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

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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.

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[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.

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 Implementation
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 identification - 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

SUPPLIES AND/OR SERVICES TO BE FURNISHED

HOME OFFICE ADDRESS

QUANTITY

TOTAL AMOUNT OF PROPOSAL
$

DIVISION(S) AND LOCATION(S) WHERE WORK IS TO BE PERFORMED

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 3-807.2(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 outweight 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.

87-847 O - 68 - 8

(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)(2))*?
☒ 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 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. 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

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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 execessive 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.

Reproduction authorized.

CONTENTS

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 oooks, 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.

(d) 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.

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(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.