-source procurement on the basis that the Government did not have procurement data that were suitable for use in soliciting competitive bids. We did not ascertain the validity of the Army's justification at that time. The contract required that an updated set of drawings suitable for use in competitive procurement be delivered 30 days after the initial production equipment was submitted for acceptance.

"In January 1959, about 7 months after the award of the contract for 462 vacuum-tube radar sets, the Electronics Command accepted a plan, submitted by Sperry to partially transistorize the radar sets. This plan was approved, and the partial transistorization was expected to result in the silent operation of the radar sets because a battery, rather than a gasoline-engine generator would be the primary source of power. The Materiel Agency reduced the quantity of radar sets on order from 462 to 402 by a contract modification, thus making $440,000 available toward offsetting the increased costs of $526,000 for the partial transistorization of the radar sets. The final contract price for 402 sets, including partial transistorization and other changes, was $3,704,108.

"In March 1960, USCONARC completed service tests of two preproduction models of the partially transistorized radar sets and concluded that (1) 3 of the deficiencies found in the service tests of the vacuum-tube-type developmental models had been carried over into the partially transistorized version without correction and (2) 20 of 29 new deficiencies found, when considered collectively, were so serious that corrective action was deemed mandatory prior to acceptance and issuance of these sets to troops. Among the major deficiencies noted and their effects on performance of the radar set were (1) erroneous range calibration, which resulted in loss of acceptable range accuracy, (2) transmission failure, which resulted in unsatisfactory detection of a target, and (3) faulty tripod design, which contributed to the cumbersome operation of the radar set and required, in many instances, time-consuming operations to realign the tripod legs. The Support Agency issued technical-action requests to the contractor in April and May 1960 that included actions to correct the above-cited deficiencies prior to production.

"Additional procurement

"Review and approval of proposed procurements of certain items at the Materiel Agency is performed by the Procurement Planning Committee. This committee consists of three officials of the Materiel Agency, the Chief Engineer of the Support Agency, and a secretary appointed by the chairman of the committee. On May 10, 1960, the Support Agency's Chief Engineer recommended that the committee require that all improvements to the radar sets recommended by USCONARC be incorporated in the 502 additional radar sets to be procured under a modification to contract –76361. He further recommended that the contract modification negotiated should provide that the improvements be made when the sets were produced, which would preclude the necessity for engineering changes for that purpose subsequent to award of the contract modification. At that time the Procurement Planning Committee consisted of:

"Col. J. G. Bent, Jr., Deputy for Procurement, Materiel Agency (chairman).
"S. Rabinowitz, Assistant Deputy for Procurement, Materiel Agency (alternate chairman).
"J. W. Weseloh, Chief Engineer, Support Agency.
"Lt. Col. P. F. Balas, Assistant Deputy for Stock Control, Materiel Agency.
"L. A. Kapust, Assistant Deputy for Industrial Preparedness, Materiel Agency.
"J. H. Schroeter, Secretary, Procurement Planning Committee, Materiel Agency.

"On May 13, 1960, the Committee agreed that the proposed procurement should be made in accordance with the recommendations of the Support Agency's Chief Engineer. On June 15, 1960, however, in a request to the Chief Signal Officers for approval of the modification to contract -76361, the Deputy for Procurement of the Materiel Agency failed to disclose that negotiations had already been held with Sperry on June 2 and June 6, 1960, on the basis that the improvements would not be required to be made in the sets to be procured under the contract modifications. Further, on June 17, 1960, the Assistant Deputy for Procurement approved the Committee's request that the USCONARC-recommended improvements not be required in these sets. We were informed that this decision was made because previous negotiations with Sperry had been on that basis and that apparently this decision overrode the objections of the Support Agency's Chief Engineer. We could find no evidence that the Chief Signal Officer was subsequently informed of the decision not to make the improvements—considered mandatory by user and engineer organizations—to the 502 radar sets subsequently ordered.

"On June 30, 1960, the Materiel Agency procured an additional 502 partially transistorized radar sets from Sperry, at a cost to the Government of $3,267,016, under a modification to contract -76361. Subsequent modifications increased the cost to $3,358,270, or a unit price of $6,690. The records show that the sole-source *procurement of this additional quantity was justified by the Army on the basis that adequate procurement data were not available for use in soliciting competitive bids.* The contracting officer did not state that urgency was a factor in the decision to procure on a sole-source basis.

"Stop-work order

"On August 29, 1960, 2 months after the award for the 502 radar sets, the Materiel Agency issued an order to Sperry to stop all production. This stop-work order was issued so that improvements, modifications, and engineering changes could be incorporated into the 402 radar sets being produced under the basic contract. These changes were necessary to correct serious deficiencies identified by USCONARC in March 1960 in its service tests of the developmental and preproduction models. These are the same changes which, prior to procurement under the contract modification, the Support Agency's Chief Engineer had recommended be required to be incorporated in the 502 radar sets proposed for procurement.

"The stop-work order, which was in effect for 15 months, was canceled, and authority to proceed with production was issued by the contracting officer on November 29, 1961. This work stoppage resulted in unnecessary costs of $356,220, which were attributable to increased labor costs and to a loss in efficiency resulting from the 15-month gap in production. This amount increased the total price to he Government for the 502 sets to $3,714,490, the amount agreed upon with Sperry in a price redetermination made in March 1962.

"In October 1961 the Army completed service tests at the Tobyhanna Army Depot of the partially transistorized radar sets. The sets tested included the improvements that had been recommended by USCONARC and required improvements identified in subsequent tests. The Army then concluded, on the basis of these tests, that the partially transistorized radar sets would be accepted as suitable to the user and that the same improvements should be incorporated into all the 904 sets then being procurred under the contract -76361. These partially transistorized radar sets were subsequently shipped to Army units for use.

"Savings resulting from competition

"On March 23, 1962, the Materiel Agency received procurement data, in the form of Government specifications and a model from the Support Agency, that were determined to be suitable for use in soliciting competitive bids. On April 16,

1962, the Procurement Planning Committee approved the plan to procure about 436 portable radar sets by formal advertising.

"On April 26, 1962, the Materiel Agency issued an invitation for bids for various quantities of the radar sets. Twenty bids were received, 10 of which were lower than the bid of $4,489 a set submitted by the sole-source producer, Sperry. The unit prices in these 10 bids ranged from $2,978 to $4,280. The lowest acceptable bid by quantity and unit price was submitted by Aeronca Manufacturing Corporation for 454 radar sets at $2,978 each. The Materiel Agency awarded contract DA-36-039-AMC-01087(E) to Aeronca on August 24, 1962, for the 454 radar sets at a price of $1,372,873.

"The lowest acceptable bid price of $2,978 a unit was a reduction of $3,712, or 55.5 percent, from the unit price of $6,690 previously paid the sole-source producer under the modification to contract -76361, or a total reduction of about $1.86 million. Further, personnel of the Materiel Agency advised us that Aeronca's performance under the contract was satisfactory and records indicate that, during December 1963 and January 1964, 73 radar sets were accepted by the Army, 45 of which were shipped overseas for use in the field.

"Agency comments and our evaluation

"On April 30, 1964, we brought these findings to the attention of the Department of Defense and proposed that the Commanding General, United States Army Materiel Command, bring this report to the attention of procuring commands, to emphasize the need to (1) develop equipment, prior to procurement, to a point where major modifications would not be required and (2) accumulate the procurement data necessary to permit timely solicitation of bids for competitive procurement. We proposed further that the procuring agencies be required to bring to the attention of higher authority all objections to planned procurements raised by interested parties, including the using and engineering organizations, so that the approving officials would be in a position to consider these objections in their evaluation of the proposed contract. *We proposed also that the Secretary of the Army take disciplinary action in this matter against those individuals who did not properly perform their duties and exercise prudent judgment in expending significant amounts of Government funds.*

"By letter dated June 26, 1964 (see appendix II), the Acting Assistant Secretary of the Army (Installations and Logistics) commented on our findings and proposals. He agreed with the facts presented in this report and advised us that a digest of this report would be brought to the attention of procuring commands. He agreed also that all objections in connection with a proposed procurement which might be raised by interested parties should be included in the facts presented to approving officials for their consideration, and he indicated that, subsequent to the procurement in question, more extensive controls were instituted regarding procurement of new equipment that included the requirement that a summary of such information be submitted to higher authority. This summary is to include engineer- and service-test results. His additional comments are summarized as follows:

"1. Army studies and reports on combat-surveillance and target-acquisition equipment covering the period fiscal years 1958-63 reflected continual emphasis upon the urgent need for this type of equipment. There was a concerted effort on the part of the Army to acquire a combat-surveillance capability as quickly as possible during that period of time. Under the Army reorganization, more extensive controls come into play in the event that urgency justifies procurement for troop issue before completion of the development and adoption as a standard item. The Combat Development Command is responsible for making recommendations to the Department of the Army on the urgency of a requirement of this nature. Further, the provisions of AR 700-20, dated July 25, 1963, require the satisfaction of 25 criteria before initiating production in a situation of this type.

"Although there was a need for equipment of this type, the fact remains that the using forces did not want the particular equipment then being considered for procurement until major deficiencies in the equipment had been corrected. On the basis of the previous negotiations with Sperry, the contract modification—contrary to the Procurement Planning Committee's initial agreement—did not provide that corrections be made when the sets were produced.

Further, the basis for the Army's justification for the sole-source procurement was not urgency but inadequate procurement data for use in soliciting competitive bids.

"2. The recommended disciplinary action was not believed to be warranted. The decisions with respect to the award in question were made in accordance with what was then accepted policy. The facts as presented, when considered in the light of the prevailing policy, were considered proper justification for the decisions.

"Officials in the Office of the Assistant Secretary of the Army (Installations and Logistics), in response to our request for clarification of the above comment, stated that, at the time of this procurement, there was an absence of guidance and control over the procurement of new equipment generally but that the Army's policy was that development and production of an item could be effectively accomplished simultaneously. Procuring officials in this instance, however, had been aware of the user and engineer objections prior to awarding this contract but had requested approval from higher authority for the award without disclosing this information.

"Conclusions

"We believe that, generally, production contracts for new equipment should not be awarded when the results of service tests performed by the user on developmental or preproduction models had disclosed deficiencies that rendered the item unsuitable for field use. We believe also that efficiency and economy are obtained for the Government by the maximum practical use of competition in procurement programs.

"As disclosed in this report, deficiencies had been identified in the developmental and preproduction models of the partially transistorized radar sets that rendered them unsuitable for Army use. Notwithstanding the serious deficiencies found by USCONARC, a decision was made by the Materiel Agency to procure an additional quantity of 502 radar sets on a sole-source basis. Further, the Materiel Agency's stated reason for procuring radar sets on a sole-source basis was that it lacked the procurement data necessary to solicit competitive bids. If the Materiel Agency had waited until an acceptable radar set was designed and procurement data suitable for solicitation of competitive bids became available, as provided for under the initial contract, the Agency could have procured the 502 radar sets at a savings of 55.5 percent, or about $1.86 million. Also, the Army could have avoided costs of $356,220 paid for the work stoppage under the contract modification for the 502 sets while the deficiencies identified in the developmental and preproduction models under previous awards were being corrected.

"The Army advised use of the corrective actions taken to preclude recurrence of situations such as this, and we will evaluate them in future reviews. In view of the fact that responsible officials (1) were aware of the deficiencies in the equipment and objections of the using forces to buying this equipment prior to the correction of these deficiencies and (2) requested approval for the award without disclosing the user and engineer objections, however, we believe that these actions should be noted in their personnel records, for consideration in future promotions, reassignments, and other personnel actions.

"The management weaknesses disclosed in this report have occurred in the past and have been identified in other General Accounting Office reports. We reported on the Department of the Army's procurement of defective radiation-measuring instruments (B–146834, dated December 17, 1963). Under five contracts for this equipment the Army spent $3.8 million even though it knew prior to each contract that the equipment was defective. We recently reported also on the noncompetitive procurement of military ¾-ton trucks (B–146921, dated August 12, 1964). By procuring these vehicles without competition, the Army incurred unnecessary costs estimated at $12.1 million even though it could have obtained the information sufficient for the competitive procurement purposes. As stated in this report and in previous reports, action has been taken by the Department of the Army to promulgate policies and regulations controlling the procurement of new equipment and to intensify its efforts to promptly obtain technical data for competitive procurement purposes. We will evaluate the effectiveness of these actions in future reviews.

"SCOPE OF REVIEW

"Our review included an examination of the records and reports relative to the development, testing, sole-source procurement, modification, and use of the AN/PPS–4 radar set within the Department of the Army for the period April 1955 to January 1964. Our review was made at the United States Army Electronics Materiel Agency, Philadelphia, Pennsylvania, and at the United States Army Electronic Materiel Support Agency and the United States Army Electronics Research and Development Laboratory, both of which are located at Fort Monmouth, New Jersey.

PRINCIPAL MANAGEMENT OFFICIALS OF THE DEPARTMENT OF DEFENSE AND THE DEPARTMENT OF THE ARMY 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.
Thomas S. Gates, Jr	December 1959	January 1961.
Neil H. McElroy	October 1957	December 1959.
Charles E. Wilson	January 1953	October 1957.
Assistant Secretary of Defense (Installations and Logistics):		
Thomas D. Morris	January 1961	Present.
Perkins McGuire	January 1957	January 1961.
DEPARTMENT OF THE ARMY		
Secretary of the Army:		
Stephen Ailes	January 1964	Present.
Cyrus R. Vance	July 1962	January 1964.
Elvis J. Stahr, Jr	January 1961	June 1962.
Wilber M. Brucker	July 1955	January 1961.
Robert T. Stevens	February 1953	July 1955.
Assistant Secretary of the Army (Installations and Logistics):		
Daniel M. Luevano	July 1964	Present.
A. Tyler Port (acting)	March 1964	July 1964.
Paul R. Ignatius	May 1961	February 1964.
Unfilled	January 1961	May 1961.
Courtney Johnson	April 1959	January 1961.
Frank Higgins	August 1954	April 1959.
Chief of Staff, U.S. Army:		
Gen. Harold K. Johnson	July 1964	Present.
Gen. Earle G. Wheeler	October 1962	June 1964.
Gen. George H. Decker	September 1960	September 1962.
Gen. Lyman L. Lemnitzer	July 1959	September 1960.
Gen. Maxwell D. Taylor	June 1955	June 1959.
Gen. Matthew B. Ridgway	July 1953	June 1955.
Deputy Chief of Staff (Logistics):		
Lt. Gen. Lawrence J. Lincoln	August 1964	Present.
Lt. Gen. R. W. Colglazier, Jr	July 1959	July 1964.
Lt. Gen. Carter B. Magruder	May 1955	June 1959.
Lt. Gen. Williston B. Palmer	October 1952	April 1955.
Commanding general, U.S. Army Materiel Command: Gen. Frank S. Besson, Jr.	July 1962	Present.
Commanding general, U.S. Army Electronics Command:		
Maj. Gen. Frank W. Moorman	August 1963	Do.
Maj. Gen. Stuart S. Hoff	August 1962	August 1963.
Chief signal officer (position abolished Mar. 1, 1964):		
Maj. Gen. E. F. Cook	....do	March 1964.
Maj. Gen. Ralph T. Nelson	May 1959	August 1962.
Maj. Gen. John D. O'Connell	May 1955	April 1959.
Maj. Gen. George I. Back	May 1961	May 1955.
Commanding general, U.S. Army Electronics Materiel Agency (position abolished May 1964):		
Brig. Gen. Wesley C. Franklin	September 1963	May 1964.
Brig. Gen. Allen T. Stanwix-Hay	August 1962	September 1963.
Col. Dougals O. Toft	June 1962	August 1962.
Brig. Gen. Charles S. Hays	November 1960	May 1962.
Brig. Gen. Elmer L. Littel	June 1957	November 1960.
Brig. Gen. William D. Hamlin	August 1956	June 1957.
Brig. Gen. William L. Bayer	October 1954	July 1956.

"APPENDIX II

"HEADQUARTERS, DEPARTMENT OF THE ARMY,
OFFICE OF THE ASSISTANT SECRETARY,
Washington, D.C., June 26, 1964.

"Mr. R. W. GUTMANN,
"*Associate Director, Defense Accounting and Auditing Division, U.S. General Accounting Office, Washington, D.C.*

"DEAR MR. GUTMANN: The following comments are provided on behalf of the Secretary of Defense in reply to your draft report of April 1964 concerning 'Unnecessary Costs Incurred in the Sole-Source Procurement of Portable Radar Sets' (OSD Case No. 2004).

"The facts presented in the GAO report are agreed with. Classified Army studies and reports on combat surveillance and target acquisition equipment covering the period FY 1958 to FY 1963 reflected continual emphasis upon the urgent need for this type of equipment. There was a concerted effort on the part of the Army to acquire a combat surveillance capability as quickly as possible during that period of time.

"A review of the circumstances as they existed at the time cannot establish that the procuring agency was in haste to obligate these procurement funds before Army obligational authority lapsed. A required delivery schedule for this radar set commencing in April 1961 had been established. This factor coupled with an estimated minimum production lead time for the contractor of 9 months and a minimum administrative lead time of 2 months to negotiate an award, indicated a requirement for an award in May 1960. However, subsequent refinements in the plan, negotiations with the contractor, and approval cycles extended the actual award date to 30 June.

"It is agreed that all objections in connection with a proposed procurement which may be raised by interested parties, such as using organizations and engineering agencies, should be included in the facts presented to approving officials for this consideration.

"Under the Army reorganization, more extensive controls come into play in the event that urgency justifies procurement for troop issue before completion of development and adoption as a standard item. The major commands, particularly those overseas, make recommendations relative to the need for new equipment. The Combat Development Command is responsible for making recommendation to the Department of the Army on the urgency of a requirement of this nature. Further, the provisions of AR 700–20, 25 July 1963 require the satisfaction of 25 criteria before initiating production in a situation of this type.

"The disciplinary action recommended by your office is not believed to be warranted. The decisions with respect to the award in question were made in accordance with what was then, accepted policy. The facts as presented, when considered in the light of the prevailing policy, are considered proper justification for the decisions.

"You recommended that this report be brought to the attention of procuring commands. Present procedures within the Department of the Army provide for distribution of a digest of all GAO reports of this type to procuring commands; a digest of this report will be included in this distribution.

"Sincerely yours,

"A. TYLER PORT,
Acting Assistant Secretary of the Army (Installations and Logistics)."

"PROCUREMENT OF INACCURATE RADIATION MEASURING INSTRUMENTS, DEPARTMENT OF THE ARMY

"(Report to the Congress of the United States, by the Comptroller General of the United States, December 1963)

"COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C.

"[B–146834]

"*To the Speaker of the House of Representatives and the President pro tempore of the Senate:*

"Enclosed is our report on the procurement of inaccurate radiation measuring instruments by the Department of the Army.

"Our view disclosed that the Army awarded five contracts for a total of 59,776 radiacmeters at a cost of about $2.9 million even though it was aware,

prior to the first production contract and each succeeding contract, that the radiacmeters were not suitable for Army use. In addition, over $663,000 has been expended to modify the radiacmeters produced under the second and third contracts, and additional costs estimated at about $200,000 will be incurred to reimburse the contractors under the fourth and fifth contracts for a temporary work stoppage until the Army investigates technical difficulties and decides whether the radiacmeters will be acceptable to using organizations. The 10,800 radiacmeters produced under the first contract have already been scrapped, and the acceptability of any of the remaining instruments is still questionable.

"These unnecessary costs have been incurred because responsible Army officials (1) were overly optimistic that deficiencies identified in tests of experimental model radiacmeters could be corrected in production despite a recommendation by the using organization not to enter into volume production until deficiencies were corrected, (2) accepted preproduction and initial production models and approved volume production without adequate and timely coordination of test data between the using organization and the engineering and procurement agencies, (3) awarded additional production contracts even though previously identified deficiencies had not been corrected, and (4) generally did not exercise their personal responsibilities to assure that Government funds were expended properly.

"The Deputy Assistant Secretary of the Army, replying on behalf of the Secretary of Defense, concurred with our findings. He stated that the Department of the Army is investigating further the causes for the conditions cited in the report. He stated also that further production of the equipment will not be accomplished until existing technical problems have been solved and the field user's accuracy requirements are met.

"The Deputy Assistant Secretary stated further that, on the basis of results of tests, it was concluded that the design of the radiacmeter was sound but that further investigation of the specific causes for the inaccuracies would be made. However, our review disclosed that responsible engineering personnel at the United States Army Electronics Materiel Support Agency, Fort Monmouth, New Jersey, agreed that the contractors met all specifications but that there was a defect in the design of the radiacmeter. In view of the position taken by the Deputy Assistant Secretary, it is evident that a conflict of opinions exists within the Army as to the soundness of the design of the radiacmeter. We did not attempt to determine whether the deficiencies in the radiacmeters resulted from the contractors' production practices or from the Government's design specifications.

"We are recommending to the Secretary of the Army that (1) those cases where supply management officials, because of the urgency of requirements for equipment, elect to overrule the recommendations of the using forces with respect to performance of the equipment and elect to enter into production before all known deficiencies are corrected be referred to the Assistant Secretary of the Army (Installations and Logistics) for his approval, (2) in the investigation of the specific causes for the deficiencies in the radiacmeters that are the subject of this report, the Department of the Army determine, and advise us, whether the deficiencies resulted from the contractors' production practices or from the Government's design specifications, and (3) consideration be given to taking disciplinary measures against management officials whose actions in this matter were not prudent. We are recommending also that the Secretary of Defense bring this report to the attention of management officials within the military departments and emphasize their responsibilities for determining the adequate performance of equipment before recommending or approving items for volume production.

"Copies of this report are being sent to the President of the United States, the Secretary of Defense, and the Secretary of the Army.

"JOSEPH CAMPBELL,
Comptroller General of the United States."

"INTRODUCTION

"The General Accounting Office has made a review of procurement of the radiacmeters IM–108/PD by the Department of the Army. This review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

"The scope of our review is shown on page 16 of this report.

"BACKGROUND

"The Department of Defense has issued engineering policies and procedures to assure that military weapons, equipment, and systems are suitable for design, production, and use by the military services. Each military service is required by the Department of Defense to establish programs to implement these policies and procedures. The Department of the Army has assigned this responsibility to each major subcommand of the Army Materiel Command.

"Under the reorganization of the Department of the Army, the United States Army Electronics Command, a major subcommand, was established in August 1962 and assumed most of the logistics functions previously performed by the Office of the Chief Signal Officer. This Command has the responsibility for the research, design, development, testing, and supply management of electronic equipment. Its mission is performed by three major agencies as follows:

"1. The United States Army Electronics Research and Development Agency, Fort Monmouth, New Jersey, conducts continuing research for the development and design of new techniques and equipment relative to communication, radar, and electronic devices.

"2. The United States Army Electronics Materiel Support Agency, Fort Monmouth, New Jersey, provides engineering specifications for procurement of electronic equipment, performs or monitors preproduction testing and qualification, and approves equipment.

"3. The United States Army Electronics Materiel Agency, Philadelphia, Pennsylvania, is the national inventory control point and, as such, computes requirements, controls assets on hand, and awards and administers contracts for procurement.

"In order to determine whether newly developed equipment is acceptable for Army use, the Department of Defense procedures require the cognizant military department to test such equipment. These tests are generally referred to as 'service tests.' The purpose of the tests is to determine the physical and operational characteristics, organizational maintenance requirements, and whether the equipment will be accurate, durable, and reliable when subjected to use by the troops in the field. In addition to these service tests, and prior to commencing production, the contractor is generally required to test a preproduction sample to determine whether the performance measurements and capability of the equipment meet the environmental and other field conditions. The contractor is required to furnish a tested preproduction sample to the Army for evaluation and approval. Such evaluation includes an examination and testing by a Government field engineer, or by the contractor under the supervision of the field engineer, to determine whether the tested preproduction sample was manufactured in accordance with contract specifications.

"The radiacmeter IM–108/PD is a tactical survey instrument uesd for detecting and measuring gamma radiation resulting from nuclear explosions and is considered vital for the safety of troops in the field. It is important that the individual using the radiacmeter obtain readings which are accurate and reliable to avoid being exposed to excessive radiation dosages. The service tests of the experimental models was conducted for the Electronics Command by the United States Continental Army Command under actual field conditions. The evaluation of the preproduction models of the radiacmeter was performed at the contractor's plant by personnel of the Field Engineering Division of the United States Army Electronics Materiel Support Agency.

"During the period from March 1958 to January 1962, five formally advertised production contracts were awarded by the United States Army Electronics Materiel Agency. The award dates, quantities, and costs of the production contracts follow:

Date of award	Contractor	Contract	
		Number of units	Cost
Mar. 29, 1958	Landsverk Electrometer Co., Glendale, Calif	10,800	$605,858
June 29, 1959	Jordan Electronics Division of Victoreen Instrument Co., Alhambra, Calif	12,817	[1] 638,098
Oct. 9, 1959	----do	12,017	[1] 615,150
June 7, 1961	Landers, Frary & Clark, New Britain, Conn	11,417	[2] 543,169
Jan. 10, 1962	Victory Electronics & Research Corp., Chicago Ill	12,725	[2] 526,163
Total		59,776	2,928,438

[1] In addition $663,000 was expended by Army depots to modify radiacmeters produced under these 2 contracts.
[2] In addition, $200,000 will be incurred under these contracts because the Government will have to reimburse the contractors for a temporary work stoppage.

"A list of the principal Department of Defense officials responsible for administration of activities discussed in this report is appended.

"FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

"Unnecessary costs incurred in the procurement of inaccurate radiacmeters

"The Army awarded five contracts for a total of 59,776 radiacmeter at a cost of about $2.9 million even though it was aware, prior to the first production contract and each succeeding contract, that the radiacmeters were not suitable for Army use. In addition, over $663,000 has been expended to modify the radiacmeters produced under the second and third contracts, and additional costs estimated at about $200,000 will be incurred to reimburse the contractors under the fourth and fifth contracts for a temporary work stoppage until the Army investigates technical difficulties and decides whether the radiacmeters will be acceptable to using organizations. The 10,800 radiacmeters produced under the first contract have already been scrapped, and the acceptability of any of the remaining instruments is still questionable.

"These unnecessary costs have been incurred because responsible Army officials (1) were overly optimistic that deficiencies identified in tests of experimental model radiacmeters could be corrected in production despite a recommendation by the using organization not to enter into volume production until deficiencies were corrected, (2) accepted preproduction and initial production models and approved volume production without adequate and timely coordination of test data between the using organization and the engineering and procurement agencies, (3) awarded additional production contracts even though previously identified deficiencies had not been corrected, and (4) generally did not exercise their personal responsibilities to assure that Government funds were expended properly.

"Disregard of user's recommendations

"In 1954 a contract was awarded to El-Tronics Incorporated for the development of two experimental model radiacmeters, 50 of each, at a total cost of $43,800. During 1956 and 1957 the United States Continental Army Command (USCONARC) performed a service test on some of the experimental model radiacmeters to determine their suitability for Army use. In May 1957, USCONARC reported to the United States Army Electronics Materiel Support Agency that several deficiencies were found in both models tested which made the radiacmeters unsuitable for use. The accuracy tests, included in the service tests, were performed by USCONARC after the radiacmeters were subjected to actual field use for several months. A serious deficiency noted during these tests was that the readings of the radiacmeters were not within the plus or minus 10 percent accuracy required by the technical military requirements. Inaccurate readings up to minus 78 percent were recorded during this test.

"USCONARC recommended to the Chief of Research and Development, Department of the Army, that a limited procurement of 1,100 radiacmeters be made to satisfy an immediate operational requirement, provided that the deficiencies noted in their tests were corrected in production. They recommended also that some production models be sent to them for testing. The records show that the Chief Signal Officer reported that all deficiencies initially identified in the experimental models could be corrected in production and therefore USCONARC's recommendation of limited procurement rather than volume production was disapproved by the Deputy Chief of Staff for Operations, Department of the Army.

"The first production contract was awarded in March 1958 for 7,200 radiacmeters IM–108/UD. The quantity was subsequently increased to 10.800. This contract proivded that preproduction models be submitted to the United States Army Electronics Materiel Support Agency (USAEMSA) for evaluation and testing to determine conformance with applicable specifications. In the testing of the preproduction models during September 1958, USAEMSA identified several deficiencies in performance and notified the contractor that some of the radiacmeters failed to meet shock, immersion, sensitivity, and calibration specification requirements. However, USAEMSA permitted the contractor to commence production provided that the deficiencies were investigated and corrected, subject to further tests during the initial production run.

"In November 1958, USAEMSA approved the radiacmeters on the basis of tests from the initial production run. As a result of these tests USAEMSA engineers recommended, however, that the calibration accuracy measurement be revised to plus or minus 15 percent rather than to plus or minus 10 percent required by the military specification, but no changes were made to the specifications at this time.

"Further, USAEMSA accepted the preproduction and the initial production run models without submitting the test results to the using organization or subjecting the units to actual field-use conditions, although USCONARC had previously advised USAEMSA that actual field use increased the inaccuracies of the radiacmeters.

"Subsequent contracts awarded before original deficiencies corrected

"In February 1959, or at least 3 months after production had started, USCONARC obtained some radiacmeters produced under the first contract for further testing. One year later, in February 1960, USCONARC reported that its tests showed that they were still unsuitable for Army use. Inaccurate readings as much as plus 67 percent were recorded during these tests. These were the same type of deficiencies as those reported in the May 1957 tests of the experimental models. In its report of February 1960, in which it stated that no priority had been assigned to this project, USCONARC recommended that production of the radiacmeters be halted until the deficiencies could be corrected. However, prior to receiving this report, the Army accepted all the 10,800 radiacmeters under the first contract and, in the meantime, awarded two additional production contracts for 24,834 radiacmeters IM–108/PD and accepted 7,155 radiacmeters under the second contract.

"Notwithstanding the length of time it took USCONARC to test the radiacmeters, USAEMSA should have been aware that the radiacmeters being produced were not acceptable for Army use. The records show that, in August 1959, an electronic engineer for USAEMSA visited the contractor's plant to investigate deficiencies noted in unsatisfactory equipment reports received from field personnel. During his visit the engineer simulated a limited field test by attaching several radiacmeters to his station wagon. During this test, among other deficiencies, the instruments deteriorated in calibration accuracy and did not come within the plus or minus 10 percent accuracy required in the military specifications. The calibration inaccuracy was attributable to the type of electrometer tube being used in the instrument. The test disclosed that when the tube was jarred its filament was adversely affected. The electronic engineer stated that this defect was a serious problem to which there seemed to be no immediate solution. However, no action was taken at this time to halt production until the defect had been corrected.

"About May 15, 1960, the United States Army Electronics Materiel Support Agency began an investigation to determine the cause of the radiacmeter deficiencies noted in the USCONARC test report. They found that the batteries used in the radiacmeters had an unusual drop in the voltage level after limited usage which caused the inaccurate readings. At this time the contractor was advised to withhold production until further notice, and USAEMSA determined that a modification was required to provide greater stability of the voltage level of the batteries. This modification was made, and on May 25, 1960, five modified radiacmeters were delivered to USCONARC for retest.

"USCONARC retested the modified radiacmeters simultaneously with some unmodified radiacmeters produced under the second contract. All those tested were again found to be unsuitable for Army use, due principally to inaccurate readings. In July 1960, USCONARC concluded that the modified radiacmeters may be suitable for use if the discrepancies were corrected. USCONARC again recommended to the United States Army Electronics Materiel Support Agency (USAEMSA) that, after deficiencies in the radiacmeters were corrected, they be submitted for retesting.

"In August 1960, because the idle production lien costs were increasing under the second production contract, USCONARC agreed to the resumption of production, based on the contractor's description of how the deficiencies could be corrected in production. Records at the Electronics Materiel Agency show that, after production was resumed, the remaining 5,662 units under the second production contract and 1,300 units under the third production contract were ac-

cepted by the Electronics Command before any modified radiacmeters were submitted to USCONARC for retesting in March 1961. Before the USCONARC test results were received by the Electronics Command in July 1961, an additional 10,717 radiacmeters, or the remaining portion of the third production contract, were accepted, and in June 1961 a fourth production contract for 11,417 radiacmeters was awarded.

"Radiacmeters scrapped because of potential casualties and fatalities to users

"In December 1961, personnel of the Electronics Command determined that all 35,634 radiacmeters procured under the first three production contracts had major deficiencies. Although a more stable radiacmeter was produced as a result of the May 1960 modification, tests showed that the radiacmeters were still subject to large errors in reading if one or more battery cells failed. The users would not be aware of this error during actual field use and their remaining in an area with excessive radiation could result in casualties and fatalities. Therefore, instructions were issued in May 1962 by the Commanding General of the United States Army Electronics Materiel Agency (USAEMA) to all commands that the initial production of 10,800 radiacmeters costing $606,000 should be disposed of.

"Acceptability of radiacmeters still questionable even after modifications

"The Electronics Command determined that it would be economically practicable to rework the radiacmeters produced under the second and third contracts, which were also subject to similar deficiencies in calibration accuracy. The costs incurred at Lexington and Sacramento Army Depots to modify these radiacmeters, which have not yet been field tested by the Army, have amounted to $663,611.

"In January 1962, a fifth production contract was awarded for an additional 8,400 radiacmeters. The quantity was subsequently increased to 12,725. USAEMSA determined that it was also necessary to change the specifications applicable to the fourth and fifth contracts in order to produce a more satisfactory radiacmeter. This change in specifications required certain modifications which were approved by the Electronics Command. All radiacmeters were then required to meet the plus or minus 10 percent calibration accuracy as provided by the original technical military requirements and would be redesignated radiacmeter IM–174/PD.

"Results of tests performed on initial production models from the fourth and fifth contracts by USAEMSA engineers and the Lexington Army Depot in May 1963 showed, however, that various engineering deficiencies in the modified IM–174/PD radiacmeters posed a question as to whether the radiacmeters would be acceptable in meeting the requirements of the using organizations. One of the limitations identified by these tests was that, after being used, the equipment could not be used again for a period of 72 hours. The reason for this limitation is due to the type of tube contained in the modified radiacmeters. This was the same deficient tube identified by the USAEMSA engineer in August 1959.

"On July 25, 1963, the Commanding General, United States Army Electronics Command, advised USAEMA that no further contracts for the production of the IM–174/PD radiacmeters were to be made either on the basis of the add-on quantities or new contracts. Subsequently on August 22, 1963, the Commanding General, United States Army Electronics Command requested USAEMA to enter into supplemental agreements with the contractors under the fourth and fifth contracts to provide for temporary work stoppages of 120 days. This temporary delay in work under these contracts will result in additional costs to the Government of about $200,000. During this period a technical investigation of the deficiencies in the IM/174–PD radiacmeters will be performed. Extensive tests of a total of 128 radiacmeters, comprising 64 produced under the fourth contract and 64 from the fifth contract, will be made by the Lexington Army Depot. Subsequent to a review of the results of these tests, the Army will make a decision whether to resume production on this item or terminate the fourth and fifth contracts.

"Agency comments

"On April 11, 1963, we brought our findings to the attention of the Department of the Army and proposed that it institute effective controls and place responsibility within the Army Materiel Command to assure that either (1)

volume production of new equipment is not undertaken when the results of tests of experimental models disclose that the item is unsuitable for field use or (2) when equipment with known deficiencies is authorized for production with the understanding that the deficiencies will be corrected, appropriate testing techniques are applied in a timely manner to determine that the items being procured will meet the requirements of the user in order to minimize the number of defective items produced.

"By letter dated June 18, 1963, the Deputy Assistant Secretary of the Army (Installations and Logistics) stated that the Department of the Army concurred with our findings. He stated that the Army had a standing policy that volume production of new equipment is not undertaken if the results of tests of experimental models disclose that the item is unsuitable for use. He advised also that normal procedures require that appropriate and timely testing techniques be applied to assure that new items meet the user's requirements. He stated that the Department of the Army is investigating further the causes for the conditions cited in this report and that further production of the equipment will not be accomplished until existing technical problems have been solved and the field user's accuracy requirements are met.

"The Deputy Assistant Secretary stated further that, on the basis of results of tests, it was concluded that the design of the IM-108/PD radiacmeter was sound but that further investigation of the specific causes for the inaccuracies would be made. However our review disclosed that responsible engineering personnel at the USAEMSA, Fort Monmouth, New Jersey, agreed that the contractors met all specifications but that there was a defect in the design of the radiacmeter. In view of the position taken by the Deputy Assistant Secretary, it is evident that a conflict of opinions exists within the Army as to the soundness of the design of the IM-108/PD, later designated the IM-174/PD radiacmeter. We did not attempt to determine whether the deficiencies in the radiacmeter resulted from the contractors' production practices or from the Government's design specifications.

"Conclusions

"Volume production of new equipment, generally, should not be undertaken when the results of tests performed by the user on experimental models disclose deficiencies that render the item unsuitable for field use. Further, when equipment with known deficiencies is authorized for volume production, with the understanding that these deficiencies will be corrected in the production model, it is of the utmost importance to determine, by appropriate testing techniques at the earliest possible time, that the deficiencies have been corrected and that the item is suitable for field use. These actions require timely and effective coordination between the responsible testing and procurement organizations.

"Notwithstanding the Army's policy that volume production of new equipment is not undertaken if the results of tests in experimental models disclose that the item is unsuitable for use, our review disclosed that deficiencies had been identified in the radiacmeters IM-108/PD experimental models that rendered the item unsuitable for use, but a decision was made to enter into volume production and a contract was awarded. Furthermore, four additional contracts for the production of these radiacmeters were awarded even though previously identified deficiencies had not been corrected. As a result, 10,800 radiacmeters that were procured at a cost of $606,000 are now being eliminated from the Army's supply system, 24,834 other radiacmeters costing over $1.2 million have been modified at a cost of over $663,000, and additional costs estimated at about $200,000 will be incurred because of a temporary work stoppage under the fourth and fifth contracts. As of September 18, 1963, the acceptability of any of the radiacmeters for Army use is still questionable pending the results of tests of the modified instruments.

"Recommendations

"We recommend to the Secretary of the Army that (1) those cases where supply management officials, because of the urgency of requirements for equipment, elect to overrule the recommendations of the using forces with respect to performance of the equipment and elect to enter into production before all known deficiencies are corrected be referred to the Assistant Secretary of the Army (Installations and Logistics) for his approval, (2) in the investigation of the specific causes for the deficiencies in the radiacmeters that are the subject of this report, the Department of the Army determine, and advise us, whether

the deficiencies resulted from the contractors' production practices or from the Government's design specifications, and (3) consideration be given to taking disciplinary measures against management officials whose actions in this matter were not prudent. We recommend also that the Secretary of Defense bring this report to the attention of management officials within the military departments and emphasize their responsibilities for determining the adequate performance of equipment before recommending or approving items for volume production.

"SCOPE OF REVIEW

"Our review included an examination of the records and reports relative to the testing, procurement, use, modification, and disposition of this equipment within the Department of the Army for the period from April 1954 to September 1963. Our review was made at the United States Army Electronics Materiel Agency, Philadelphia, Pennsylvania, and the United States Army Electronics Materiel Support Agency, Fort Monmouth, New Jersey.

"PRINCIPAL MANAGEMENT OFFICIALS OF THE DEPARTMENT OF DEFENSE AND THE DEPARTMENT OF THE ARMY RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure	
	From—	To—
DEPARTMENT OF DEFENSE		
Secretary of Defense:		
Robert S. McNamara	January 1961	Present.
Thomas S. Gates, Jr	December 1959	January 1961.
Neil H. McElroy	October 1957	December 1959.
Charles E. Wilson	January 1953	October 1957.
Assistant Secretary of Defense (Installations and Logistics):		
Thomas D. Morris	January 1961	Present.
Perkins McGuire	January 1957	January 1961.
DEPARTMENT OF THE ARMY		
Secretary of the Army:		
Cyrus R. Vance	July 1962	Present.
Elvis J. Stahr, Jr	January 1961	June 1962.
Wilber M. Brucker	July 1955	January 1961.
Robert T. Stevens	February 1953	July 1955.
Assistant Secretary of the Army (Installations and Logistics):		
Paul R. Ignatius	May 1961	Present.
Unfilled	January 1961	May 1961.
Courtney Johnson	April 1959	January 1961.
Frank Higgins	August 1954	April 1959.
Chief of Staff, U.S. Army:		
Gen. Earle G. Wheeler	October 1962	Present.
Gen. George H. Decker	October 1960	September 1962.
Gen. Lyman L. Lemnitzer	July 1959	October 1960.
Gen. Maxwell D. Taylor	June 1955	June 1959.
Gen. Matthew B. Ridgway	July 1953	June 1955.
Deputy Chief of Staff (Logistics):		
Lt. Gen. R. W. Colglazier, Jr	July 1959	Present.
Lt. Gen. Carter B. Magruder	May 1955	June 1959.
Lt. Gen. Williston B. Palmer	October 1952	April 1955.
Commanding general, U.S. Army Materiel Command: Lt. Gen. Frank S. Besson, Jr.	July 1962	Present.
Commanding general U.S. Army Electronics Command:		
Maj. Gen. Frank W. Moorman	August 1963	Do.
Maj. Gen. Stuart S. Hoff	August 1962	August 1963.
Chief signal officer:		
Maj. Gen. E. F. Cook	---do	Present.
Maj. Gen. Ralph T. Nelson	May 1959	August 1962.
Maj. Gen. John D. O'Connell	May 1955	April 1959.
Maj. Gen. George I. Back	May 1951	May 1955.
Commanding general, U.S. Army Electronics Materiel Agency (formerly U.S. Army Signal Supply Agency):		
Brig. Gen. Wesley C. Franklin	September 1963	Present.
Brig. Gen. Allen T. Stanwix-Hay	August 1962	September 1963.
Col. Douglas O. Toft	June 1962	August 1962.
Brig. Gen. Charles S. Hays	November 1960	May 1962.
Brig. Gen. Elmer L. Littel	June 1957	November 1960.
Brig. Gen. William D. Hamlin	August 1956	June 1957.
Brig. Gen. William L. Bayer	October 1954	July 1956.
Brig. Gen. James S. Willis	May 1953	September 1954."

Mr. DOMINICK. Mr. President, information which reached me yesterday is very disturbing. I am informed that the radio set AN/PRC–77 is, today, being manufactured by a company other than RCA, in a foreign country, by a company which is not American owned, and is being manufactured in accordance with the very drawings that Mr. Brooks has alleged to me do not exist. A representative of the foreign company has acknowledged publicly that the foreign company is, in fact, manufacturing this walkie-talkie radio set. In view of the foregoing, I believe that the public and the Congress is entitled to the real truth in this matter. I have, therefore, requested the Federal Bureau of Investigation to come into this case and learn how these manufacturing drawings came into foreign hands while the Army officials themselves claim that a data package on this radio equipment does not exist.

Mr. President, in addition, I intend to insert for the Record a copy of the letter which I have directed to the Comptroller General of the United States concerning this matter. Among other things, I have requested that an audit be conducted of the earlier $20 million RCA contract for radio sets the Army procured at $2,156.91 each. Two million two hundred thousand dollars had already been paid RCA for development of this radio, after which RCA subsequently quoted a price of $843.37 per unit for the identical equipment in open competitive bidding. The purpose of this audit, of course, is to identify and recapture any excess profits which had to be generated in such an enormous contract for such a little radio.

Mr. President, I am more fully convinced than ever that in view of the questionable transactions which are coming to light an in-depth investigation into our military procurement practices should be initiated by Congress without further delay.

Mr. President, I ask unanimous consent that a very interesting article by Mr. Willard Edwards which appeared in the Chicago Tribune on September 23, 1967, be printed in the Record.

There being no objection, the article was ordered to be printed in the Record, as follows:

"CAPITOL VIEWS

"(By Willard Edwards)

"WASHINGTON, September 22.—The panic button was pressed in the Pentagon this week when Sen. Peter H. Dominick [R., Colo.] arose on the Senate floor and asked a quiet question. Forces were thereby initiated that could mushroom into a scandal of government-shaking proportions.

" 'Was it not time,' Dominick inquired, 'to determine whether outright dishonesty, and not just bureaucratic fumbling and inefficiency, was responsible for the accumulating evidence of monumental waste in military procurement practices? Specifically, was someone in the defense department getting rich thru the allotment of huge contracts to large corporations despite lower bids by competitors? With more than 18 billion dollars allotted this year for military purchases, the temptation was great.'

"It was a question that has been begging for utterance in recent months. Dominick, a member of the Senate armed services committee, backed it up by citing two recent cases he had uncovered which suggested corruption instead of the inefficiency often accepted as normal to war time spending. He asked the government operations committee to determine whether the facts warranted a full-scale investigation and public hearings.

"Scores of members have received complaints of cases similarly indicating fraud. Small business firms thruout the nation have reported numerous instances in which they were frozen out of defense contracts by bigger corporations with influential contacts in Washington. In all cases, the defense department paid more for supplies than was necessary.

"DOMINICK SECRETLY APPLAUDED FOR CANDOR

"Dominick brought into the open a situation which many had been loath to discuss and they secretly applauded his candor. Secretary of Defense Robert S. McNamara was alerted to the danger. President Johnson was advised that a political volcano was rumbling and might erupt in an election year. An emergency meeting of defense department officials was called to debate the threat.

"McNamara has weathered many storms by putting up a barrage of angry denials and counter-charges. But he will proceed cautiously in this crisis, having

been burned badly in his first encounter with congressional criticism of military procurement. He was forced to beat a quick retreat after his first savage and sarcastic reaction to revelations by Rep. Otis G. Pike [D. N.Y.] of inexcusable defense buying.

"Pike made public a series of military purchases which defied reasonable explanation. He told of small items of hardware, such as washers and nuts and bolts, for which the military paid $1.55 each when they were available in any hardware store for 6 cents apiece.

"The amounts were small but, as Pike remarked, the principle was not. McNamara, accustomed to dealing in billions of dollars, ridiculed Pike as a nitpicker. The New York congressman struck back by displaying a generator knob, available to any citizen for $1.62, for which the army had paid $312.50. Next day, a red-faced military canceled the contract.

"DOMINICK'S CASES DEAL WITH BIG AMOUNTS

"Pike referred to the purchases as 'stupid' and 'wasteful,' not ascribing more sinister motives. The cases revealed by Dominick, however, not only dealt in big amounts but could not be excused as due to ignorance or inefficiency.

" 'A small firm in Aurora, Colo.,' Dominick said, 'developed a lightweight flame thrower, submitted the low bid in it, and then found itself losing the contract to a bigger company which had bid more than double the amount. In the second case, a small business concern in Philadelphia lost out on a 10 million dollar contract for a portable radio altho its bid was $884,856 lower than the successful bidder, the giant Radio Corporation of America.'

" 'Both cases were marked by such glaring inequities,' Dominick said, that he felt impelled to ask, 'whether any specific benefits have been derived by anyone in the army or elsewhere as a consequence of this peculiar procedure.'

"In other words, did someone get a rakeoff? There are more than 100 similar cases of exorbitant costs and indefensible buying methods awaiting the congressional probe. On Capitol hill, the odds are considered more than even that the investigation could develop into an expose of deals dwarfing the '5 percent' operations of influence peddlers in the Truman era."

Mr. DOMINICK. I ask unanimous consent that the letter from the Army dated September 21, 1967, to me and my letter to the Comptroller General dated September 28, 1967, be included at this point in the Record.

There being no objection, the letters were ordered to be printed in the Record, as follows:

"DEPARTMENT OF THE ARMY,
OFFICE OF THE ASSISTANT SECRETARY,
Washington, D.C., September 21, 1967.

"Hon. PETER H. DOMINICK,
U.S. Senate,

"DEAR SENATOR DOMINICK: I have read your remarks of 19 September relating to two Army procurement transactions and feel it might be helpful to clarify a few of the points you raised. As you may know the Comptroller General has performed complete and impartial reviews of these procurements.

"The Research and Development contract for a multi-shot portable flame weapon was protested by Custom Packaging Company to the General Accounting Office. The Assistant Comptroller General, in a report of 29 June 1967, copy attached, states, 'A study of the record on this procurement as supplemented by presentations on behalf of Custom leads to the conclusion that the award as made represented a proper discharge of procurement responsibility and discretion as to which we find no legal basis to question.' Therefore, the protest was denied.

"I can find nothing to support the inference that any technical innovations by Custom Packaging were revealed to any other contractor. None of the requirements contained in the Request for Proposals disclose any design features submitted by Custom Packaging. The requirements listed were in sufficient detail to permit potential contractors to offer proposed designs, and were developed independently of Custom Packaging.

"This procurement followed the normal Research and Development procedure to obtain formal proposals from interested and qualified Companies setting forth their technical approach to provide the required weapon. In such a case we are not seeking the lowest price proposal, but rather the technical approach which would be most likely to provide the best weapon to meet the requirements of our

Armed Forces. All proposed contractors were informed of this intention and of the fact that it was anticipated to award a cost reimbursement-type contract. The proposals submitted by Custom and several others, including Nortronics, were carefully evaluated by the Government, and Nortronics was selected since it offered the technical approach most likely to result in the best weapon. As noted by the General Accounting Office, 'The Proposal of Custom was rated lowest and the proposal of Nortronics . . . received the highest rating.' The General Accounting Office further noted, 'Although Custom demonstrated its portable flame weapon system for Edgewood Arsenal, the record shows that such demonstration was not successful and that, in the considered judgment of technical personnel, such weapon did not meet the needs of the Government. We find nothing in the record which would lead to the conclusion that Custom had a valid basis for assuming that the Government would award it a contract for such weapon.'

"With regard to the procurement of PRC–25/77 Radios, the two-year contract awarded to RCA in April 1967 which you cited was also the subject of a protest to the General Accounting Office and in his letter of 1 June 1967, copy attached, the Assistant Comptroller General concludes. 'Therefore, no legal basis exists to object to the subject procurements.' I further note that Decitron has protested the 16 August 1967 award of the second increment of the April 1967 contract to RCA to the General Accounting Office. Acting on a request from that office, the Army is currently preparing an administrative report in response to this protest and we will be guided by the Comptroller General findings.

"The successor radio to the PRC–25, the PRC–77, which was developed under a product improvement program by RCA provides substantially better communication capabilities, a means of secure voice transmission, increased range, lighter weight and less battery drain. Because of these advantages the improved radio was urgently needed in Southeast Asia and RCA was awarded a contract in June 1966 to produce initial production quantities while further design changes and improvements were being effected. In order to provide for competition in future procurements, this contract included a requirement for the delivery of a procurement data package. Due to design changes resulting from concurrent field testing, it was determined that competitive procurement of this radio could not be achieved prior to 1 January 1968. Therefore, the follow-on two-year contract was awarded to RCA to meet the priority requirements for Southeast Asia.

"With regard to the unsolicited proposal by Decitron a competitive data package was not available in April 1967. As a matter of fact, due to design changes resulting from concurrent field tests, the final procurement package will not be available until early December 1967. Even if the data package had been delivered by 31 March 1967, it could not have been available for competitive procurement for some months due to the necessity of Government review and verification. RCA was the only producer capable of manufacturing the radio to meet the required delivery schedule. It is presently anticipated that competitive procurement of the PRC–77 Radio will be accomplished in early 1968.

"I trust this information will be of value to you in your further evaluation of these procurement.

"Sincerely,

"ROBERT A. BROOKS,
Assistant Secretary of the Army (Installations and Logistics)."

"U.S. SENATE,
COMMITTEE ON ARMED SERVICES,
Washington, D.C., September 28, 1967.

"Hon. ELMER B. STAATS,
Comptroller General of the United States,
Washington, D.C.

"DEAR MR. COMPTROLLER GENERAL: On September 19, 1967, I delivered a speech in the Senate which concerned two Army procurements, one of which involved the AN/PRC–25 and the AN/PRC–77 Radio Set which I understand is now pending under a protest No. B–161031. For your ready reference, a copy of my remarks is attached. In addition, I have attached a copy of a letter dated 21 September 1967, which I received from the Assistant Secretary of the Army Installations and Logistics, dealing with this very matter.

"From the Army letter of 21 September, it appears that the Signal Corps is running a development program parallel to a production program for the same equipment. I am aware of the GAO Reports on the IN–108 Radiacmeter and the AN/PPS–4 Radar procurement wherein the Army previously did exactly the same thing in continuing development with parallel production which resulted in the waste of millions of tax dollars. (Comp. Gen. B–146834 and B–146906.)

"It is for these very reasons that I hereby request the GAO to identify for me by name, rank and grade, title of all civilian and military personnel who are involved in the AN/PRC–25 and AN/PRC–77 development and production including engineering, logistic and contracting officials with particular emphasis on those names of Army employees common to AN/PPS–4 and IM–108 Radiacmeter procurements.

"In addition, I request that the GAO audit RCA Contract 89511 in an effort to recapture possible excess profits which must have been realized under a $20.5 Million award for radio sets at a unit price of $2,156.91 (after $2.2 Million had already been paid RCA for development) in a non-competitive procurement for that equipment which RCA subsequently quoted at $843.37 per unit the very instant the force of competition was introduced into the procurement for the same radio.

"And finally, it is requested that I be supplied a summary of DD–250 Documents which cover shipments made by RCA under contracts 01292 initiated March 21, 1965, and 10410, showing line for line, item for item, shipping dates.

"When the audit is complete under Contract 89511, please arrange to supply me with a completely priced bill of materials for the radio set supplied by RCA under that contract, showing item for item prices and sources, which I want to use for comparison with other information from other manufacturers covering this same equipment.

"Very truly yours,

"PETER H. DOMINICK,
"U.S. Senator."

MILITARY PROCUREMENT PRACTICES [1]

Mr. DOMINICK. Mr. President, on September 19, 1967, I delivered an initial floor speech concerning questionable military procurement policies and procedures. It concerned two Army contracts. Both were awarded to big business firms although substantially lower bids were on file from small business firms. Specifically, one award was given to Northrop Nortronics—a division of Northrop Aviation—the high bidder, over Customs Packaging Co., the low bidder. The other award was given to Radio Corp. of America, the high bidder over Decitron Electronics Corp., the low bidder.

The first contract involved a shoulder-borne portable flame weapon. The other contract involved a portable walkie-talkie radio set. In both transactions the procedures used to justify the excessive cost to the taxpayers seemed to me to be so highly questionable that I urged that Congress proceed with a thorough investigation of our military procurement policies.

The case involving my constituent, Custom Packaging Co., Aurora, Colo., clearly pointed out a serious shortcoming in our ability to properly review transactions involving millions upon millions of the taxpayers' dollars. Congress has depended upon the Comptroller General of the United States to accomplish the technical aspects of this review. The Comptroller General has acknowledged that this is not being done.

In response to the protest filed by my constituent, the Comptroller General responded in part as follows:

"Your claim of improper use by the procuring activity of proprietary information contained in Custom's unsolicited proposal is categorically denied by responsible and knowledgeable technical personnel of the Department of the Army. And while your rebuttal and other correspondence dealing with this allegation strongly disputes the conclusion reached by the Army Technical Personnel, we have no alternative but to accept the facts as reported by the Army. In factual disputes, such as here, which are technically beyond the competence of our office because of the scientific or engineering concepts involved, we must accord a significant degree of finality to the Administrative position."

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[1] Reprinted from Congressional Record, 90th Cong., 1st sess., Oct. 4, 1967.

In other words, Mr. President, the Comptroller General is saying that no review was made of the charge beyond asking the Army whether it disagreed with the assertion made by my constituent. Of course, the Army responded in the manner it did in order to protect those responsible for this questionable transaction in the first place.

The Small Business Administration also questioned the Comptroller General about the award of the contract to Nortronics at more than twice the amount bid by Custom Packaging Co. In his response to the Small Business Administration, the Comptroller General hedged the question posed by the Small Business Administrator that, under the Small Business Act, provision is made that where a small business concern is certified by SBA to be a competent Government contractor with respect to capacity and credit, the procuring officers of the Government must accept such certification as conclusive. After having admitted in his letter to my constituent that in actual fact no review was made, the Comptroller General goes on to say:

"On the basis of the record before us, we are of the view that Custom's proposal was technically non-responsive to the Army's requirements as detailed in the statement of work accompanying the request for proposals. In reaching this view, we are aware that some of Custom's deficiency disclosed in the technical evaluation related to its capacity and credit."

And then he revealed the following:

"However, Custom received only a rating of 2 on its technical approach to the government's requirements out of a possible weighted factor of 40."

This "weighted average" method of eliminating the lowest bidder struck me as being familiar. Upon checking, I find that this very same gambit was used to eliminate the low bidders on the development of a portable radio communications set which has the official nomenclature AN/PRC–62( ). The Army Electronics Command awarded a contract to the Radio Corp. of America—and here we go again with RCA. This is the third time I have brought them up—for $1,073,150 in spite of the fact that the Army had received substantially lower bids from such companies as Bendix Radio, General Motors Delco Radio Division, Raytheon, General Dynamics, Magnavox, Sylvania, and others. The lowest bid received for this AN/PRC–62 radio came from the International Telephone & Telegraph Co. We all know these are the giants of the electronics industry.

It is a well-known fact that the United States—and we can say this again after today's debate—is not a profitmaking organization. But, when we have procurement officials who can throw out low bids from firms such as I.T. & T., who are enormously well qualified to develop any kind of radio we could think of, then I think it is high time we took another look at the regulation the Army cited as justification for its actions. The Army justified these actions under section IV, part 2 of the Armed Services Procurement Regulations. Just how does this work?

The Comptroller General's report No. B–160809 explains how the Army did this in the case of my constituent, Custom Packaging Co. First, they completely ignored the price of the item to be procured. Then the Army proceeded to assign an arbitrary set of "values" to the various bids. The Army said that technical approach to the problem was to count 40 percent; technical personnel 20 percent; background experience only 15 percent; facilities 15 percent; and schedule—whatever that is—was to count 10 percent.

Having established this approach, the Army then contrived a new set of numbers having nothing whatever to do with price, and lo and behold, Nortronics got the highest rating, while Custom Packaging Co., which conceived the flame weapon, developed it at its own expense—and demonstrated it to the Army—got a rating of two points out of a possible weighted factor of 40. This, I might say, is despite the fact that SBA had certified the company's capacity and credit ahead of time.

Mr. President, the case of the AN/PRC–62 radio procurement was well documented by GAO report B–152884. There again the weighted average was used. The report shows that in awarding the contract to the Radio Corp. of America for an amount in excess of $1 million, the Army Electronics Command ignored the following lower bids:

I.T. & T., $421,140.
Bendix Radio, $434,627.
Advanced Communications, $470,445.
Electronics Communications, $489,155.

General Motors Delco Radio Division, $556,152.

The report contains the following incredible admission:

"We could not independently evaluate the technical aspects of the proposals, nor could we determine from an engineering standpoint whether the Agency's technical evaluations were reasonable. Furthermore, many of the Agency's technical evaluations were not adequately documented. However, our review disclosed that the Agency's engineers responsible for evaluating the proposals were in general agreement that RCA's proposal was the best."

Of course, they would.

Mr. President, I think we ought to think about this for a second. Here is the Office of the Comptroller General which is designed to be at least Congress agency to determine whether the executive departments of the Government are operating in the best interests of the taxpayers and in the best interests of the country. Yet, they have said now on three consecutive occasions that they were not qualified to analyze the scientific and other material which forms the basis of the Army's decision. Consequently, the only thing they can do is accept the Army's decision, even when in the Comptroller General's report it says it is not documented, and the Army's opinion has been based on the claimed lack of technical competency of companies like International Telephone & Telegraph.

Can we conceive of any more ridiculous position than having the Army come up and try to tell the Comptroller General or anybody else that ITT or Bendix or Advanced Communications or General Motors cannot build a portable radio? It is the most ridiculous thing I have ever heard of.

Here we have another $500,000—that is not a great amount in the present budget—thrown down the drain solely because the Army wants to deal with RCA to the exclusion of everybody else. I say it is amazing indeed.

I am informed today that the Army is right this minute scheduling $8.5 million in this fiscal year into sole-source noncompetitive production for the AN/PRC–62( ) radio set that I have just finished talking about, where we have bids from five perfectly competent companies that are far lower than the bid from RCA. In view of what has transpired, it will come as no surprise when RCA is announced as the lucky company that is going to get this "urgent" award—much to its happy surprise.

I would not be surprised next month to learn that the Army has generated another of its classic "urgent" requirements—this time for shoulder-borne flame weapons to be produced by Nortronics on a noncompetitive basis, because the Army will say they need them in a hurry, even though they have a 2-year development program already in operation.

The Senate Select Committee on Small Business, of which I am a member, has recently held hearings, during the course of which I was assured by Mr. Robert Moot, the Administrator of the Small Business Administration, that SBA is going to be far more vigorous in seeking corrective action in this area. We have been promised a report on the cases which I have previously reported to the Senate. I am looking forward to receiving these reports.

Mr. President, I believe that this free ride on the taxpayers' back has gone on long enough. Surely, not every research and development program has to come up devoid of manufacturing drawings, precisely in point of time to coincide with an overpowering, overriding demand for immediate delivery. Certainly, we should be capable of orderly planning that would allow open competitive bidding for our military requirements. As it is today, less than 15 percent of all the money spent by the Pentagon—the billions of dollars that we spend—is awarded under contracts based on competitive bidding and public opening of bids. This situation exists in spite of the fact that it is common knowledge that competitive bidding reduces the cost from 30 to 50 percent under noncompetitive costs.

Mr. President, as I have said, this is the third speech I have made on this subject, and the third series of contracts I have brought up. I hope to bring up more such instances in the future, because the point I am making is that somewhere something is wrong in the Army procurement system. One result of this wrong is that tax funds are being spent at a rate far in excess of what is needed. Another result is that the low bidder, time and time again, has been knocked out as the eventual procurer of the contract, and it is given to the big companies that already seem to have a great number of defense contracts. This situation raises questions in my mind and, I believe, in the minds of all of us.

I do not wish to accuse anybody of wrongdoing. But it seems to me that the cases I have already developed are sufficient in nature and in scope to warrant a thorough-going congressional investigation into what is happening in the military procurement policies as they are being administered today under the Secretary of Defense.

(The DOD subsequently requested the insertion of the following into the record:) (See pp. 395, 590.)

Senator Dominick's concern regarding an increased percentage of military procurement accomplished without open competition is without foundation. The Department of Defense publishes annually a report on military prime contract awards and subcontract payments. The latest report covers the period July 1966 to July 1967. Table 9 on pages 32 and 33 of this report reflects competition in military procurements during FY 66 and FY 67. This Table shows that $20.6 billion were awarded on a competitive basis during FY 67 and this represented 47.5% of all Defense purchases. In our reports to the Congress we have stated that 42.9% of all Defense purchases were awarded after price competition. A contract is reported as awarded on the basis of price competition only if the successful contractor won the award by a competitive proposal that definitely provided the lowest evaluated price to the Government. Our reports have not included awards made as a result of technical or design competition—a circumstance which is present when two or more equally qualified sources of supply are invited to submit design or technical proposals, with the subsequent contract award based primarily on this factor rather than on a price basis. Research and development contracts are examples of military awards which fall into this category. It is not correct to state that in Defense purchasing "the average percentage of noncompetitive procurement reaches 86%".

Senator Dominick incorrectly stated that the 100 largest business firms continually get a larger share of Defense business. A Defense report of the 100 Companies and their Subsidiary Corporations listed according to the net value of military prime contract awards for FY 67 shows that the percentage of Defense contracts going to the top 100 Companies has been reduced from 74.2% in 1961 to a low of 63.8% in 1966 with a slight increase of 1.7% in 1967, resulting from an up-swing in aircraft procurement of $2.2 billion in FY 67.

Senator Dominick's comments on the issues surrounding the Research and development contract for a shoulder-borne, transportable flame thrower were discussed in detail in a visit by Assistant Secretary of the Army (R&D) O'Neal with Senator Dominick on 8 February 1967. Subsequently, in a letter of 20 October 1967, Secretary of the Army Resor commented further on this issue. Secretary Resor's letter was entered in the Congressional Record by Senator Dominick on October 24, 1967. Secretary Resor's letter follows:

"OCTOBER 20, 1967.

"Hon. PETER H. DOMINICK,
"*U.S. Senate.*

"DEAR SENATOR DOMINICK: I read with concern your statements in the Congressional Record of 19 and 28 September and 4 October concerning Army procurement policy. I have personally inquired into the matters you raised. For the reasons which follow, my conclusion is that Army actions were made honestly and in accordance with the needs of our combat forces in Southeast Asia.

"You raised first the question of award of the research and development contract for a multi-shot portable flame thrower to Northrop Nortronics, and suggested that the award should have been made to Custom Packaging Company of Aurora, Colorado. Nine manufacturers submitted proposals in response to the Army's request. After a careful technical evaluation Nortronics was ranked 1, Custom 9. Weighting certain factors used in the technical evaluation did not affect Custom's ranking, since no company received a lower score in four of the five characteristics evaluated—technical approach, technical personnel, background experience, and facilities. If the elements of the evaluation had not been weighted at all, the ranking of these two companies would have been exactly the same: Nortronics 1, Custom 9.

"You emphasized that Custom proposed a price of $167,608 for the contract compared to Nortronics' estimate of $387.000. The Army took these cost proposals into account in making the award. But such cost figures, inevitably based on difficult estimates, cannot be made the controlling factor in a research and

development contract, in which the paramount goal is to obtain a product which will meet field requirements. This fact is recognized in the Armed Services Procurement Act, 10 U.S.C., Sec 2304(a)(11), and also in ASPR 4–106.4 and 4–106.5, which make clear that in research and development contracts estimates of cost seldom can be the controlling factor. Custom's proposal simply was not up to the standard required, and the Army would have been wasting money and imperiling the entire development program to award the contract to a company offering so little prospect of success.

"Other questions concerning Custom's efforts to obtain the contract were thoroughly considered by the Comptroller General, who set out in detail the efforts of Custom to interest the Army in its product. See Ms. Comp. Gen. B–160809, 29 June 1967. While the Army was ready to give Custom every consideration, that hardly can be regarded as a solicitation. The fact the contract was awarded one working day before the date once estimated as the approximate time of award was of no consequence, and Custom was promptly notified. The Army did not use or disclose any of Custom's proprietary data, and the Comptroller General concluded that there was 'no substantial basis' for such an allegation.

"The other question you raised concerned several aspects of the development and procurement of the AN/PRC–25 and AN/PRC–77 portable field radios. I shall discuss briefly the principal points which you mentioned.

"First, you suggest that the Army paid too much—$951 per unit—for the 4158 PRC–25 radios purchased for the Marine Corps from RCA by contract of 13 August 1965. That contract was awarded by competitive negotiation to meet an urgent requirement from Southeast Asia for 13,158 PRC–25s. Military necessity required delivery of the entire amount by 30 June 1966, 10 months thence. Only two companies—RCA and Memcor—were in production and could meet that deadline. The Army awarded a contract for 9,000 to Memcor, the lowest-price proposer, which represented that company's total capability to meet the deadline. The remaining quantity, 4158, was awarded to RCA at a unit price of $881.00 not $951. This price understandably was higher than the $625 previously bid by RCA on an earlier buy because the quantity was less (4158 instead of 7278), the production leadtime was less (4 months instead of 12) and Government-furnished equipment was less ($3 per unit instead of $53).

"Second, you expressed concern over the necessity of contracting sole-source for production of the PRC–77 on 28 April 1967. RCA's first production contract called for delivery of a running set of drawings (those used for the initial production run) on 31 March 1967, the date of delivery of the first PRC–77. The initial running set was delivered on 3 May 1967, only 33 days after the originally specified delivery date. This delay resulted from changes in Army operational criteria imposed by new requirements for related communication equipment which were not furnished RCA until February 1967, eight months after contract award. Unavoidable delay by the Army in developing interface data for the related communications security equipment also necessitated a rollback in production deliveries. After negotiations, deliveries were rescheduled to begin in August 1967, five months after the original contract schedule. The contract was modified accordingly. Satisfactory updated production drawings reflecting the communications security interface data were submitted on 6 September 1967. Thus delay in delivery of drawings was attributable to modification in Army requirements, not to RCA. The delay was necessary in order to assure proper characteristics of the production model.

"It is regrettable that military urgency sometimes requires us to begin and to increase production of vital equipment before the widest competition can be obtained. Yet the military requirement was real, was formalized in a memorandum signed by Mr. Vance, then Deputy Secretary of Defense, and could not be ignored. All such requirements are examined carefully to substantiate the urgency of the need. But once the need of our men in the field is clear, the Army always will choose to act at once and save lives, rather than delay in the hope of saving dollars.

"Third, you discussed the PRC–77 contracting officer's rejection of a letter offer by Decitron Electronics Corporation of Brooklyn, New York, to produce the PRC–77 at a unit price of $893.75, or $43.41 per unit less than the price in the contract awarded RCA.

"Decitron's unsolicited letter was not an acceptable proposal. It merely named a price and requested information on the product to be built. The company had

only the most general knowledge of the PRC–77. To build it Decitron would have needed extensive technical data to be obtained from the first production contract, and to wait for them would require slippage in necessary delivery schedules. Without these data, any radio built by Decitron, even if it met most of the general performance standards of the PRC–77, could not be a PRC–77. It would be a new item, with many parts not interchangeable with those of the PRC–77 and probably unable to interface with the amplifier and classified equipment which the PRC–77 uses.

"You also referred to two modifications of the second PRC–77 production contract increasing the quantity, while extending the delivery time. Actually, only one of the modifications you mentioned increased the basic contract quantity. This occurred on 31 May for an additional 1298 units at the basic contract price, in order to meet an urgent need for Southeast Asia—priority '06'. Deliveries will not stretch out beyond the contract term: the 1298 radios will be delivered by RCA between February 1968 and August 1968 at no increase in unit cost to the Government. The production period of the basic contract is February 1968 through May 1969.

"The action on 16 August 1967 was not an increased buy. It was simply the exercise of the second-year part (5400) of the basic two-year contract. The Army awarded a two-year contract in order to obtain a substantially more favorable price per unit on the first-year buy.

"You stated that a foreign company is building the PRC–77 with the RCA drawings. I assume you referred to the radio being manufactured by Tadiran, a company in Israel. That firm does not have the PRC–77 drawings, and as far as the Army is aware is building only a PRC–25 with some improvements designed into it by that firm. It is not a PRC–77.

"In regard to the PRC–62 radio, award of the contract followed established procedures for research and development awards, as is well documented in the General Accounting Office report of 13 February 1964 to former Congressman Wilson which you noted. The Army did not imply that ITT, Bendix, Advanced Communications or General Motors cannot build a portable radio. As the GAO report to Congressman Wilson states: 'All fifteen proposals received were considered responsive.' The award was made to RCA because it submitted the proposal judged most capable of meeting the Army's requirements.

"You implied a favoritism by the Army toward RCA, and toward larger contractors in general, which simply does not exist. The Army certainly makes every effort to award contracts to small business, but cannot do so at the sacrifice of meeting military needs. RCA is a highly competent company and has played a major role in development of portable radios over the years. That it obtains some of the Army's electronics contracts can hardly be surprising. But RCA is by no means the Army's major electronics contractor. It received only $28.5 million out of $851.1 million total USAECOM awards in FY 1967. Nor does Decitron, the company which attempted to obtain the second PRC–77 production contract, lack military business. On 21 September 1967 the Defense Contract Administration Service advised that Decitron's capacity is so overloaded that a plant survey will have to be conducted before placement of any additional Government contracts with the firm.

"Although no names or instances were specified, you implied possible misconduct of Army personnel in award of the PRC–25 and PRC–77 contracts to RCA. I have no reason to entertain such a suspicion and no evidence to support it. However, if any misconduct is revealed by you or by the investigative agencies now on the scene, I shall of course take prompt action.

"Assuring fair, honest and efficient practices in all Army procurement agencies is a responsibility which is taken seriously at all levels of the Army. I should be pleased to discuss the matters covered above, or any others, with you at any time. I believe that in reviewing them you will conclude that the contracting decisions in question were made not only honestly, but wisely and prudently as well.

"Sincerely,

"STANLEY R. RESOR, *Secretary of the Army.*"

The procurement of the AN/PRC–25 Radio Set mentioned by Senator Dominick is discussed in detail in Secretary Resor's 20 October 1967 letter.

The AN/GRA–6 Control Group mentioned by Senator Dominick was developed prior to March 1949 and six production contracts were entered into from that

date through 1951 at prices ranging from $215.00 to $302.78. During the period 28 June 1961 through 31 October 1961, four contracts and two options were awarded at unit prices ranging from $130.00 to $144.89. These awards were for Set Aside and Non-Set Aside procurements for labor surplus areas. All of these awards were subsequently terminated for default, or because of the use of surplus materials contrary to the terms of the contract. During the period 28 August 1963 to 16 July 1964, reprocurement of the above defaulted contracts was made under two competitively negotiated and formally advertised Small Business Set Aside solicitations. A Small Business firm in Philadelphia, Pennsylvania, was the successful contractor for all reprocurements at unit prices of $182.00, $193.00 and $173.00.

As a result of the Southeast Asia buildup, four negotiated sole source procurements were awarded to the Philadelphia firm during the period 20 August 1965 through 28 December 1966. Increase options on two of these contracts were exercised within the same period. The negotiated prices were based on audits performed by Defense Contract Audit Agency and or U.S. Army Electronics Command, Philadelphia Procurement Division and in all cases involving sole source procurements prices were negotiated with the assistance of certificates of current cost and pricing.

All of these sole source awards covered urgent priority procurements requiring earliest possible delivery. The contractor was actually in production throughout the time frame of these six awards. Previous experience had shown that he had met required delivery schedules and had submitted reasonable competitive prices. Award to the current producer entailed minimal administrative leadtime to contract award (one month) followed by four to six months production leadtime. Award to a new producer under formally advertised procedures would involve an administrative leadtime of three months to contract award, followed by 13 months production time. Thus, award to the active producer meant a procurement leadtime of five to seven months as opposed to 16 months with a new producer. Also inherent in a new award was the risk of a repetition of the unsatisfactory results as experienced with the earlier contractors. The decision to go sole source gave greatest assurance of early delivery as required by the priority Southeast Asia requirements. The increase in unit cost from $182 to $314.23 is largely reflected in material cost due to varying quantities and accelerated deliveries.

Navy Procurement of AN/APX–72 Transponder

In late 1964 and early 1965, the Naval Research Laboratory (NRL), using its senior scientific and engineering personnel, built a hand-made laboratory model of the AN/APX–72 transponder. Many of the components incorporated in this model were obtained from industry sources which had developed them.

It is not practicable to go immediately from such a model into production without extensive development. It was determined to go to industry for such development. In April 1965, following extensive industry-wide competition. Bendix received a contract award from NRL for $58,000 (later increased to $124,000) to develop production models of the AN/APX–72 that could be quantity produced as economically as possible. During this competitive solicitation, 11 companies submitted the best technical proposal and the lowest price.

In June 1966, pursuant to the authority of Title 10, U.S.C., Section 2304(a) (14), the Navy issued a letter contract to Bendix for the production of 2,310 AN/APX–72 transponder units. Bendix, the developer and sole producer of the AN/APX–72 transponder, was the only firm considered qualified to economically manufacture and deliver the required equipment within the time available. It is not uncommon to award first production contracts for relatively complex electronic units to the company which developed the equipment to assure that the development is in fact capable of being mass produced and to avoid the long delays inherent in training a new producer who is unfamiliar with the equipment.

In April 1967, under a leader-follower arrangement, Bendix was awarded a contract for 8,590 transponders—the FY 1967 requirement—with the proviso that 40% of these units must be subcontracted on a competitive basis to a "follower" company. The leader-follower arrangement, which is an "extraordinary" but well established procurement technique, is useful when it is necessary that all units of equipment in service be absolutely identical. In some fields, particularly complex electronics, it is virtually impossible to accomplish this

result simply by having a new producer follow drawings or specifications previously used by an earlier producer. By making the follower a subcontractor to the leader (Bendix) and holding the leader accountable for configuration control, variations in the equipments of the new producer can be eliminated or at least held to a minimum. It was originally considered highly desirable that these transponders be identical because it was felt that the resultant life-time savings in field maintenance, spare parts, and training costs would more than offset any likely small increase in acquisition costs.

The intention to award the leader-follower contract to Bendix was not publicized in advance because of the urgency of the procurement and the fact that award would have to be made to that company for reasons already explained above. However, the actual contract award to Bendix was publicized in the *Commerce Business Daily* with the intention to have a "follower" subcontractor selected by Bendix on a competitive basis.

Contrary to Senator Dominick's statement, Bendix did not hand-pick the "follower". The Navy provided Bendix with the names of six qualified competitors to be solicited. Others came in as a result of the Navy-directed publicity in the *U.S. Department of Commerce Business Daily.* The Navy reviewed the procedures used by Bendix to ensure that competition was properly conducted. Twenty-seven responses were received as the result of publicizing this planned subcontract in the *Commerce Business Daily.* Of this total, 14 companies which appeared to meet the required qualifications were then requested by Bendix to submit management and technical proposals. Ten of the companies responded to this request. Six of these ten were considered technically qualified and were asked to submit price proposals. Four of these six were in an extremely close price range, and award was made to the low responsive and responsible offerer, Wilcox Electric Company, Inc.

It is true that Bendix gave the potential follower subcontractors a data package. However, this data package alone, without the technical guidance and know-how that Bendix was obligated to furnish under the leader-follower concept, was not adequate to permit production by a new source. We believe that the use of the leader-follower technique has resulted in a gain of at least six months in getting a second source into production.

The Navy's original procurement plan did contain restrictive language as to the Navy's intent that its requirements for FY 1968 through FY 1970 would be solicited by the Government competitively between Bendix and the selected follower producer. This was based on the desire to achieve complete identicality in all equipments.

Since the original procurement and maintenance plan were developed over a year ago, it has now been concluded that maintenance and spare parts stockage at the field level will not be undertaken at a level of detail below major modules of the complete equipment. Hence, while it is imperative that these modules be interchangeable performance-wise—the so-called form, fit, and function interchangeability—it is not necessary that the modules be absolutely identical internally.

This change in field maintenance planning appears to make it feasible to obtain an approved technical data package suitable for broad competitive procurement about March 1968. Hence, it is now likely that a significant portion of our future AN/APX–72 transponder requirements can be bought through unrestricted competition.

(Responding to the testimony of Senator Dominick, the GAO subsequently supplied the following material:) (See p. 395.)

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., December 26, 1967.

B–158193.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Economy in Government,
Joint Economic Committee,
Congress of the United States.

DEAR MR. CHAIRMAN: In response to your request made during the course of hearings before the Subcommittee on Economy in Government of the Joint Economic Committee, we have reviewed the testimony of Senator Peter H. Dominick on November 29, 1967, and we offer the following comments.

During the Senator's testimony, attention was focused on the increasing percentage of military procurements accomplished without recourse to the formal

advertising procedures. In particular, four specific instances were cited by Senator Dominick as indicative of procurements manifesting a lack of effective competition. This theme was further emphasized by the Senator in statements on the floor of the Senate, and submitted to the committee for the record.

We considered some of the procurements mentioned by Senator Dominick under our bid protest procedures, and we are attaching for the record copies of those decisions. Although the decisions are self-explanatory, it should be noted that in these cases two factors were present which had a significant impact on our legal review of the procurements.

First, our Office must accord a significant degree of finality to the contracting agency's determination in resolving the technical and scientific questions which arise during the negotiation process since we do not possess the in-house technical or engineering capability necessary to conduct an independent evaluation. This policy is illustrated in the protest of the Custom Packaging Company, B–160809, June 29, 1967, 46 Comp. Gen., pp. 885, 893, discussed by Senator Dominick. We believe that this policy represents the only practical avenue open to our Office in disposing of technical contentions advanced by unsuccessful offerors in the face of contrary advice from the procurement agency. Over the years, we have given consideration to the feasibility of employing various categories of technical personnel to assist us in reviewing technical and scientific determinations made by the procurement agencies both in bid protest cases and in audit reviews. However, the arguments against our Office establishing and maintaining an engineering review capability which could, in contested cases, result in an anomalous situation where our Office would be substituting its judgment for that of the contracting agencies have always seemed the most compelling. The significant and, we believe, prohibitory effects of such an arrangement would be the unnecessary diffusion of procurement responsibility and extended and possibly unreasonable delays in effecting procurements. Moreover, the resolution of the highly complex technical questions presented would necessitate the retention of a staff of experts in each of the many diverse areas of technical competence reflected in the broad spectrum of Government procurement.

The second feature common to the bid protests referred to by Senator Dominick is the fact that the contracts were negotiated under certain exceptions to the requirement for formal advertising authorized in section 2304(a) of title 10, United States Code. In each case the determination to negotiate under the exception used was one which, as a result of the provisions of 10 U.S.C. 2310, was final, and thus our Office lacked the authority to question the legality of the negotiated award. However, we found in the cases referred to by Senator Dominick that the determinations to negotiate the procurements were, in our opinion, adequately justified and documented.

The Department of the Army's procurements of AN/PRC–25 and AN/PRC–77 radios are being reviewed by our audit staffs. At the request of Senator Dominick we initiated the audit of the Army procurements to determine whether any excess profits were realized. We expect to issue our report on these reviews in February 1968. Further, as you requested in the hearings on December 8, 1967, we are reviewing the AN/APX–72 transponder procurement by the Navy Department. Our study of this procurement has not developed to the extent that we may offer comments at this time. However, we expect to issue a report on or about March 15, 1968.

Sincerely yours,

FRANK H. WEITZEL,
Assistant Comptroller General of the United States.

[Enclosures]

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., June 29, 1967.

B–160809.

Mr. JOHN E. REILLY,
Attorney at Law,
2025 Western Federal Building,
Denver, Colo.

DEAR MR. REILLY: Further reference is made to your telegram and letters dated February 1, 6, and March 22, 1967, protesting on behalf of the Custom Packaging Co.—a small business concern—against the award of a contract by

the Department of the Army to Nortronics, a Division of Northrop Corporation, under request for proposals No. DAAA15-67-R-0116, issued by the United States Army Edgewood Arsenal, Edgewood Arsenal, Maryland. Receipt is also acknowledged of your rebuttal letter on May 15, 1967, submitted in response to the report of the contracting officer.

The protest arises from an unsolicited proposal submitted by Custom to Edgewood Arsenal on April 15, 1966, covering the presentation of a shoulder borne, rapid fire rocket powered, fire flame delivering weapon. A film demonstration of the weapon was submitted with the unsolicited proposal. The cover letter of the proposal contained the following statements:

"Inasmuch as the system contains several patentable features, we would appreciate having the information contained in our proposal treated as proprietary. We have taken the preliminary steps toward the protection of these features with our patent lawyer, but will await your suggestions relating to the continuance of that effort."

By letter dated May 11, 1966, Edgewood Arsenal acknowledged receipt of the unsolicited proposal and advised Custom that:

"You should understand that the receipt and evaluation of your proposal by the Army does not imply a promise to pay, a recognition of novelty or originality or any relationship which might require the Government to pay for use of information to which it is otherwise lawfully entitled. However, you may be sure the Army has no intention of using any proposal in which you have property rights without proper compensation."

Pursuant to the request contained in the May 11 letter, Custom executed a memorandum of understanding as follows:

"The undersigned acknowledges that this date he has, on behalf of (himself, or Custom Packaging Company) made a disclosure of an inventive proposal to the Department of the Army relating to A SHOULDER BORNE, ROCKET POWERED, FLAME DELIVERING WEAPON.

"It is understood that the Department of the Army has accepted the above proposal for the purpose of evaluating it and advising of any possible interest, provided that the acceptance to determine such interest does not, in itself, imply a promise to pay, a recognition of novelty or originality or a contractual relationship such as would render the Government liable to pay for any use of information in the proposal, to which it would otherwise lawfully be entitled."

Thereafter, on October 14, 1966, request for proposals No. DAAA15-67-R-0116 was issued to 16 firms, including Custom, for quotations on the furnishing of research services incident to the design, development, test, evaluation and fabrication of a multi-shot portable flame weapon system. A statement of work accompanied the request and provided in part that:

"II. STATEMENT OF WORK

* * * * * * *

"*A. Phase I—Literature Search and Preliminary Design Concepts*

"1. The Contractor shall review the technology and design of the M72 LAW and the 3.5 inch bazooka to assure maximum utilization of common components and compliance with common military and operational characteristics. In addition, the background information concerning the experimental test data which was generated under a Marine Corps program for determining the effectiveness of an encapsulated flame round will be furnished by the Government.

* * * * * * *

"*C. Phase III—Final Design and Fabrication of Government Items*

"Upon approval of the Phase II test results and design, the Contractor shall manufacture twenty launchers and 2000 rounds (in clips, cylinders or magazine as appropriate) to be delivered to the Government F.O.B., Edgewood Arsenal, Maryland. These units will be made in accordance to the approved specifications and drawings, filled and fuzed."

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"*VI. Level of Effort*

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"*B.*

"It is recognized that the Contractor may not be able to accomplish all the technical requirements and make delivery of all items covered by the technical

description of the work within the level of effort set out herein. The Contractor's obligation with respect to completion of the technical work, including fabrication of items, will be deemed complete upon expenditure of the level of effort set out above provided that the Contractor has performed the work in accordance with sound technical procedures and good work practice. Notwithstanding the above, the Contractor must keep all data current, complete and deliver all reports as required by the contract and comply with all other requirements of the contract."

Interested offerors were advised that a cost-reimbursement contract was anticipated and that the principal criteria that would be used in the evaluation of proposals would be (a) technical approach, (b) caliber of personnel, (c) background experience, (d) facilities available, and (e) proposed schedule. Nine proposals were received and evaluated by a Technical Evaluation Committee in accordance with the foregoing factors and weights agreed upon prior to evaluation rating. The weights assigned each of the criteria were: technical approach 40 percent; technical personnel 20 percent; applicable background experience 15 percent; facilities 15 percent; and schedule 10 percent. The proposal of Custom was rated lowest and the proposal of Nortronics, a Division of Northrop Corporation, received the highest rating. The lowest offer in the amount of $168,000 was submitted by Custom and the other eight offers ranged from $269,000 to $404,000. Nortronics submitted an offer of $387,000.

By telegram dated February 1, 1967, to the procurement agency, Custom protested against the possible award of a research and development contract to Nortronics. The bases for its protest were: (1) that such contract was based on a weapon that had been developed and satisfactorily demonstrated to the procuring installation by Custom prior to the issuance of the request for proposals; (2) that the weapon system developed by Custom contained proprietary information; (3) that the weapon system developed by Custom and as demonstrated to the procuring installation fulfilled the basic requirements of the request for proposals; and (4) that since the weapon system developed by Custom was a completed hardware item, it was inappropriate for the procuring installation to buy under a research and development type contract an item already in existence and sufficiently defined for procurement by formal advertising procedures.

In view of the urgency of the South East Asia requirement for the flame weapon system, which bore Issue Priority Designator 0–2, the contracting officer requested and received approval to make an award prior to the resolution of the protest. On February 3, 1967, after a period of negotiation with the corporation, cost-plus-incentive-fee contract No. DAAA15–67–C–0343 was awarded to Nortronics in the total estimated amount of $353,300.

You allege that the request for proposals was based on Custom's independent research and findings which utilized the uniqueness of that company's ideas, all of which were disclosed to Edgewood Arsenal technical personnel by means of, and through its unsolicited proposal. Further, you contend that Custom's proprietary rights in such disclosed information were violated by the issuance of the request for proposals. Therefore, you request that we direct the Department of the Army to cancel the award made to Nortronics and to direct an award to Custom, or, in the alternative, that the procuring activity should first negotiate with Custom to obtain unlimited rights to the data contained in the unsolicited proposal before proceeding further pursuant to Defense Procurement Circular No. 24 dated February 26, 1965 (Armed Services Procurement Regulation (ASPR) 9–202). However, upon review of the entire record before us, we find no legal or factual basis to question the award of the contract to Nortronics.

Your claim of improper use by the procuring activity of proprietary information contained in Custom's unsolicited proposal is categorically denied by responsible and knowledgeable technical personnel of the Department of the Army. And while your rebuttal and other correspondence dealing with this allegation strongly dispute the conclusion reached by the Army technical personnel, we have no alternative but to accept the facts as reported by the Army. In factual disputes, such as here, which are technically beyond the competence of our Office because of the scientific or engineering concepts involved, we must accord a significant degree of finality to the administrative position. Hence, without questioning the actual character of the claimed proprietary information, we believe that this aspect of the protest properly may be resolved on grounds other than those involving the resolution of disputed technical facts.

We note that the request for proposals was issued on October 14, 1966, and that proposals thereunder were to be submitted by November 18, 1966, or about 6 months after Custom had submitted its unsolicited proposal to Edgewood Arsenal. Custom had ample opportunity to study the request for proposals before it responded thereto but it took no exception in its proposal or otherwise with respect to the alleged inclusion of its "proprietary" information. There is no indication of any protest by Custom until it appeared that it was an unsuccessful offeror. The courts have taken the position that a party to maintain his proprietary rights in information must take reasonable action to prevent or suppress its unauthorized use. See, for example, *Ferroline Corp.* v. *General Aniline & Film Corp.*, 207 F. 2d 912, 914; *Globe Ticket Co.* v. *International Ticket Co.*, 104 A. 2d 92. Here, Custom made no attempt subsequent to issuance of the request for proposals to protest against the allegedly improper disclosure until it became aware of the fact that it was not being considered for award. In this posture of the matter, coupled with the administrative denial of disclosure, we must conclude that no substantial basis exists for questioning the actions of the procurement agency in this regard. See B–149295, September 6, 1962; B–153144, June 4, 1964; B–154038, August 4, 1964; B–154818, November 16, 1964.

Pursuant to the negotiation authority in 10 U.S.C. 2304(a)(11), paragraph 3–211 of ASPR authorizes negotiation of contracts for property or services that the Secretary of the Department determines to be for experimental, developmental or research work, or for making or furnishing property for experiment, test, development or research. This authority to negotiate such contracts is applicable in the following circumstances listed in ASPR 3–211.2:

"(i) Contracts relating to theoretical analysis, exploratory studies and experiment in any field of science or technology;

"(ii) Developmental contracts calling for the practical application of investigative findings and theories of a scientific or technical nature;

"(iii) Contracts for such quantities and kinds of equipment, supplies, parts, accessories, or patent rights thereto, and drawings or designs thereof, as are necessary for experiment, development, research, or test; or

"(iv) Contracts for services, tests, and reports necessary or incidental to experimental, developmental, or research work."

It seems clear from the documented record that the technical nature of this procurement was such that two-step formal advertising under ASPR 2–501 *et seq.* was neither feasible nor practicable. Since "development" was involved, the exact nature and extent of the proposed work and the precise method of accomplishing the same could not be established in advance. Moreover, the work contemplated was subject to improvisation and change based on the offeror's approach prior to the establishment of firm contract requirements. It will be noted from a reading of the two-step formal advertising procedures that the "development" work involved here was not amenable to those procedures. *Cf.* ASPR 4–104. The procurement was, however, on a competitive basis to the maximum practical extent. As indicated above, proposals were requested from 16 sources and 9 firms responded. All offers which were determined to be technically acceptable were evaluated under the established criteria on a common basis. Aside from this the determination to negotiate this contract under 10 U.S.C. 2304(a)(11) is final as a matter of law under 10 U.S.C. 2310(b). While the request for proposals and the contract called for the furnishing of 20 weapons and 2,000 rounds of ammunition for test purposes, the procurement was primarily for research and development under the regulations referred to above.

You contend that negotiations should have been conducted with Custom in accordance with ASPR 3–805.1(a) which provides, with certain stated exceptions, that after receipt of initial proposals, written or oral discussions shall be conducted with all responsible offerors who submit proposals within a competitive range, price and other factor considered. However, ASPR 3–805.1(d) provides with reference to the negotiation of research and development contracts that:

"(d) The procedures set forth in (a) * * * above may not be applicable in appropriate cases when special services (such as architect-engineer services) or when cost-reimbursement type contracting is anticipated. Moreover award of such contract and R&D contracts may be properly influenced by the proposal which promises the greatest value to the Government in terms of possible performance, technical quality, ultimate producibility, growth potential and other factors rather than the proposals offering the lowest price or probable cost and fixed fee."

The negotiation procedures followed here were generally in accordance with section IV, and part 2, ASPR, which is concerned with the procurement of research and development services pursuant to the negotiation authority of 10 U.S.C. 2304(a)(11). The pertinent provisions of section IV are as follows:

"4–106.3. *Conduct of Negotiations.*—See 3–804 and 3–805. The contracting officer should make certain that each prospective contractor fully understands the details of the various phases of the Government's requirement, especially the statement of work. This may be best accomplished by conferences between a prospective contractor, the contracting officer, and appropriate technical personnel, particularly where there is doubt that a work statement is understood or will be interpreted correctly by prospective contractors.

"4–106.4. *Evaluation for Award.*—

"(a) Generally, research and development contracts should be awarded to those organizations, including educational organizations, which have the highest competence in the specific field of science or technology involved. However, awards should not be made for researh or development capabilities that exceed those needed for the successful performance of the work.

"(b) Before determining the technical competence of prospective contractors, and recommending to the contracting officer the concern or concerns that they consider most technically competent, cognizant technical personnel shall consider the following:

"(i) the contractor's understanding of the scope of the work as shown by the scientific or technical approach proposed;

"(ii) availability and competence of experienced engineering, scientific, or other technical personnel;

"(iii) availability, from any source, of necessary research, test, and production facilities;

"(iv) experience or pertinent novel ideas in the specific branch of science or technology involved; and

"(v) the contractor's willingness to devote his resources to the proposed work with appropriate diligence.

"(c) In determining to whom the contract shall be awarded, the contracting officer shall consider not only technical competence, but also all other pertinent factors including management capabilities, cost controls including the nature and effectiveness of any cost reduction program (see 3–101(viii)), and past performance in adhering to contract requirements, weighing each factor in accordance with the requirements of the particular procurement (see 1–903). * * *

* * * * * * *

"4–106.5 *Evaluation of Price and Costs.*—

"(a) While cost or price should not be the controlling factor in selecting a contractor for a research or development contract, cost or price should not be disregarded in the choice of the contractor. It is important to evaluate a proposed contractor's cost or price estimate, not only to determine whether the estimate is reasonable, but also to determine his understanding of the project and ability to organize and perform the contract. * * *"

Although Custom demonstrated its portable flame weapon system for Edgewood Arsenal, the record shows that such demonstration was not successful and that, in the considered judgment of technical personnel, such weapon did not meet the needs of the Government. We find nothing in the record which would lead to the conclusion that Custom had a valid basis for assuming that the Government would award it a contract for such weapon. In regard to Custom's unsolicited proposal, ASPR 4–106.1(e)(5) provides that the submitter of an unsolicited proposal is not necessarily entitled to preferential treatment in the award of any contract because of his submission. Moreover, and in view of the reported deficiencies in the weapons system proposed in the unsolicited proposal, it would seem that any expectation of preferential treatment was dissipated when the request for proposals was issued.

In regard to the failure of the procuring activity to insert in the request for proposals a notice that an award may be made without discussion of the proposals (ASPR 3–805.1(a)(v)), the contracting officer has advised that it was intended that discussions would be held with other offerors but that after receiving the proposal of Nortronics, it was determined that no benefit would accrue to the Government by conducting discussions with offerors rated significantly lower than Nortronics. Considering the objective of research and development procure-

ment and the correlative responsibility of Edgewood Arsenal to maintain scientific and technological superiority requisite to promote and advance the effectiveness of military operations (ASPR 4–102), we believe on the basis of the record before us that the procurement responsibility was properly discharged in making the award to Nortronics. ASPR 3–805.1(a) which prescribes the negotiation procedures to be applied in the selection of offierors for negotiation and award is an implementation of 10 U.S.C. 2304(g). That provision of law reads as follows:

"(g) In all negotiated procurements in excess of $2,500 in which rates or prices are not fixed by law or regulation and in which time of delivery will permit, proposals shall be solicited from the maximum number of qualified sources, consistent with the nature and requirements of the supplies or services to be procured, and written or oral discussions shall be conducted with all responsibile offerors who submit proposals within a competitive range, price, and other factors considered. * * *"

A study of the record on this procurement as supplemented by presentations on behalf of Custom leads to the conclusions that the award as made represented a proper discharge or procurement responsibility and discretion as to which we find no legal basis to question.

Although other contentions relating to this procurement have been advanced, they relate mainly to procurement administration involving judgment determinations as to which we have no comments to offer. See B–158842, March 30, 1966. Your protest is therefore denied.

The film submitted by Custom in support of its protest is returned.

Very truly yours,

FRANK H. WEITZEL,
Assistant Comptroller General of the United States.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., June 29, 1967.

B–160809.

Hon. BERNARD L. BOUTIN,
Administrator, Small Business Administration.

DEAR MR. BOUTIN: Reference is made to a letter dated June 2, 1967, from your General Counsel, commenting on the administrative report concerning the protest of the Custom Packaging Co. against the award of a negotiated research and development contract to Nortronics, a Division of Northrop Corporation, pursuant to request for proposals No. DAAA15–67–R–0116, issued by the United States Army Edgewood Arsenal for the design, development and manufacture of a multi-shot portable flame weapon system.

Enclosed is a copy of our decision of today to the company's attorney denying the protest.

In his letter, your General Counsel states that the record does not indicate that the contracting officer determined that the proposal submitted by Custom was technically nonresponsive; that since the contracting officer has stated that he conducted negotiations solely with Nortronics because its proposal was superior to all others received, there is an implication that Custom's proposal was inferior to that of Nortronics and that if this is so, this may go to the responsibility of Custom to perform the procurement. Your General Counsel requests that our Office determine whether the contracting officer should have referred the question of the responsibility of Custom to perform the procurement to the Small Business Administration for determination under the certificate of competency procedures.

By enactment of section 8(b)(7) of the Small Business Act, 15 U.S.C. 637(b)(7), the Congress has limited the authority of administrative officers to make final determinations of responsibility of small business bidders by providing that where a small business concern is certified by SBA to be a competent Government contractor with respect to capacity and credit, the procuring officers of the Government must accept such certification as conclusive. However, this limitation on the administrative authority relates only to determinations of "capacity and credit." In this connection, Armed Services Procurement Regulation (ASPR) 1–705.4(c), in recognition of the SBA authority, contemplates the referral to SBA of only bids or proposals of small business concerns which contracting officers propose to reject solely for the reason that the bidders or offerors have been

found to be nonresponsible as to capacity and credit. In the instant case, however, it appears that the proposal of Custom would not meet the urgent military requirements of the Army. The technical evaluation of Custom's proposal was reported to us as follows:

"This company proposes to improve the basic weapon which was demonstrated at Edgewood Arsenal in February 1966. The one piece launcher and stock is too long; when the magazine is attached the weapon takes on a bulky appearance. The performance of the unit is not supported by any data and the described characteristics are probably the subjective judgment of the promoters.

"Most of the approach and scope repeat the information that is in the RFP. The use of a non-standard rocket motor would present serious delays in the manfiring program. No alternative designs are given. There are no calculations to support the proposed design."

Moreover, although not referred to in the administrative report, there is for consideration ASPR 1-705.4(b) which reads in part:

"In procurement where the highest competence obtainable or the best scientific approach is needed, as in certain negotiated procurement of research and development, highly complex equipment, or personal or professional services, the certificate of competency procedure is not applicable to the selection of the source offering the highest competence obtainable or best scientific approach. However, if a small business concern has been selected on the basis of the highest competence obtainable or best scientific approach and, prior to award, the contracting officer determines that the concern is not responsible because of lack of capacity or credit, the certificate of competency procedure is applicable."

On the basis of the record before us, we are of the view that Custom's proposal was technically nonresponsive to the Army's requirements as detailed in the statement of work accompanying the request for proposals. In reaching this view, we are aware that some of Custom's deficiencies disclosed in the technical evaluation related to its capacity and credit. However, Custom received only a rating of 2 on its technical approach to the Government's requirements out of a possible weighted factor of 40. We feel that this reasonably demonstrates that the failure of Custom to be considered for negotiation was due to its deficiencies in the area of compliance with the Government's expressed requirements.

Sincerely yours,

FRANK H. WEITZEL,
Assistant Comptroller General of the United States.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., September 14, 1967.

B-160809.

Hon. JOHN L. MCCLELLAN,
Chairman, Senate Permanent Subcommittee on Investigations,
Committee on Government Operations,
U.S. Senate.

DEAR MR. CHAIRMAN: Reference is made to your letter of August 15, 1967, referring to certain information your subcommittee developed with regard to the $167,608 fixed-price proposal of the Custom Packaging Co. under request for proposals DAAA-15-67-R-0116, issued by the United States Army Edgewood Arsenal, which was passed over in favor of a Northrop Nortronics $387,000 cost-plus-incentive-fee proposal. Our review of the matter is requested particularly within the context of 10 U.S.C. 2304(g) and the implementation in ASPR 3-805.1.

This matter was the subject of two decisions (B-160809) of June 29, 1967; one to the attorney for Custom Packaging Co. and the other to the Administrator of the Small Business Administration. The former decision stated that considering the objective of research and development procurement and the correlative responsibility of Edgewood Arsenal to maintain scientific and technological superiority requisite to promote and advance the effectiveness of military operations, our Office believed that, on the basis of the record before it, the award made to Nortronics represented a proper discharge of procurement responsibility and discretion and was not subject to question by our Office. The latter decision held that since the contracting officer did not reject the Custom Packaging proposal for lack of responsibility, the matter was not required to be submitted to the Small Business Administration for consideration under the certificate of

competency procedures. A copy of each of the decisions is enclosed for your information.

The information reported to have been developed by the subcommittee is that the request for proposals divulged to industry at large on exclusive invention developed by Custom Packaging; that the engineering effort proposed by Custom Packaging approximated the engineering requirement estimated by the contract review panel; that the lower Custom Packaging proposal is due largely to low labor and overhead rates, and that Custom Packaging apparently offered a performance bond guaranteeing delivery at its offered fixed price.

As indicated in the decision to the attorney for Custom Packaging, the determination whether Edgewood Arsenal incorporated in the request for proposals proprietary information disclosed by Custom Packaging on its previous unsolicited proposal was technically beyond the competence of our Office because of the scientific engineering concepts involved. With respect to the statement that the engineering effort proposed by Custom Packaging approximated the engineering requirement estimated by the contract review panel, as we noted in the decision to the Small Business Administration, the proposal evaluation committee found the Custom Packaging proposal to be largely repetitious of the information in the request for proposals and it was not supported by performance data or calculations confirming the proposed design. While it is true that Custom Packaging did use in its price proposal lower labor and overhead rates than were utilized by Nortronics in its proposal, the Nortronics price proposal was increased by the fact that it estimated substantially more man-hours for the effort than were estimated by Custom Packaging.

The record furnished our Office by the Department of the Army in connection with the June 29 decisions does not show that Custom Packaging proposed to offer the Government a performance bond. However, even if such a tender was made, it would have been of questionable value, since, while such a bond would have provided some protection to the Government, it would not have insured the development of the weapon within the desired time frame. Of course, Edgewood Arsenal had no assurance that Nortronics would develop the weapon within the allotted time, but from the evaluation of its proposal, administrative personnel believed that there was a greater probability of successful development in the approach offered in the Nortronics proposal. In that connection, the Nortronics proposal was rated on a weighted basis by the proposal evaluation committee at an 865 total, whereas Custom Packaging was rated lowest of all nine proposals at a total weighted rate of 250.

With respect to negotiations, 10 U.S.C. 2304(g) provides:

"In all negotiated procurements in excess of $2,500 in which rates or prices are not fixed by law or regulation and in which time of delivery will permit, proposals shall be solicited from the maximum number of qualified sources consistent with the nature and requirements of the supplies or services to be procured, and written or oral discussions shall be conducted with all responsible offerors who submit proposals within a competitive range, price, and other factors considered: Provided, however, That the requirements of this subsection with respect to written or oral discussions need not be applied to procurements in implementation of authorized setaside programs or to procurements where it can be clearly demonstrated from the existence of adequate competition or accurate prior cost experience with the product, that acceptance of an initial proposal without discussion would result in fair and reasonable prices and where the request for proposals notifies all offerors of the possibility that award may be made without discussion."

ASPR 3-805.1 which prescribes the negotiation procedure to be followed in the selection of offerors for negotiation and award is an implementation of that statutory provision. While ASPR 3-805.1(a) provides that after receipt of initial proposals, written or oral discussions shall be conducted with all responsible offerors who submit proposals within a competitive range, price and other factors considered, ASPR 3-805.1(d) provides that the procedures set out in ASPR 3-805.1 (a) may not be applicable in appropriate cases and that research and development contracts may be properly influenced by the proposal which promises the greatest value to the Government in terms of possible performance, technical quality, ultimate productibility, growth potential and other factors rather than the proposals offering the lowest price or probable cost and fixed fee.

In decision B-161483, July 14, 1967, 47 Comp. Gen., p. 29, referenced in your letter, our Office held that the failure of a low proponent to pass a benchmark test

should not have automatically precluded the proponent from discussions to determine whether the proposal which otherwise met requirements could be improved to meet the benchmark requirements. Unlike the referenced situation, the immediate case involved a proposal for a research and development contract. While our Office has held that the statutory and regulatory requirement for negotiations with all responsible offerors who submit competitive offers is equally applicable where a research and development contract is contemplated (B–158686, September 2, 1966, to the Secretary of the Army), the contracting officer advised us that the Custom Packaging proposal was not considered to be within a competitive range because it was imperative to utilize the highest technical competence available to the Government for the development of a weapon urgently needed for combat purposes.

In this context, Custom Packaging's proposal ranked last of the nine proposals received and was ranked very low as indicated by the spread in the weighted rates shown above. Moreover, Custom Packaging received a weighted rating of 80 out of a possible rating of 400 on technical approach. In the June 29 decision to the Small Business Administration, we stated that the company received a rating of two on the technical approach out of a possible weighted factor of 40. However, two—a rating of "poor"—was weighted by a factor of 40 extended to a weighted rating of 80. Ten, which was the rating of "excellent-superior," was the highest unit score attainable and would be projected out to a weighted rating of 400. Thus, even if through discussions with Custom Packaging, the weighted rating on the technical approach could have been brought up to 400, the total score would have only been 570, or almost 300 less than the total weighted score Nortronics received. Thus, it is not apparent how any benefit could have accrued to the Government by conducting discussions with Custom Packaging in view of the heavy emphasis placed upon the technical approach by the administrative office. In addition to being rated "poor" by the proposal evaluation committee on technical approach, the Custom Packaging proposal was also rated "poor" by the committee on technical personnel, background experience and facilities.

Although Custom Packaging was within a competitive range pricewise, both 10 U.S.C. 2304(g) and ASPR 3–805.1(a) require discussions with offerors who submit proposals within a competitive range, price and other factors considered. The term "other factors" has been held to include the technical acceptability of proposals. B–159540, January 11, 1967. Thus, whether a proposal is within a competitive range is not limited to an appraisal of price alone. As demonstrated above, the Custom Packaging proposal was so technically deficient that it was believed that discussions with the company could not bring it up to an acceptable level. We therefore are unable to conclude on the record before us that the proposal was within a competitive technical range that would have required discussions pursuant to the law and regulations. In this connection, as noted above and in our June 29 decisions, the procurement regulations provide that in selecting a contractor for research and development, the award of the contract can be influenced by the proposal demonstrating the highest competence and best scientific approach rather than the lowest price.

We trust the foregoing serves the purposes of your request.

Sincerely yours,

R. F. KELLER,
Acting Comptroller General of the United States.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., June 1, 1967.

B–161031.

Mr. STANLEY A. REVZIN,
Vice President, Bristol Electronics, Inc.,
New Bedford, Mass.

DEAR MR. REVZIN: Reference is made to your telegram and letter of March 9 and 16, 1967, respectively, protesting against the action of the Army Electronics Command in restricting a procurement for AN/PRC–77 radio sets under request for proposals PIIN DAABO5–67–R–1176 to the Radio Corporation of America (RCA) on a sole-source basis primarily because the AN/PRC–77 radio set is an improved version of the AN/PRC–25 radio set which your company is manufacturing under a contract awarded after a formal advertisement for bids.

The Army Electronics Command contracting officer has advised us that improvements to the AN/PRC–25 radio were necessary to assure compatibility with a radio frequency amplifier which would extend the range of the radio. Although the amplifier would have the desirable effect of intensifying the output signal, it would also have the undesirable effect of intensifying unwanted signals. A product improvement program was initiated by the Army Electronics Command to meet the problem and also to improve reliability and logistic support by a complete solid-state design and elimination of the electron tube R–F output amplifier.

On March 31, 1965, RCA was awarded a contract for the reengineering and modification of 12 AN/PRC–25 sets. The contract was modified January 17, 1966, to provide for interface facilities with classified equipment. This new requirement was considered to affect interchangeability of the basic radio. As a result, a new designation, AN/PRC–77, was assigned to the modified AN/PRC–25. The contract was modified again on April 29, 1966, for other services on an additional quantity in connection with the classified program.

The differences between the AN/PRC–25 and the AN/PRC–77 radios are summarized by the contracting officer as follows:

"Externally, the AN/PRC–25 and AN/PRC–77 radios are identical in appearance with identical panel controls and equipment cases. However, the AN/PRC–77 in addition to the functional capabilities of the AN/PRC–25, has significant advantages over the AN/PRC–25 for operation with R–F amplifier AM–4306 and with classified equipment. The AN/PRC–77 is of complete solid-state design whereas the AN/PRC–25 utilizes one electron tube as the output R–F power amplifier. The elimination of the electron tube permitted use of the existing front panel power connector for interface connection with the classified equipment. The solid-state design also permitted the elimination of the AN/PRC–25 power converter. Receiver R–F amplifier and squelch circuitry of AN/PRC–77 provide substantial improvement over the original AN/PRC–25 design:

"(1) The receiver is less vulnerable to desensitization in the presence of high-energy R–F fields.

"(2) Re-transmission operation has been substantially improved.

"(3) Wide band output circuitry has been added to accommodate interface with classified equipment.

"In the transmitter portion of the AN/PRC–77, the original AN/PRC–25 frequency control and modulation schemes were re-designed. Notably, the side-step oscillator, a major source of signal interference was eliminated.

"Reduced spurious radiations has resulted in a significantly larger number of available operating channels when operating with other radios. Modulator circuitry was also added, again to accommodate interface requirements with classified equipment. Of the twenty-five (25) electronic modules originally used in both the transmitter and receiver portions of the AN/PRC–25, only eight (8) of the modules used in the AN/PRC–77 are interchangeable with the AN/PRC–25."

Concerning the differences in the radios and the utility of the improvements, the contracting officer has advised:

"(1) Complete solid state design of the AN/PRC–77 permitted removal of the power converter and use of the existing front panel power connector for interface connection with classified equipment. In replacement of the electron tube power amplified additional R–F driver stages were required. Accordingly, two (2) additional sections were added to the variable tuning capacitor. Maximum R–F power output was increased from 1.0 watts to 1.5 watts in the high-frequency band and from 1.5 watts to 2 watts in the low-frequency band. Input power was reduced approximately ½ of that required by the AN/PRC–25, increasing battery life correspondingly. Weight was reduced by approximately ½ lb.

"(2) Transmitter frequency control generation and modulation schemes were re-designed, reducing the number and amplitude of spurious radiations. This has resulted in substantial reduced radio-frequency interference when operating with other radios. Previously, frequency assignments in which the radio could operate had to be spaced sufficiently far enough apart to assure that one radio operating on a given frequency would not interfere with a second radio located near by but operating on a separate frequency. The redesign of the radio had the effect of drastically reducing the frequency separations previously required. The additional frequency assignments now available in re-transmission operation are of particular importance since it offers greater selectivity to the Commander in a tactical situation in his choice of channels of communication and elimina-

tion of overcrowded conditions on the limited channels then available. Operation with R–F amplifier AM–4306 is improved accordingly with reduction of mutual interference.

"(3) Receiver radio-frequency circuitry was re-designed to improve desensitization characteristics when operating in the vicinity of high-energy RF fields. The improvement in this area again increases the number of available frequency assignments when operating with other radios. Squelch circuitry was also redesigned to increase sensitivity and to provide improved re-transmission operation. Wide band amplifier and interlock circuitry was also added to accommodate an interface with classified equipment."

It is indicated further that because of the electrical and mechanical changes to the modules and main chassis of the AN/PRC–25 radio, tooling or gauging for the AN/PRC–25 could not be used in producing the AN/PRC–77 and phasing into an existing AN/PRC–25 production line would not be possible at the present time.

The AN/PRC–77 radio was approved for limited production by the Office of the Chief of Research and Development, Department of the Army, in June 1966 after eight AN/PRC–77 prototypes were tested in-plant and in the field. The tests demonstrated that the radio met the requirements for reduced spurious responses and radiations, improved receiver performance when exposed to high level R–F field radiation and compatibility with classified equipment while maintaining the ruggedness of the AN/PRC–25. The testing is summarized as follows:

"(1) Complete electrical testing under room environment.
"(2) Mechanical testing including vibration, bounce, and shock tests.
"(3) Environmental testing including heat, cold, and humidity tests.
"(4) Radio frequency interference tests.
"(5) Field testing including communication range tests.
"(6) Re-transmission testing.
"(7) System testing with classified equipment."

Following the approval of the Department of the Army for an initial limited production of AN/PRC–77 radios, the first production contract was placed with RCA on June 29, 1966. There was an immediate and urgent Southeast Asia requirement for the radios and the requirement was assigned an 02 priority designator. As a result, the contract was negotiated under the authority of 10 U.S.C. 2304(a)(2) and ASPR 3–202.2(vi). The statute authorizes contracts to be negotiated if the public exigency will not permit delay incident to advertising. ASPR 3–202.2(vi) permits utilization of this authority when a purchase request cites an issue priority designator 1 through 6. The negotiation was restritced to RCA because procurement data was not available for competition and the company as the designer of the radio was believed to be the only source capable of furnishing the sets starting in March 1967 with completion by September 1967.

Drawings and data from this first production contract are not expected to be delivered to the Government until late 1967. The contracting officer has stated that until such time as the production design has been verified by first article testing, proven out in production, and production drawings released, the Army is not in a position to provide technical data for competition. In the absence of competitive procurement data and in view of the continued priority for the equipment, subsequent production contracts also have been placed with RCA as the only known source capable of furnishing the radio within the required time frame under the authority of 10 U.S.C. 2304(a)(2) and ASPR 3–202.2(vi), cited above. The contracts, the last of which was awarded on April 28, 1967, under request for proposals PIIN DAAB05–67–R–1176, cover production through May 1969 and these contracts had the advance approval of the Department of the Army which had extended the initial June 1966 approval for limited production in October and December 1966.

The contracting officer has further advised that, based upon current expectations of the receipt of drawings and data from the production contractor, it is anticipated that a technical data package adequate for competition will be available late this year. At that time, an advertisement of competitive bidding on a 3-year multiyear procurement is contemplated. While a competitive procurement is planned toward the end of the year, it is indicated that procurement leadtime of 20 months will have to be provided to accommodate new suppliers and this will result in initial delivery about August 1969, whereas delivery of the last procurement is required starting in February 1968. It is indicated that if the

last procurement was postponed until the article could be let to competition, there would be an 18-month delay in initial delivery which was not considered justified in view of the priority for the radios.

The increase in costs of AN/PRC–77 radio sets over AN/PRC–25 radio sets is justified by the Army Electronics Command based on the following considerations:

"(a) The AN/PRC–77 Radio Set contains more (and more highly complex) components than the AN/PRC–25 Radio Set.

"(b) The AN/PRC–77 equipment contains new components and significant changes to existing components both of which result in more complex circuitry and changed or new test specifications.

"(c) The new (or changed) components are being produced on a first-time basis which results in additional start-up costs and higher production costs (e.g. new tooling, new test equipment, plant rearrangement, additional production and other engineering costs as well as increases in material and factory labor costs)."

The contracting officer recognizes that RCA has a competitive advantage since it is the sole producer of the AN/PRC–77 radio sets. However, he emphasizes that such advantage is due strictly to the circumstances which have been set forth above.

As indicated above, the procurements for the AN/PRC–77 radio sets were negotiated under the authority of 10 U.S.C. 2304(a)(2). Section 2310(b) of title 10, United States Code, specifically provides that administrative decisions to negotiate under 10 U.S.C. 2304(a)(2) are "final." Therefore, no legal basis exists to object to the subject procurements. However, in view of the representations made by the procurement agency it would appear that AN/PRC–77 radio sets will be procured by the end of this year under competitive procedures.

Very truly yours,

FRANK H. WEITZEL,
Assistant Comptroller General of the United States.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., December 7, 1967.

B–161031

Mr. H. T. STARKAND,
President, Decitron Electronics Corp.,
Brooklyn, N.Y.

DEAR MR. STARKAND: Reference is made to your letter of August 30, 1967, protesting the August 16, 1967, modification of contract DAABO5–67–C–0170(E) with Radio Corporation of America (RCA), Camden, on the basis that the United States Army Electronics Command has on record a March 7, 1967, bid from your company lower than the modification price and that the modification cannot be justified on the grounds that there is an urgent requirement for the radio sets being procured or that there is a lack of data which would permit competition.

Contract DAABO5–67–C–0170(E) is a 2-year multi-year procurement for AN/PRC–77( ) radio sets awarded on April 28, 1967, to RCA, the equipment developer and sole current producer, on the basis that there was no procurement data available for competition and that the company as the developer of the radio was the only known source capable of furnishing the sets within the required time frame. The contract was awarded under the authority of 10 U.S.C. 2304(a)(2) and paragraph 3–202.2(vi) of the Armed Services Procurement Regulation (ASPR). The statute authorizes contracts to be negotiated if the public exigency will not permit delay incident to advertising. ASPR 3–202.2(vi) permits utilization of this authority when a purchase request cites an issue priority designator 1 through 6. The first-year requirement was assigned an 06 designator and the second year an 02 designator. Section 2310(b) of title 10, United States Code, specifically provides that administrative decisions to negotiate under 10 U.S.C. 2304(a)(2) are final. See B–161031, June 1, 1967, regarding the same procurement. Therefore, no legal basis exists to object to the "urgency" determination.

The August 16, 1967, modification of contract DAABO5–67–C–0170(E) did not provide for any more units than were contemplated by the contract. It merely

represents the second-year increment which was included in the original multiyear quantities and total contract price. Any understanding that the modification added quantities over the original contract quantities may have arisen from incomplete information published in the Commerce Business Daily with respect to the modification.

With respect to the lack of competitive procurement data, the contracting officer has advised that RCA did not deliver drawings suitable for processing for a data package for competitive procurement until September 1, 1967. Further, he has indicated that if the second-year requirement was postponed until the article could be let to competition, there would be a delay in initial delivery which was not considered justified in view of the priority for the radios.

In view of the foregoing, your protest is denied.

Very truly yours,

FRANK H. WEITZEL,
Assistant Comptroller General of the United States.

APPENDIX 12

SPECIAL QUESTIONS AND ANSWERS

DECEMBER 12, 1967.

Hon. ELMER B. STAATS,
Comptroller General of the United States,
Washington, D.C.

DEAR MR. STAATS: At hearings of the Subcommittee on Economy in Government on December 8, 1967, members were granted permission to submit additional questions to witnesses with the replies thereto to be included in the record of the hearings.

This question has been referred to you:

"GAO stated that contractors are required by OEP regulation to obtain advance approval to use Government-owned machine tools on commercial work exceeding 25% of the total usage.

"Does this apply to equipment purchased from DOD and other funds *besides Defense Production Act funds?*

"In either case, what approvals and denials were made by the OEP to what companies, for what amount of equipment?"

Your reply will be appreciated as soon as possible but not later than December 21, 1967.

Sincerely,

WILLIAM PROXMIRE, *Chairman.*

COMPTROLLER GENERAL OF THE UNITED STATES.
Washington, D.C., December 21, 1967.

B-140389.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States.

DEAR MR. CHAIRMAN: Reference is made to your letter of December 12, 1967, asking us to reply to the two questions raised by members of your Subcommittee on Economy in Government concerning the requirement established by the Office of Emergency Planning that contractors "obtain advance approval to use Government-owned machine tools on commercial work exceeding 25 percent of the total usage." You specifically asked if this requirement applies to equipment purchased with Department of Defense funds and other funds besides Defense Production Act funds.

On the basis of a review of Defense Mobilization Order 8555.1, issued by the Office of Emergency Planning on November 13, 1963, and discussions with officials of the Office of Emergency Planning and the Department of Defense, we have determined that the requirement for advance approval is not restricted to equipment purchased from Defense Production Act funds. The Order is applicable to 18 classes of metal-working machines and machine tools owned by those Federal departments and agencies having production equipment emergency preparedness functions assigned by Executive Orders.

You also requested information concerning the extent to which requests were made to the Office of Emergency Planning for the use of Government-owned industrial plant equipment, the amount of equipment involved, and the actions taken by that Office.

Data furnished us by the Office of Emergency Planning during our review indictate that a total of five lease requests had been submitted to that Office during the period January 1, 1965 to November 21, 1966. A brief discussion on each of these lease requests follows.

PROPOSED LEASE OF GOVERNMENT-OWNED PRODUCTION EQUIPMENT TO THOMPSON RAMO WOOLDRIDGE, INC., CLEVELAND, OHIO

On February 5, 1965, a letter was submitted by the Director for Weapons Systems Scheduling and Analysis, Office of the Assistant Secretary of Defense (Installations and Logistics), requesting approval to lease the entire package of equipment used for production of M–14 rifles to Thompson Ramo Wooldridge, Inc., Cleveland, Ohio, for use in developing and producing commercial sporting rifles.

On March 25, 1965, the Deputy Director, Office of Emergency Planning, denied the request for approval of the proposed lease on the basis that it would provide Thompson Ramo Wooldridge an unfair competitive advantage over established United States companies producing sporting rifles.

RENEWAL OF LEASE OF GOVERNMENT-OWNED PRODUCTION EQUIPMENT TO ALLIS-CHALMERS MANUFACTURING COMPANY, YORK, PENNSYLVANIA

On March 19, 1965, a letter was submitted by the Director for Weapons Systems Scheduling and Analysis, Office of the Assistant Secretary of Defense (Installations and Logistics), requesting authority to renew for 3 years a 40-foot vertical boring mill with an option for an additional 3-year renewal to the Allis-Chalmers Manufacturing Company, York, Pennsylvania. This item was originally leased to S. Morgan Smith Company, York, Pennsylvania, which subsequently merged with Allis-Chalmers.

On April 16, 1965, the Deputy Director, Office of Emergency Planning, approved the renewal for 3 years but denied the request for renewal option.

LEASING OF ITEMS INCLUDED IN THE AIR FORCE HEAVY PRESS PROGRAM

On August 18, 1965, a letter was submitted by the Director for Weapons Analysis and Readiness, Office of the Assistant Secretary of Defense (Installations and Logistics), requesting approval for deviation from the rental rates established by the Office of Emergency Planning for leasing of Government-owned production equipment for nondefense use so that leases of items included in the Air Force heavy press program could be renewed. Approval of partial nondefense use of a 144-inch tapered sheet rolling mill by ALCOA, Davenport, Iowa, was also requested.

On October 4, 1965, the Office of Emergency Planning approved the rate deviations and the renewal of leases through December 31, 1966, but requested a review of methods of leasing and usage with a view to possible modifications which would increase the yearly monetary return to the Government. Approval for the nondefense use of the rolling mill was granted on the same date.

At that time companies leasing items under the Air Force heavy press program were:

Alcoa, Cleveland, Ohio.
Wyman-Gordon Co., N. Grafton, Mass.
Alcoa, Lafayette, Ind.
Dow Chemical Co., Madison, Ill.
Harvey Aluminum Co., Torrance, Calif.
Kaiser Co., Halethorpe, Md.
Curtiss-Wright, Buffalo, N.Y.
Canton Drop Forge, Canton, Ohio.

LEASE OF GOVERNMENT-OWNED PRODUCTION EQUIPMENT TO OLIN MATHIESON CHEMICAL CORPORATION, NEW HAVEN, CONNECTICUT

On February 28, 1966, a letter was submitted by the Director for Weapons Analysis and Readiness, Office of the Assistant Secretary of Defense (Installations and Logistics), requesting approval for the lease of five items of Government-owned production equipment to Olin Mathieson Chemical Corporation for approximately 90 days until replacement items ordered by the company were delivered. This request was approved by the Office of Emergency Planning on March 4, 1966.

PROPOSED LEASE OF FACILITIES COMPRISING AIR FORCE PLANT NO. 13, WICHITA, KANSAS, TO THE BOEING COMPANY FOR NONDEFENSE USE

On September 9, 1966, a letter was submitted by the Assistant Secretary of Defense (Installations and Logistics) requesting approval of an Air Force proposal to lease the facilities comprising Air Force Plant No. 13, Wichita, Kansas, to the Boeing Company for nondefense work.

On October 13, 1966, the Director, Office of Emergency Planning, approved the proposed lease subject to certain conditions which were made subject to review based on further information.

On October 20, 1966, the Assistant Secretary of the Air Force (Installations and Logistics) requested the Office of Emergency Planning to remove the conditions imposed in the letter of October 13, 1966, on the basis of additional information.

In light of the additional information presented by the Air Force, the Office of Emergency Planning, on October 24, 1966, modified the conditions set forth in its letter of October 13, 1966, as follows:

"The lease will be for a five-year period with two additional five-year options for renewal.

"The annual rental rates established in Defense Mobilization Order 8555.1 for machinery and equipment may be applied to the age of the machinery and equipment at the mid-point of the initial five-year period of the lease. This same rate will be applicable during each of the five-year option periods provided for in the lease."

We have not examined into the extent to which other requests have been made to the Office of Emergency Planning subsequent to November 21, 1966. In the event you wish us to pursue this matter, we shall be glad to do so.

We trust that this information is responsive to the questions raised in your inquiry.

Sincerely yours,

FRANK H. WEITZEL,
Assistant Comptroller General of the United States.

DECEMBER, 12, 1967.

Hon. THOMAS D. MORRIS,
Assistant Secretary of Defense, Installations and Logistics, Department of Defense, Washington, D.C.

DEAR TOM: Members of the Subcommittee on Economy in Government were granted permission to ask additional written questions of witnesses who appeared at subcommittee hearings ending on December 8, 1967.

The following questions are therefore submitted to the DOD for answers:

1. GAO Report, "Need for Improvements in Controls over Government-Owned Property in Contractors' Plants," B–140389, November 24, 1967, page 10, states that DCAS and the military services have cognizance over the administration of Government-owned property at about 5508 contractors' plants.

Will you furnish a listing of the contractor plants and the value (cost or otherwise) of the Government-owned property at each.

Your reply will be appreciated as soon as possible but not later than December 21, 1967.

Sincerely,

WILLIAM PROXMIRE, *Chairman.*

NOTE: Information furnished in response to above letter is retained in the subcommittee files and not included herein.

HOUSE OF REPRESENTATIVES,
Washington, D.C., December 14, 1967.

Hon. WILLIAM E. PROXMIRE,
Chairman, Subcommittee on Economy in Government, Joint Economic Committee, U.S. Senate, Washington, D.C.

DEAR BILL: I had intended asking the Comptroller General the following questions concerning the A–76 Program.

If it is not too late, will you please ask him to submit answers to these questions for the record:

1. Under a liberal interpretation of the ruling of the Counsel for the Civil Service Commission is not the A–76 Program seriously threatened?

2. What do you estimate is a relative extent of the government participation in "service activities" like Force Account compared to "product activities"?

3. I have noted that the GAO has made a number of studies which have questioned service type contracts but has the GAO made any studies questioning the government's conduct of service type activities like Force Account? If so, please supply a list of such studies.

Sincerely,

THOMAS B. CURTIS.

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., January 26, 1968.

Hon. WILLIAM E. PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States.

DEAR MR. CHAIRMAN: This is in response to a letter from your Executive Director dated December 28, 1967, requesting our comments on three questions raised by the Honorable Thomas B. Curtis concerning Bureau of the Budget Circular No. A–76 in his letter to your Subcommittee on Economy in Government, dated December 14, 1967.

Question 1. Under a liberal interpretation of the ruling of the Counsel for the Civil Service Commission is not the A–76 Program seriously threatened?

We believe that the October 1967 opinion of the General Counsel of the Civil Service Commission relates to contracts in which the relationship between the Government and the contractors' employees is tantamount to an employer-employee relationship. The opinion relates, in general, to contracts which provide for the performance of a Government function in Government facilities and under detailed supervision by Government employees. The elements and criteria applied in the General Counsel's opinion are to be used in determining whether a contract by its terms, or in its performance, constitutes the procurement of personal services proscribed by the Government personnel laws.

The provisions of Circular No. A–76 manifest the executive branch philosophy of relying upon the private sector to satisfy the Government's "commercial or industrial" needs. It is our view that the services which might be involved in the opinion generally are not "commercial or industrial" in nature. The conversion of any commercial or industrial service now being performed by a contractor as an "independent contractor" to in-house operation must still be justified under the rules prescribed in Circular No. A–76.

There are a wide range of services of an industrial and commercial nature which agencies lawfully undertake in conformity with the existing policy directive set forth in that circular and which continue to be proper. It is significant, however, that the circular specifically states that it will not be "used to justify departure from any law or regulation, 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."

In our opinion, the ruling of the Counsel for the Commission does not seriously threaten the policies enunciated in Circular No. A–76. However, it does perhaps point up a need for clarification of that circular so as to more clearly establish a distinction between products and services that are commercial and industrial in character, and thus clearly in the realm of the private sector, and the type of services involved in the opinion in question. We brought this matter to the attention of the Director of the Bureau of the Budget by letter dated August 3, 1967.

Question 2. What do you estimate is a relative extent of the Government participation in "service activities" like Force Account compared to "product activities"?

We do not believe that there is any readily available information on which a broad estimate could be made. Although Bureau of the Budget Circular No. A–76 calls for an inventory of commercial or industrial activities of more than a nominal size, we understand that this inventory has not been completed. However, the Department of Defense has furnished us with certain data for fiscal

year 1967, developed in connection with the inventory requirement, which may prove helpful to you as we have summarized it below:

	Personnel		Dollars	
	Number	Percent	Amount (in thousands)	Percent
Contract	157,447	23.4	$1,459,725	21.3
Government:				
Civilian	396,008			
Military	117,474			
Subtotal	514,274	76.6	5,398,409	78.7
Total	671,721	100.0	6,858,134	100.0

The above activities include maintenance, repair, and modification of equipment such as aircraft, vehicles, missiles, and communication equipment; maintenance and operations such as utilities operation (Government-owned), installation bus services, laundry services, custodial services, and maintenance of furniture, buildings, and grounds; nonmanufacturing services such as packing and crating, warehouse operations, printing, photographic services, and communications; and data processing services such as systems work, programming, and equipment operation.

Question 3. Has the General Accounting Office made any studies questioning the Government's conduct of service-type activities like Force Account? If so, please supply a list of such studies.

Enclosed is a list of studies of Government service-type activities which we have made in recent years. The nature of our finding or conclusion in each case is indicated where appropriate. This list also includes some cases in which we found that it would be advantageous for the Government to rely on commercial sources for items or parts rather than produce them in its own industrial-type activities. A number of these studies originated with requests from congressional committees or individual members of the Congress, and our reports generally were restricted in distribution, as is our custom in such circumstances unless otherwise authorized by the addressee. These restricted reports are indicated on the list. We believe, however, that arrangements can be made to have copies provided to you, along with any of the others on the list, if you so desire.

There have been a number of other studies in which similar questions were involved, particularly as a side issue to some more immediate review objective. In many cases conclusive determinations could not be readily made or the effort required to do so was not deemed justified in terms of relative significance.

In addition to other review work pertaining to service-type activities, this Office has presently in process a report concerning selected activities of the Department of the Army. In several of these cases, we found that the services could be provided more economically by contract than under Government "in-house" operation. In these cases the significant factor was the lower wages paid by the contractors compared with wages which would apparently be required to meet minimum applicable Government standards.

Please let us know if you have any further questions or comments on this matter.

Sincerely yours,

ELMER B. STAATS,
Comptroller General of the United States.

REPORTS RELATING TO SERVICE-TYPE AND CERTAIN OTHER ACTIVITIES CONDUCTED BY THE GOVERNMENT

Report title or subject	Reference	Date
Operation of a dairy farm by the U.S. Naval Academy, Annapolis, Md., Department of the Navy (we found that it would be more economical to rely on commercial sources for dairy products)	B-156167	Mar. 23, 1966
Savings available through more extensive use of contract vehicle service and of certain mail-handling equipment, Post Office Department	B-114874	Nov. 29, 1965
Failure to curtail operation at Government expense of military commissary stores in continental United States where adequate commercial facilities are available, Department of Defense	B-146875	Apr. 16, 1964
Letter to the chairman of the Joint Economic Committee concerning commissary stores (contents restricted)	B-146875 [1]	July 9, 1964
Letter to Hon. Thomas B. Curtis concerning commissary stores (contents restricted)	B-146875 [1]	Dec. 14, 1964
Followup review of Government production compared to procurement of weapons and related parts, Department of the Army (we found that unnecessary costs were incurred by placing orders with arsenals without comparing costs with prices of commercial sources)	B-146848	Aug. 31, 1964
Unnecessary costs resulting from Government production of M-60 machineguns and repair parts rather than procurement from the commercial source, Department of the Army	B-146883	Aug. 21, 1964
Unnecessary costs resulting from Government production of M-14 rifle repair parts rather than procurement from commercial sources, Department of the Army	B-146848	Feb. 7, 1964
Letters to Hon. Harold T. Johnson concerning maintenance of radio equipment (contents restricted)	B-148347 [1]	June 29, 1962
(Contents restricted)	B-148347 [1]	Oct. 22, 1962

[1] Information in these reports not to be released to persons outside GAO without the approval of the congressional official to whom the report is addressed.

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
December 18, 1967.

Hon. ELMER B. STAATS,
Comptroller General of the United States,
Washington, D.C.

DEAR MR. STAATS: Enclosed is a copy of a letter dated December 8, 1967 from the Honorable William B. Widnall concerning testimony given to the Subcommittee on Economy in Government by Mr. Lewis R. Caveney on November 30, 1967.

Will you please investigate the points raised by this letter and report to the Subcommittee? At the present time, no date has been set for additional hearings but I would appreciate your report as soon as your staff load will permit.

Sincerely,

WILLIAM PROXMIRE, *Chairman.*

HOUSE OF REPRESENTATIVES,
Washington, D.C., December 8, 1967.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
New Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: In his testimony before the Subcommittee on Economy in Government of the Joint Economic Committee on November 30, Mr. Lewis R. Caveney of the Bryant Computer Products Division of Ex-Cell-o Corporation noted one instance in which had the Government procured a computer system on the basis of buying from peripheral manufacturers rather than from one systems manufacturer the savings to the Government in that one instance alone would have amounted to $429,250. He also stated that this savings was just the initial cost savings, that additional savings were possible in the one instance, from a savings on 336 square feet of space, at $100 per square foot, according to the General Services Administration, and a savings on the number of individual parts which required maintenance and manpower. Mr. Caveney contended that his figures in this one instance could be substantiated by the General Accounting Office.

My inquiry, then, is this: Could the General Accounting Office both substantiate the instance Mr. Caveney referred to and go one step further and study computer procurements in both the General Services Administration and the Department of Defense to determine what savings could accrue to the Federal

Government by direct procurement of peripheral parts of computer systems from peripheral manufacturers? I note the studies that have been made concerning the procurement of aeronautical space parts and others which have led to a substantial savings for the Federal Government.

We are currently spending some $3 billion annually for computer systems. If the Federal Government can purchase these systems at a substantial savings by direct purchase from the peripheral manufacturers, then a study such as I propose would be well worth the effort. I would hope that such a study could be completed for the Joint Economic Committee before its next meeting in the Spring of 1967.

Sincerely,

WILLIAM B. WIDNALL,
Member of Congress.

At the time these hearings went to press the GAO had not completed the study covering the points raised by Representative Widnall. Their reply will be furnished to the Subcommittee on Economy in Government upon completion and will be retained in the subcommittee files.

APPENDIX 13

BUREAU OF THE BUDGET CIRCULAR A–76 REVISED WITH ANALYSIS

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., August 30, 1967.

CIRCULAR NO. A–II, REVISED—TRANSMITTAL MEMORANDUM NO. I

To: The heads of executive departments and establishments.
Subject: Policies for acquiring commercial or industrial products and services for Government use.

Transmitted herewith is a revision of Bureau of the Budget Circular A–76 dated March 3, 1966. It is issued to clarify some provisions of the earlier circular and to lessen the burden of work by the agencies in implementing its provisions. A brief summary of the changes is attached.

There is no change in the Government's general policy of relying upon the private enterprise system to supply its needs, except where it is in the national interest for the Government to provide directly the products and services it uses.

We intend to keep the provisions of the circular under continuing review. We anticipate that further changes will be desirable in light of experience gained from implementing the circular's provisions, including the required reviews of existing Government commercial or industrial activities to be completed by June 30, 1968. We intend to give special attention to the adequacy of the guidelines contained in the circular for such matters as comparative cost analyses; the circumstances under which cost differentials in favor of private enterprise are appropriate; and the use of contracts involving support services that require minimal capital investment.

We welcome your suggestions.

PHILLIP S. HUGHES,
Acting Director.

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., August 30, 1967.

CIRCULAR NO. A–76—REVISED

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 Bureau of the Budget Circular A–76 issued March 3, 1966. It is issued to clarify some provisions of the earlier circular and to lessen the burden of work by the agencies in implementing its provisions. The basic policies 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 are the same as those contained in Circular A–76 dated March 3, 1966.

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 involving additional capital investment of $25,000 or more or additional annual costs of production of $50,000 or more. A reactivation, expansion, modernization, or replacement of an activity involving additional capital investment of $50,000 or more or additional annual costs of production of $100,000 or more are, for purposes of this circular, also regarded as "new starts." 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. The term does not include a Government-owned contractor-operated activity.

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 regulation, 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 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 Administra-

tions 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 reply 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 cost 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 compensation 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 cost of facilities and equipment to be constructed to Government specifications. Cost comparison studies should also be made in other cases if there is reason to believe that savings will not be made, however, if in-house provision of the product or service, or commercial procurement thereof, is clearly justified in accordance with other provisions of this circular.

The determination as to whether to purchase or to lease equipment or to construct buildings or acquire their use under lease-construction arrangements involves a determination of the difference in costs under the alternatives, and the principles set forth in this circular should be applied to the extent relevant in making such determinations.

(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. Similarily, if such a discontinuance is expected to result in premature retirement of Government employees which will cause a significant increase in retirement costs to the Government, such increased cost should be added to the cost of procurement from commercial sources. 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.) For purposes of economy and simplicity in making cost comparison studies, generally agreed costs that would tend to be the same under either alternative need not be measured and included (for example, bid and award costs and operating costs under lease-purchase alternatives).

(c) 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. The objectives should be to compute, as realistically as possible, the incremental or additional cost that would be incurred by the Government under the alternatives under consideration. In making such determinations it is important that recognition be given to the full amount of additional or incremental direct and indirect cost to be incurred in providing the products or services required. 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 the full cost to the Government of retirement systems, calculated on a normal cost basis, 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. In computing the depreciation cost of new or additional facilities or equipment to be acquired if a Government activity is started or continued and in determining comparative costs under lease-purchase alternatives, appropriate recognition should be given to estimated residual or salvage values of the facilities or equipment.

(7) *Interest.*—Compute interest for any new or additional capital to be invested based upon the average rate of yield for long-term Treasury bonds as shown in the current monthly Treasury Bulletin. The method of computation should provide for reduction in the capital investment to which interest is applied over the useful life of the asset on a straight line basis.

(8) *Indirect costs.*—Include any additional indirect costs incurred 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 have been included in the inventory by June 30, 1966. Other information needed to complete the inventory should be added as reviews required in paragraphs 7 (b) 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. It is emphasized that 10 percent is not intended to be a fixed figure.

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 commercal 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 appropriate implementing instructions and by providing adequate management support and procedures for review and followup to assure that the instructions are placed in effect. A copy of the implementing instructions issued by each agency will be furnished to the Bureau of the Budget.

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 October 2, 1967.

PHILLIP S. HUGHES,
Acting Director.

SUMMARY OF CHANGES IN BUREAU OF THE BUDGET CIRCULAR NO. A–76 AS REVISED AUGUST 1967

PARAGRAPH 3—DEFINITIONS

3.a. The definition for a "new start" has been split as between (a) a newly established Government commercial or industrial activity and (b) a reactivation, expansion, modernization, or replacement of an activity. These separate definitions have been provided so that different dollar limitations on capital investment and annual cost of production may be applied. There is no change in the dollar limitations applicable to newly established Government commercial or industrial activities. But the dollar limitations have been doubled for the category of "new starts" that are a reactivation, expansion, modernization, or replacement of an activity. The change is necessary in order to avoid applying the "new start" procedures to routine adjustments for handling existing workload. For example, the replacement of a single machine tool at a shipyard may easily add capital cost of more than $25,000, or the addition of only 10 employees at relatively low grades would add more than $50,000 per year to production cost. This type of change occurs several times a year at a large facility and, under the terms of the earlier Circular A–76, each such change would have to be treated as a "new start" with a detailed cost study and a special approval.

3.b. The definition of a Government commercial or industrial activity has been clarified. The earlier circular, by definition, excluded a Government-owned, contractor-operated activity but the wording was not entirely clear. The change

made clarifies the fact that a Government-owned, contractor-operated activity is not to be regarded as a Government commercial or industrial activity for purposes of the circular.

PARAGRAPH 4—SCOPE

4.c. The words "professional staff" that were contained in the carlier circular have been eliminated. Paragraph 4.c. is intended to exempt various kinds of staff advisory services which are so intimately related to the processes of top management and control of Government programs that the general provisions of A–76 favoring reliance upon commercial sources should not be applicable. The term "professional staff" was so broad that it could be interpreted to apply to a large variety of services which are commercially available and which are not necessarily related intimately to top management and control of Government programs. The change will clarify the meaning of this subparagraph.

PARAGRAPH 6—COST COMPARISONS

A change is made in the third unnumbered paragraph to make clear that if there is reason to believe savings can be realized by the Government providing for its own needs, cost comparison studies should be made before deciding to rely upon a commercial source. However, the changed wording also makes it clear that cost studies will not be required if in-house provision of the product of service, or commercial procurement thereof, is clearly justified in accordance with other provisions of the circular.

A new numbered paragraph has been added to provide guidelines for applying provisions of the circular to purchase versus lease of equipment, and to construction of buildings versus acquisition under lease-construction arrangements. The paragraph requires a determination of the difference in costs under the alternatives, and application of the principles set forth in the circular in making judgments in these areas.

6.a. A sentence has been added providing that if discontinuance of a Government commercial or industrial activity will result in premature retirement of Government employees, and will cause a significant increase in retirement costs to the Government, such increased costs should be added to the cost of procurement from commercial sources.

6.b. This is a new subparagraph. It provides that costs which would tend to be the same for both Government and industry need not be measured and included in comparative cost analyses (for example, bid and award costs and operating costs under lease-purchase alternatives). The change is made in the interest of economy and simplicity in making cost comparisons.

6.c. (Paragraph 6.b. in the earlier circular). A sentence has been added to clarify the fact that the incremental method of costing is to be employed and to emphasize the importance of a realistic recognition of all such additional or incremental costs.

6.c.(1). (Paragraph 6.b.(1) in the earlier circular). Some additional wording has been added to clarify, in connection with personal services and benefits, that the full cost to the Government of retirement systems should be included.

6.c.(6). (Paragraph 6.b.(6) in the earlier circular). A sentence has been added to make clear that appropriate recognition should be given to estimated residual or salvage value of facilities or equipment in computing depreciation.

6.c.(7). (Paragraph 6.b.(7) in the earlier circular.) This paragraph has been rewritten to provide that the computation of interest for any new or additional capital to be invested will be based upon the average rate of yield for long-term Treasury bonds as shown in the current monthly Treasury Bulletin. Also, the method of computation suggested would provide for reduction in the capital investment to which interest is applied as the asset is depreciated. The purpose of the change is to clarify the rate and source of interest to be charged and to provide guidance as to the principal to which it is to be applied. The suggested rate is a readily available measure of the current cost of money to the Government and the provision for reducing the balance to which interest is applied is considered reasonable because the interest cost should not go on indefinitely.

6.c.(8). (Paragraph 6.b.(8) in the earlier circular.) A change in wording has been made to clarify that Government costs should include any additional indirect costs incurred for such activities as management and supervision, budgeting, accounting, personnel, legal, and other applicable services.

PARAGRAPH 7—ADMINISTERING THE POLICY

7.b.(3). In the past there has been some misunderstanding about the cost differential in favor of private enterprise due to uncertainties relating to Government production costs, equipment obsolescence, and other factors, including the amount of capital investment involved. A sentence has been added to clarify the fact that the 10-percent cost differential in favor of private enterprise, mentioned in this subparagraph, is not intended to be a fixed figure. The differential may be more or less than 10 percent, depending upon the circumstances in each individual case.

PARAGRAPH 8—IMPLEMENTATION

A sentence has been added requiring agencies to furnish the Bureau of the Budget with a copy of their implementing instructions.

APPENDIX 14

The following statistical information was not available at the time of the hearings but was subsequently supplied by the Department of Defense:

MAGNITUDE OF DOD PROPERTY MANAGEMENT ACTIVITIES

PROPERTY HOLDINGS

The total of DOD's real and personal property holdings has risen annually from $129 billion in fiscal year 1955 to $196 billion at the end of fiscal year 1967.

Real property holdings increased from $21 to $38 billion and personal property holdings, including construction in progress, from $107 to $157 billion during the 13-year period.

However, "supply systems" inventories have been reduced by $9.4 billion during this period and "stock funds" by $0.7 billion. During 1967, there was a considerable buildup of supply inventories.

TABLE 1.—DOD PROPERTY HOLDINGS AS OF JUNE 30, FISCAL YEARS 1955–67 [1]

[In millions of dollars]

Total and type of property	1955	1956	1957	1958	1959	1960	1961
Total	128,694	134,082	146,021	149,465	150,660	154,617	158,508
Real	21,343	22,918	24,892	26,891	29,689	31,997	34,038
Personal	107,351	111,164	121,129	112,574	120,971	122,620	124,470
Supply systems	50,780	50,974	53,799	47,652	44,467	42,002	40,837
Stock funds	8,153	9,772	10,970	8,913	8,162	7,312	6,413
Appropriated funds	42,627	41,202	42,829	38,739	36,305	34,690	34,424

Total and type of property	1962	1963	1964	1965	1966	1967
Total	164,835	171,364	173,455	176,221	183,570	195,552
Real	35,378	36,565	36,734	37,557	38,390	38,495
Personal	129,457	134,799	136,721	138,664	145,180	157,057
Supply systems	40,652	40,096	38,795	36,986	37,661	41,361
Stock funds	6,154	6,527	5,749	5,327	5,850	7,503
Appropriated funds	34,498	33,569	33,046	31,659	31,811	33,858

[1] Source, "Real and Personal Property of the Department of Defense," an annual report.

Expenditures for DOD military functions represented 8.8 percent of the gross national product in fiscal year 1967, as compared to 7.6 percent in fiscal year 1966.

SUPPLY SYSTEMS INVENTORIES

As stated in table 1 above, the total of "supply systems" inventories from fiscal year 1955 through fiscal year 1966, was reduced from $51 to $38 billion or $13 billion. In fiscal year 1967, it was increased to $41 billion. The stratification of such stocks, or breakdown into purpose for which they are held, reflects a distinct change during fiscal years 1964, 1965, and 1966. In prior years, the strata were peacetime operating stocks, mobilization reserve stock, economic and contingency retention stocks, and excess stock. These are shown in table 7 and are explained in footnotes 2 through 7.

Stratification of supply systems inventories as of June 30, 1964, and June 30, 1965, was in accordance with improved logistics guidance which called for application of assets first against requirements to support (1) approved forces; that is Active and high-priority Reserve Forces of the 5-year force structure and financial program; and (2) general forces.

The guidance was again changed so that, as of June 30, 1966 and June 30, 1967, assets are applied to approved forces, either as authorized for acquisition or for retention.

The data for these strata are not comparable with that in prior years, except in a very general way, and therefore, have not been shown separately in the table (see footnotes) but are included in subtotal and total.

The criteria for the establishment of economic retention and contingency retention strata have not been drastically revised, although the exigencies of world situations may result in somewhat different levels being established under them. The excess strata now represents those stocks that are beyond limits of a particular service and for which screening for utilization by other elements of the Department of Defense is underway but for which final DOD disposal action has not been initiated. They are significantly less in value than those reported in prior years.

TABLE 2.—DOD SUPPLY SYSTEMS INVENTORIES BY INVENTORY STRATAS AS OF JUNE 30,[1] FISCAL YEARS 1958-67

[In millions of dollars]

Total and inventory strata	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967
Total	46,585	44,203	41,727	40,537	40,299	39,684	38,383	36,506	37,167	40,341
Unstratified	2,440	3,056	2,083	1,819	1,837	1,425	2,582	2,704	3,221	3,070
Total stratified	44,145	41,147	39,644	38,717	38,462	38,259	35,801	33,802	33,946	37,271
Peacetime operating [2]	14,538	15,306	15,657	14,722	15,601	15,379	([3])	([3])	([3])	([3])
Mobilization reserve [4]	12,134	11,530	10,893	11,030	10,725	10,921	([3])	([3])	([3])	([3])
Economic retention [5]	5,593	4,703	6,618	6,343	5,454	5,912	3,596	3,629	4,180	3,760
Contingency retention [6]	1,050	1,611	1,361	1,246	1,040	636	1,248	1,814	1,865	2,310
Excess stocks [7]	10,418	7,146	5,115	5,377	5,643	5,411	5,528	3,466	3,250	3,158

[1] Total inventories in this table do not include value of Navy shipboard supplies included in table 3.

[2] Peacetime operating stock is that portion of the total quantity of an item on hand which is required to equip and train he planned peacetime forces and support the scheduled establishment through the normal appropriation and leadtime periods.

[3] These strata are not available for 1964, 1965, 1966, and 1967 because of changes in logistics guidance. In 1965 their sum was $24,893,000,000, divided into approved force stocks ($23,665,000,000) and general force stocks ($1,228,000,000). The guidance was again revised in 1966 when the sum of these 2 was $24,651,000,000 allocated to approved forces as levels of acquisition ($23,640,000,000) and retention ($1,011,000,000). In 1967, the sum was $28,043,000,000, allocated to approved forces as levels of acquisition ($27,173,000,000) and retention ($870,000,000).

[4] Mobilization reserve materiel requirement: The quantity of an item required to be in the military supply system on M-day, in addition to quantities for peacetime needs, to support planned mobilization to expand the materiel pipeline, and to sustain in training, combat, or noncombat operations prescribed forces until production by industry equals consumption.

[5] Economic retention stock is that portion of the quantity in long supply which it has been determined will be retained for future peacetime issue of consumption as being more economical than future replenishment by procurement.

[6] Contingency retention stock is that portion of the quantity in long supply of an obsolete or nonstandard item for which no programed requirements exist and which normally would be considered as excess stock, but which has been determined will be retained for possible military or defense contingencies for United States or allied forces.

[7] Excess stock as reported herein is stock which is indicated to be above the sum of footnotes 2, 3, 4, and 5 above and for which specific determination as being within the needs of the Department of Defense has not been made or disposal action initiated.

SCOPE OF PROCUREMENT ACTIVITIES

The net value of military procurement actions amounted to $41.8 billion in fiscal year 1967, an increase of $6.1 billion over fiscal year 1966.

TABLE 3.—NET VALUE OF MILITARY PROCUREMENT ACTIONS IN THE UNITED STATES AND POSSESSIONS, FISCAL YEARS 1951–67

[In billions of dollars]

Fiscal year	Net value of military procurement actions	Fiscal year	Net value of military procurement actions
1951	31.9	1960	22.5
1952	42.2	1961	24.3
1953	28.4	1962	27.8
1954	11.9	1963	28.1
1955	15.5	1964	27.5
1956	18.2	1965	26.6
1957	19.9	1966	35.7
1958	22.8	1967	41.8
1959	23.9		

Source: "Military Prime Contract Awards and Subcontract Payments or Commitments, July 1966–June 1967," Office of the Secretary of Defense.

The breakdown of awards by States and the District of Columbia for experimental, developmental, test, and research work shows (see table 12):

Percent of total:	*Number of States*
Over 30	1
5 to 10	3
4 to 5	2
3 to 4	5
2 to 3	1
1 to 2	7
0 to 1	32

TABLE 4.—MILITARY PRIME CONTRACT AWARDS OF $10,000 OR MORE FOR RESEARCH, DEVELOPMENT, TEST AND EVALUATION WORK, BY REGION AND STATE AND BY TYPE OF CONTRACTOR, FISCAL YEAR 1967

Region and State	Type of contractor							
	Total		Educational institutions		Other nonprofit institutions [1]		Business firms	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
U.S. total	$5,995,892	100.0	$381,690	100.0	$289,991	100.0	$5,324,211	100.0
New England	649,067	10.8	107,608	28.2	28,464	9.8	512,995	9.6
Maine	283	(2)	0	.0	34	(2)	249	(2)
New Hampshire	36,925	.6	532	.1	0	.0	36,393	.7
Vermont	4,301	.1	122	(2)	0	.0	4,179	.1
Massachusetts	507,000	8.5	102,625	26.9	27,307	9.4	377,068	7.1
Rhode Island	12,675	.2	3,023	.8	0	.0	9,652	.2
Connecticut	87,883	1.5	1,306	.3	1,123	.4	85,454	1.6
Middle Atlantic	903,463	15.1	57,929	15.1	33,983	11.7	811,551	15.2
New York	467,698	7.8	30,985	8.1	21,505	7.4	415,208	7.8
New Jersey	178,458	3.0	6,223	1.6	122	(2)	172,113	3.2
Pennsylvania	257,307	4.3	20,721	5.4	12,356	4.3	224,230	4.2
East North Central	519,687	8.7	40,996	10.7	24,038	8.3	454,653	8.6
Ohio	261,176	4.4	7,646	2.0	11,392	3.9	242,138	4.5
Indiana	49,715	.8	977	.3	2,218	.8	46,520	.9
Illinois	51,339	.9	16,894	4.4	10,159	3.5	24,286	.5
Michigan	130,701	2.2	13,435	3.5	104	(2)	117,162	2.2
Wisconsin	26,756	.4	2,044	.5	165	.1	24,547	.5

See footnotes at end of table.

TABLE 4.—MILITARY PRIME CONTRACT AWARDS OF $10,000 OR MORE FOR RESEARCH, DEVELOPMENT, TEST AND EVALUATION WORK, BY REGION AND STATE AND BY TYPE OF CONTRACTOR, FISCAL YEAR 1967—Con.

Region and State	Type of contractor							
	Total		Educational institutions		Other nonprofit institutions [1]		Business firms	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
West North Central	180,433	3.0	6,084	1.6	166	0.1	174,183	3.3
Minnesota	75,334	1.3	1,915	.5	224	.1	73,195	1.4
Iowa	13,227	.2	1,122	.3	0	.0	12,105	.2
Missouri	78,166	1.3	2,234	.6	[3] −79	------	76,011	1.4
North Dakota	35	[2]	14	[2]	21	[2]	0	.0
South Dakota	195	[2]	43	[2]	0	.0	152	[2]
Nebraska	3,515	[2]	64	[2]	0	.0	3,451	.1
Kansas	9,961	.2	692	.2	0	.0	9,269	.2
South Atlantic	843,042	14.0	93,758	24.6	53,798	18.6	695,486	13.1
Delaware	2,755	[2]	226	.1	0	.0	2,529	[2]
Maryland	217,246	3.6	73,540	19.3	5,479	1.9	138,227	2.6
District of Columbia	38,899	.6	8,900	2.3	10,978	3.8	19,021	.4
Virginia	71,449	1.2	727	.2	26,429	9.1	44,293	.8
West Virginia	9,983	.2	345	.1	7,920	2.7	1,718	[2]
North Carolina	79,939	1.3	4,460	1.2	1,282	.4	74,197	1.4
South Carolina	609	[2]	229	.1	0	.0	380	[2]
Georgia	220,989	3.7	1,001	.3	1,580	.5	218,408	4.1
Florida	201,173	3.4	4,330	1.1	130	.1	196,713	3.7
South Central	477,838	8.0	11,713	3.1	6,815	2.3	459,310	8.6
Kentucky	961	[2]	372	.1	0	.0	589	[2]
Tennessee	60,471	1.0	941	.3	75	[2]	59,455	1.1
Alabama	25,213	.4	807	.2	969	.3	23,437	.4
Mississippi	376	[2]	285	.1	0	.0	91	[2]
Arkansas	261	[2]	41	[2]	0	.0	220	[2]
Louisiana	1,669	[2]	839	.2	37	[2]	793	[2]
Oklahoma	13,339	.2	1,783	.5	283	.1	11,273	.2
Texas	375,548	6.3	6,645	1.7	5,451	1.9	363,452	6.8
Mountain	199,936	3.3	15,644	4.1	2,699	.9	181,593	3.4
Montana	436	[2]	333	.1	0	.0	103	[2]
Idaho	105	[2]	40	[2]	0	.0	65	[2]
Wyoming	15	[2]	15	[2]	0	.0	0	.0
Colorado	97,159	1.6	5,551	1.5	713	.3	90,895	1.7
Utah	16,525	.3	2,984	.8	28	[2]	13,513	.3
Nevada	9,341	.2	28	[2]	147	.1	9,166	.2
New Mexico	33,188	.6	5,113	1.3	1,326	.5	26,749	.5
Arizona	43,167	.7	1,580	.4	485	.2	41,102	.8
Pacific	2,212,629	36.9	44,328	11.6	139,874	48.2	2,028,427	38.1
Washington	222,059	3.7	5,935	1.6	312	.1	215,812	4.1
Oregon	920	[2]	591	.2	0	.0	329	[2]
California	1,989,650	33.2	37,802	9.9	139,562	48.1	1,812,286	34.0
Alaska and Hawaii	9,797	.2	3,630	1.0	154	.1	6,013	.1
Alaska	1,689	[2]	1,614	.4	60	[2]	15	[2]
Hawaii	8,108	.1	2,016	.5	94	[2]	5,998	.1

[1] Includes contracts with other Government agencies.
[2] Less than 0.05 percent.
[3] The negative value results from contract cancellations in excess of new awards.

TABLE 5.—MILITARY PRIME CONTRACT AWARDS OF $10,000 OR MORE FOR EXPERIMENTAL, DEVELOPMENTAL TEST, AND RESEARCH WORK IN ORDER OF RANK BY STATE AND THE DISTRICT OF COLUMBIA, FISCAL YEAR 1967

Rank	State	Percent	Total percent
1	Wyoming	(1)	(1)
2	North Dakota	(1)	(1)
3	Idaho	(1)	(1)
4	South Dakota	(1)	(1)
5	Arkansas	(1)	(1)
6	Maine	(1)	(1)
7	Mississippi	(1)	(1)
8	Montana	(1)	(1)
9	South Carolina	(1)	(1)
10	Oregon	(1)	(1)
11	Kentucky	(1)	(1)
12	Louisiana	(1)	(1)
13	Alaska	(1)	(1)
14	Delaware	(1)	(1)
15	Nebraska	(1)	(1)
16	Vermont	0.1	0.1
17	Hawaii	.1	.2
18	Nevada	.2	.4
19	Kansas	.2	.6
20	West Virginia	.2	.8
21	Rhode Island	.2	1.0
22	Iowa	.2	1.2
23	Oklahoma	.2	1.4
24	Utah	.3	1.7
25	Alabama	.4	2.1
26	Wisconsin	.4	2.5
27	New Mexico	0.6	3.1
28	New Hampshire	.6	3.7
29	District of Columbia	.6	4.3
30	Arizona	.7	5.0
31	Indiana	.8	5.8
32	Illinois	.9	6.7
33	Tennessee	1.0	7.7
34	Virginia	1.2	8.9
35	Minnesota	1.3	10.2
36	Missouri	1.3	11.5
37	North Carolina	1.3	12.8
38	Connecticut	1.5	14.3
39	Colorado	1.6	15.9
40	Michigan	2.2	18.1
41	New Jersey	3.0	21.1
42	Florida	3.4	24.5
43	Maryland	3.6	28.1
44	Georgia	3.7	31.8
45	Washington	3.7	35.5
46	Pennsylvania	4.3	39.8
47	Ohio	4.4	44.2
48	Texas	6.3	50.5
49	New York	7.8	58.3
50	Massachusetts	8.5	66.8
51	California	33.2	100.0

[1] Less than 0.05 percent.

APPENDIX 15

REFERENCES TO SUBCOMMITTEE REPORTS, HEARINGS, AND STAFF STUDIES

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 Congress, second 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 Congress, first 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 Congress, second 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 Congress, first sess. (Hereinafter called "Report, July 1965.")

Report, May 1966: "Economic Impact of Federal Procurement—1966," report of the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee, Congress of the United States, 89th Congress, second sess. (Hereinafter called "Report, May 1966.")

Report, July 1967: "Economy in Government," report of the Subcommittee on Economy in Government of the Joint Economic Committee, Congress of the U.S., 90th C., 1st sess. (Hereinafter called "Report, July 1967.")

Hearings, 1960: "Impact of Defense Procurement," hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 86th Congress, second session, January 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," hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 87th Congress, first session, 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 Congress, first session, March 28, 29, and April 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, 88th Congress, second session, April 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 Congress, first session, April 27, 28, and 29, 1965. (Hereinafter called "Hearings, 1965.")

Hearings, 1966: "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 Congress, second session, January 24, and March 23 and 24, 1966. (Hereinafter called, "Hearings, 1966.")

Hearings, 1967: "Economy in Government," hearings before the Joint Economic Committee, Congress of the United States, 90th Congress, first session, May 8, 9, 10 and 16, 1967, parts 1 and 2. (Hereinafter called "Hearings, 1967.")

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 Congress, second session, 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 Congress, first session, 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 Congress, second session, April 1964. (Hereinafter called "Staff Materials, 1964.")

Staff study, 1965: "Background Materials on Economic Impact of Federal Procurement," prepared for the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee, Congress of the United States, 89th Congress, first session, 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 Congress, second session, March 1966. (Hereinafter called "Staff Materials, 1966.")

Staff study, 1967: "Background Material on Economy in Government—1967," materials prepared for the Subcommittee on Economy in Government of the Joint Economic Committee, Congress of the United States, 90th Congress, first session, April 1967. (Hereinafter called "Staff Materials, 1967.")

Staff study, 1967—updated: "Economy in Government—1967," updated background material, materials prepared for the Subcommittee on Economy in Government of the Joint Economic Committee, Congress of the United States, 90th Congress, first session, November 1967. (Hereinafter called "Staff Materials, 1967 updated.")

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