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REVIEW OF DEFENSE PROCUREMENT POLICIES, PROCEDURES AND PRACTICES

Part I—Introduction and Truth in Negotiations (Public Law 87-653)

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HEARINGS BEFORE THE SUBCOMMITTEE FOR SPECIAL INVESTIGATIONS OF THE COMMITTEE ON ARMED SERVICES HOUSE OF REPRESENTATIVES NINETIETH CONGRESS

FIRST SESSION

UNDER THE AUTHORITY OF

H. Res. 124

HEARINGS HELD AUGUST 3 AND SEPTEMBER 25, 1967

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REVIEW OF DEFENSE PROCUREMENT POLICIES
PROCEDURES AND PRACTICES
Part I—Introduction and Truth in Negotiations (Public Law 87-653)

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REVIEW OF DEFENSE PROCUREMENT POLICIES, PROCEDURES, AND PRACTICES

Part I—Introduction and Truth in Negotiations (Public Law 87-653)

THURSDAY, AUGUST 3, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ARMED SERVICES,
SUBCOMMITTEE FOR SPECIAL INVESTIGATIONS,
Washington, D.C.

The subcommittee met at 10 a.m., Hon. Porter Hardy, Jr. (chairman of the subcommittee), presiding.

Members present: Porter Hardy, Jr., Otis G. Pike, Charles S. Gubser, and Alexander Pirnie.

Staff present: John T. M. Reddan, special counsel; Richard A. Ransom, professional staff member; and Joan F. Webb, secretary.

Mr. HARDY. Let the committee come to order.

Let the record show the presence of Mr. Pike, Mr. Gubser, and myself, constituting a quorum.

We are opening a new hearing this morning. I have a statement that I would like to read.

Almost immediately after July 4, 1776, the House Committee on Naval Affairs (a forerunner to the Armed Services Committee) found it had to tackle thorny problems in connection with military procurement and contracting.

Such problems have been with us ever since. One of the earliest cases involved Mr. Thomas Kemp, a Navy contractor, who ran into trouble building two sloops of war at Baltimore. It seems that when he undertook the job, the Chesapeake Bay area, where he procured his timber and other materials, had been a free and open waterway, but then the British moved in and blockaded the upper and lower parts of the bay and continued to do so for almost a year. Cut off from his regular source of supply, the contractor was forced to pay a premium for the naval materials and his additional expenses soared to a staggering sum of \$6,223.12, and to recoup this sum he presented a petition to the Committee on Naval Affairs. This naturally got him into something of a hassle with the Military Establishment, and with Congress which had trouble finding money then as it does nowadays. However, the policy in those days was amazingly simple. The House committee informed the contractor that:

When the petitioner entered into the contract, he necessarily took the chances of the rise or fall in the price of the articles necessary for its completion. If it [the price] had *fallen*, the advantage would have resulted to him, and not to the United States, and if it has *risen*, the loss should be his.

Fortunately for the struggling young Government, the cost-plus-fixed-fee contracts hadn't at that time come into being.

A review of the history of military management of procurement shows that although the basic theme of the problems hasn't changed much over the years, a multitude of variations has been brought into play by our worldwide commitments, sophisticated weapons systems and a staggering military budget. In the old days, almost every transaction could be examined without too much trouble. Now, the size of the procurement task is almost beyond imagination. We face a defense expenditure this year of about \$75 billion, and almost \$40 billion is for procurement of materials and services from contractors. The decisions which are made and the billions which are allocated for defense affect our entire economy and the repercussions are felt around the world.

We must, then, be constantly aware of the potential long-range effect of our procurement decisions and be constantly on the alert to eliminate projects or expenditures that produce little or no benefit to the goal of defense. In the management of our procurement system over the past few decades there have been a few minor repairs here and there, but now it seems imperative that a broad review be undertaken to determine whether major changes should be made to promote improved economy and efficiency.

With this objective in mind, Chairman Rivers has directed the subcommittee to consider all aspects of defense procurement and recommend improvements in the system. Within this directive, we plan to examine matters ranging from the generation of military procurement requirements to the delivery and deployment of the item or service purchased. Special note will be taken of buy-ins, change orders, organization structure, negotiator competence, and funding sources. We will be concerned also with such collateral matters as proprietary interests, and the adequacy of pricing and cost information in negotiated procurements.

This, of course, is an enormous undertaking, but I believe it can be accomplished in a reasonable time by dividing it into manageable segments. We plan to utilize the services of the General Accounting Office, for, in my opinion, a group with equal competence in the area of immediate concern could not be assembled in a reasonable time except at a prohibitive cost.

As a matter of fact, I am not sure it could be assembled at all.

Now, Chairman Rivers shares this view, also, and on March 21 of this year he addressed a letter to the Comptroller General requesting support of the General Accounting Office in carrying out this study. I will insert in the record at this point a copy of the chairman's letter, together with the Comptroller General's reply which is dated April 6, 1967. I don't believe there is any necessity for reading those at this time.

(The correspondence referred to follows:)

MARCH 21, 1967.

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

DEAR MR. STAATS: Last year, as you know, my Subcommittee for Special Investigations made an examination of the Department of Defense Cost Reduction Program. Your agency was most helpful to us in this undertaking, as it has been in many other investigations, and I am most appreciative of your cooperation.

As the work progressed it developed increasing evidence of procurement deficiencies and indicated the need for a broad review of procurement policies and procedures. This conclusion finds further support in your report of March 17 on the costs of bidding charged to Government contracts and I have, therefore, instructed the Special Investigations Subcommittee to concern themselves with this matter. However, any meaningful examination would require a thorough understanding of procurement practices—an understanding which your agency

has acquired through years of experience. Because of your expertise in this field, it occurs to me that yours is the best qualified agency to undertake such a preliminary study, and I would, therefore, appreciate it if you would perform this service for the Committee.

Since procurement deficiencies translate into waste of dollars, it is imperative that the spadework necessary to support remedial action be started as soon as possible. I would suggest that you might wish to discuss the matter with the Subcommittee in order that you may be apprised in greater detail as to our requirements.

Sincerely,

L. MENDEL RIVERS, *Chairman.*

COMPTROLLER GENERAL OF THE UNITED STATES,

Washington, D.C., April 6, 1967.

Hon. L. MENDEL RIVERS,
Chairman, Committee on Armed Services,
House of Representatives.

DEAR MR. CHAIRMAN: Reference is made to your letter of March 21, 1967, concerning the indicated need for a broad review of procurement policies and procedures and advising us that you have instructed the Subcommittee for Special Investigations to concern themselves with this matter.

You also state that because of our expertise in the procurement field you believe that the General Accounting Office is the best qualified agency to undertake a preliminary study of the matter and you request that we perform this service for the Committee.

We are always glad to work with your Committee and its Subcommittees on all matters of mutual interest. However, I must point out that any *overall* study of procurement policies and procedures will necessarily require a very significant use of manpower.

Over the years we have devoted a very considerable part of the time of our audit and legal personnel to the procurement field, particularly in the Department of Defense and the military departments. For example, during the period January 1, 1966, through February 28, 1967, we issued 116 reports in the Defense procurement area. Nineteen of these reports were sent to Congress; 4 to committees of the Congress; 13 to Members of Congress; and 80 to the Secretary of Defense. An identification of these reports is enclosed as Attachment I.

Of our total audit staff of 2,200 in Washington and in the field, approximately 1,100, or 50 percent, are assigned to Defense work for the six months period January 1 to June 30, 1967. Of the 1,100 staff members, 272 are assigned to the Defense procurement and contracting area, exclusive of our work concerned with supply management. Our allocation of audit time for the current six months period to the Defense procurement area was made after careful consideration of our overall accounting and auditing responsibilities in all areas of Federal expenditures. Summaries of reports in process and of current assignments relating to our procurement work are enclosed as Attachments II and III, respectively.

With reference to the availability of audit personnel, we want you to know that we have been making every effort to recruit additional people. However, the employment of accountants and auditors for the Federal Government is one of the most difficult areas in the Federal employment field. We visit over 500 colleges and universities each year and are successful in hiring approximately 350 young college graduates. However, due to losses to the military service and transfers to other agencies and to private business we are just able to hold our own. For example, during the period February 1, 1966, to January 31, 1967, we recruited 351 accountants and auditors. However, we lost 335, leaving a net gain of only 16.

Considering the factors set out above, we are not in a position to agree to perform an overall procurement study requiring a significant use of our current audit personnel without seriously curtailing the work we presently have under way in the procurement field as well as the work we must perform in other areas for which we are responsible.

We will be glad, of course, to see what we can work out with the Subcommittee, perhaps studies of individual areas as distinguished from an overall study, and we will meet with the Subcommittee to discuss the matter at its convenience.

Sincerely yours,

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

Enclosures.

[Attachment I]

Reports issued by the General Accounting Office in period Jan. 1, 1966, through Feb. 28, 1967, on matters relating to procurement in the Department of Defense

Procurement practices (38 reports):

Issued to the Congress (9 reports):

	Report No.	Date
Potential savings through direct procurement of components used in production of variable timing fuzes, Department of the Navy.....	B-132977	Feb. 23, 1966
Policy guidance strengthened on direct procurement of components needed by contractors in production of weapon systems and other major end items, Department of Defense.....	B-158604	Apr. 29, 1966
Management of the procurement of major equipment and related spare parts by the U.S. Marine Corps, Department of the Navy.....	B-158482	June 3, 1966
Policy of leasing motor vehicles for use by Government contractors, Department of Defense.....	B-146876	Sept. 20, 1966
Long-term leasing of buildings and land by Government contractors, Department of Defense.....	B-156818	Sept. 20, 1966
Procurement of printing of technical manuals from equipment manufacturers, Department of Defense.....	A-90545	Nov. 28, 1966
Savings available by purchasing rather than leasing commercial 2-way radio equipment, Department of Defense.....	B-160410	Jan. 10, 1967
Procurement of foreign-produced aircraft ejection-seat system, Department of Defense.....	B-146778	Jan. 18, 1967
Potential savings in the procurement of spare aircraft parts for outfitting aircraft carriers, Department of the Navy.....	B-133118	Feb. 23, 1967

Issued to committees of the Congress (2 reports):

Printing service contract awarded by Andrews Air Force Base (Joint Committee on Printing).....	A-90545	Mar. 4, 1966
Cost analysis of A-7A aircraft procurement program (House Committee on Appropriations).....	B-15637	June 23, 1966

Issued to Members of the Congress (7 reports):

Circumstances surrounding award of a painting contract (Congressman Downing).....	B-157554	Jan. 17, 1966
Procurement of cotton duck (Senator Lausche).....	B-157833	Mar. 10, 1966
Procurement of chemicals for removal of paint and rust (Congressman Mackay).....	B-159034	May 12, 1966
Procurement of liquid oxygen and liquid nitrogen (Congressman Morris).....	B-159057	July 19, 1966
Procurement policies at Naval Construction Battalion (Congressman Teague).....	B-159035	July 22, 1966
Procurement of steel helmets (Senator Hart).....	B-158907	Sept. 23, 1966
Paperwork associated with Defense procurements (Congresswoman Dwyer).....	B-160116	Dec. 1, 1966

Issued to the Secretary of Defense (20 reports):

	Report No.	Date
Procurement of.....		
Components for flight control systems.....	B-146972	Jan. 12, 1966
Jet engines.....	B-157278	Jan. 19, 1966
Radio sets.....	B-151717	Jan. 21, 1966
Radar computer sets.....	B-146774	Feb. 17, 1966
Communication equipment.....	B-158512	Feb. 17, 1966
Technical data for F-4 aircraft.....	B-152600	Feb. 24, 1966
Systems for launch control facilities.....	B-146876	Apr. 5, 1966
Spare and ground equipment for "Jetstar".....	B-158899	Apr. 12, 1966
Systems for launch control facilities.....	B-146876	Apr. 13, 1966
Aeronautical spare parts.....	B-158928	Apr. 19, 1966
Aircraft carrier, CVA-67.....	B-154258	May 12, 1966
Components for batteries.....	B-146805	June 17, 1966
Artillery shell fuzes.....	B-146999	June 28, 1966
Ships.....	B-157401	Aug. 30, 1966
Beds for launch control capsules.....	B-146876	Sept. 21, 1966
Duck cloth and webbing.....	B-157833	Sept. 21, 1966
Axles for 5-ton truck.....	B-146973	Nov. 9, 1966
Subscriptions to periodicals.....	B-160146	Nov. 9, 1966
Radio sets for vehicles.....	B-160118	Nov. 22, 1966
Components for missile systems.....	B-160566	Jan. 23, 1967

Negotiation of prices (42 reports):

Issued to the Congress (5 reports):

Pricing of recorders purchased from Midwestern Instruments, Inc., Tulsa, Okla., Department of the Air Force.....	B-146966	Feb. 17, 1966
Prices negotiated on selected contracts for ammunition and weapon components, Department of the Army.....	B-157535	Apr. 21, 1966
Procurement of thrust vector control nozzles for the Minuteman missile program, Department of the Air Force.....	B-146876	Sept. 30, 1966
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.....	B-39995	Jan. 16, 1967
Survey of reviews by the Defense Contract Audit Agency of contractors' price proposals subject to Public Law 87-653, Department of Defense.....	B-39995	Feb. 15, 1967

Issued to committees of the Congress (1 report):

Organization and functions of the Defense Contract Audit Agency (House Committee on Government Operations).....	B-159724	Oct. 18, 1966
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Issued to the Secretary of Defense (36 reports):

Prices negotiated with—

Foster Wheeler Corp.....	B-146733	Jan. 6, 1966
Lockheed Aircraft Corp.....	B-146966	Jan. 11, 1966
TRW, Inc.....	B-146983	Mar. 7, 1966
The Boeing Co.....	B-146876	Mar. 16, 1966
Ford Instrument Co.....	B-132973	Mar. 25, 1966
Martin-Marietta Corp.....	B-146970	Mar. 30, 1966
Westinghouse Electric Corp.....	B-158567	Mar. 30, 1966
Lockheed-Georgia Co.....	B-158626	Apr. 5, 1966
Honeywell, Inc.....	B-158759	Apr. 5, 1966
The Boeing Co.....	B-146876	Apr. 15, 1966
Honeywell, Inc.....	B-146761	Apr. 19, 1966

[Attachment I]

Reports issued by the General Accounting Office in period Jan. 1, 1966, through Feb. 28, 1967, on matters relating to procurement in the Department of Defense

Negotiation of prices (42 reports)—Continued		Report No.	Date
Issued to the Secretary of Defense (36 reports)—Continued			
Prices negotiated with—Continued			
Radio Corp. of America	B-146982	Apr. 27, 1966	
The Boeing Co.	B-146717	Apr. 27, 1966	
Southern Pacific Pipe Lines, Inc.	B-153467	Apr. 27, 1966	
General Electric Co.	B-156521	Apr. 27, 1966	
Radio Corp. of America	B-158940	Apr. 27, 1966	
Eitel-McCullough, Inc.	B-146967	Apr. 28, 1966	
Lockheed-Georgia Co.	B-158626	May 5, 1966	
The Frank G. Hough Co.	B-159128	May 16, 1966	
Newton-New Haven Co.	B-157535	May 17, 1966	
Honeywell, Inc.	B-146761	May 23, 1966	
Do.	B-158846	June 8, 1966	
Eastman Kodak Co.	B-133149	July 8, 1966	
Holley Corp.	B-146876	July 14, 1966	
Arde-Portland, Inc.	B-153545	July 14, 1966	
General Dynamics Corp.	B-146876	July 19, 1966	
The Boeing Co.	B-146956	Aug. 3, 1966	
Sparton Corp.	B-146705	Sept. 8, 1966	
The Boeing Co.	B-146876	Sept. 26, 1966	
Radio Corp. of America	B-160044	Sept. 26, 1966	
Atwood Vacuum Machine Co.	B-146966	Oct. 3, 1966	
Lockheed-Georgia Co.	B-125074	Oct. 13, 1966	
Bell & Howell Co.	B-133037	Dec. 14, 1966	
Lockheed-California Co.	B-146761	Jan. 12, 1967	
Honeywell, Inc.	B-39995	Dec. 21, 1966	
Compliance with pricing requirements of Public Law 87-653			
Administration of contract terms and conditions (36 reports):			
Issued to the Congress (5 reports):			
Need for postaward audits to detect lack of disclosure of significant cost or pricing data available prior to contract negotiation and award, Department of Defense	B-158193	Feb. 23, 1966	
Royalties charged to Government for use of chemical milling inventions by Government contractors, Department of the Air Force	B-133386	Apr. 12, 1966	
Selected overhead costs charged to Government contracts by the Univac Division of Sperry Rand Corp., St. Paul, Minn., Department of Defense	B-146962	Apr. 21, 1966	
Charges to Defense contracts for use of company-operated and chartered aircraft, Department of Defense	B-146948	Aug. 9, 1966	
Price increases under shipbuilding contracts, Department of the Navy	B-159206	Dec. 5, 1966	
Issued to committees of the Congress (1 report):			
Subcontracting operations of prime contractor for production of F-4 aircraft (House Committee on Appropriations)	B-152600	Mar. 31, 1966	
Issued to Members of the Congress (6 reports):			
Costs to Government resulting from a contractor's default (Congressman Young)	B-152598	Feb. 3, 1966	
Typing services furnished by a contractor (Congressman Teague)	B-158840	May 19, 1966	
Investigations, of specific instances of delays by the Government in payment of contractors' invoices; requested by—			
Senator Case	B-159444	Sept. 2, 1966	
Senator Douglas	B-160188	Nov. 23, 1966	
Congressman Reinecke	B-160322	Jan. 12, 1967	
Special tooling sold to and repurchased from a contractor (Senator Russell)	B-160777	Feb. 10, 1967	
Issued to the Secretary of Defense (24 reports):			
Administration of contracts with—			
Republic Aviation Corp.	B-156639	Jan. 18, 1966	
International Latex Corp.	B-158141	Jan. 24, 1966	
General Electric Co.	B-146732	Jan. 28, 1966	
Do.	B-156521	Feb. 4, 1966	
Do.	B-156313	Feb. 14, 1966	
Sperry Rand Corp.	B-157929	Feb. 18, 1966	
Lockheed Missiles & Space Co.	B-133386	Mar. 2, 1966	
Douglas Aircraft Co.	B-133246	Mar. 25, 1966	
Martin-Marietta Corp.	B-132992	Mar. 29, 1966	
International Business Machines Corp.	B-125092	May 16, 1966	
Bath Iron Works	B-159206	June 22, 1966	
Various contractors	B-146919	June 28, 1966	
Sperry Rand Corp.	B-157691	June 29, 1966	
Ingalls Shipbuilding Corp.	B-146751	July 1, 1966	
North American Aviation, Inc.	B-146876	July 14, 1966	
Zenith Radio Corp.	B-157900	Sept. 8, 1966	
Various contractors	B-159312	Sept. 21, 1966	
Lockheed Missiles & Space Co.	B-160095	Oct. 18, 1966	
Various contractors	B-146748	Nov. 9, 1966	
Thiokol Chemical Corp.	B-146897	Nov. 29, 1966	
Global Associates	B-152598	Dec. 2, 1966	
The Boeing Co.	B-146876	Dec. 27, 1966	
Hercules Inc.	B-146876	Feb. 2, 1967	
United Aircraft Corp.	B-146900	Feb. 28, 1967	

SUMMARY OF REPORTS ISSUED

Addressee	Reports issued	Subject of reports		
		Procurement practices	Negotiation of prices	Administration of contract terms and conditions
Congress.....	19	9	5	5
Committees of Congress.....	4	2	1	1
Members of Congress.....	13	7	-----	6
Secretary of Defense.....	80	20	36	24
Total.....	116	38	42	36

[Attachment II]

REPORTS IN PROCESS AT FEBRUARY 28, 1967, ON MATTERS RELATING TO
PROCUREMENT IN THE DEPARTMENT OF DEFENSE*Procurement practices (9 reports)*

Potential savings through direct procurement of metal parts for production of ammunition, Department of the Army (report issued to the Secretary of Defense in March 1967, B-157535).

Biservice logistics support planning for the F-111 aircraft weapon system, Department of Defense (report issued to the House Committee on Appropriations in March 1967, B-153545).

Selection of instruments for use in Army aircraft.

Higher prices paid for sonobuoys to maintain production base not needed for mobilization purposes, Department of the Navy.

Procurement of equipment and gasoline by contractors operating Government-owned ammunition plants, Department of the Army.

Leasing of buildings and land by a Government contractor, Department of Defense.

Potential savings through direct procurement of petroleum products for use by certain contractors, Department of the Navy.

Procurement of technical manuals, Department of Defense.

Overhaul of USS Shangri-La.

Negotiation of prices (9 reports)

Prices of missile fuel, Department of the Air Force.

Target prices of Minuteman incentive contracts, Department of the Air Force.

Prices of spare parts for CH-47A helicopters, Department of the Air Force.

Prices of electronic tubes, Department of Defense.

Prices of nuclear submarine propulsion systems, Department of the Navy.

Prices of special tooling, test equipment, and design changes for Minuteman program, Department of the Air Force.

Prices of wing beam assemblies for C-141 aircraft, Department of the Air Force.

Prices of jet aircraft engine airfoils, Department of the Air Force.

Effect of application of weighted guideline principles on profits paid to contractors, Department of Defense.

Administration of contract terms and conditions (5 reports)

Administration of contracts for the production of portable ice cream plants, Department of Defense (report issued to the Secretary of Defense in March 1967, B-160230).

Controls over maintenance of commonality between the Air Force and Navy versions of the F-111 aircraft, Department of Defense (report issued to the House Committee on Appropriations in March 1967, B-153545).

Acquisition of technical data for the F-111 aircraft program, Department of Defense (report issued to the House Committee on Appropriations in March 1967, B-153545).

Costs of bidding and related technical efforts charged to Government contracts, Department of Defense (report issued to the Congress in March 1967, B-133386).

Allocation of engineering expenses to Government contracts, Department of the Navy.

SUMMARY OF REPORTS IN PROCESS

	<i>Reports</i>
Procurement practices (including 2 reports issued in March 1967) -----	9
Negotiation of prices -----	9
Administration of contract terms and conditions (including 4 reports issued in March 1967) -----	5
Total -----	23

[Attachment III]

DEFENSE DIVISION

PROCUREMENT ASSIGNMENTS IN PROCESS CATEGORIZED BY AREAS OF MAJOR INTEREST

Coordination with Defense Organizations and Development of Information on Procurement Matters (3)

Survey of procurement practices of the Department of Defense and its Military Departments—negotiated procurements.

Survey of procurement practices of the Department of Defense and its Military Departments—advertised procurements.

Survey of Department of Defense procurement policy and management activities.

Decisions Before Solicitation of Bids or Proposals (3)

Review of additional costs to Government cost-type contracts due to General Electric's leasing of plant, equipment, and furnishings at its Missile and Space Division.

Review of intracompany purchases of materials for HAWK missile system contracts by the Raytheon Company.

Review of noncompetitive procurement of aeronautical spare parts.

Solicitation and Evaluation of Bids or Proposals and Contract Awards (9)

Review of pricing and administration of contract with General Electric Company for conversion and rehabilitation of AN/FPS-6 radar sets.

Review of procurement of anthracite coal by the U.S. Army in Europe for Fiscal Years 1962 through 1967.

Review of contract activities at Food and Machinery Corporation, Northern Ordnance Division.

Review of ship repair and ship conversion activities of the Department of the Navy.

Review of the evaluation of negotiated prices of contracts awarded under the provisions of Public Law 87-653.

Survey of negotiated contracts at World Tool and Engineering Company, Division of National Presto Industries, Inc.

Review of lease versus purchase of facilities and equipment by contractors and subcontractors working primarily on Government contracts.

Review of small purchases within the Department of Defense.

Survey of fixed-price contracts for the repair and/or replacement of subsystems and components.

Contract Administration Including Contractors Performance and Contract Termination (16)

Review of the prices established for 404M transistors produced by Radio Corporation of America for the Minuteman missile program.

Review and analysis of Air Force contracts by individual contractors.

Review of pricing and costs of forgings supplied under purchase orders issued by subcontractors or prime contracts on defense procurements.

Preliminary review of target costs and requirements for technical publications provided under fixed-price-incentive contracts awarded to General Electric Company, Small Aircraft Engine Department, during calendar years 1962 through 1965.

Preliminary review of target costs and requirements estimated for field service provided under fixed-price-incentive contracts awarded to General Electric Company, Small Aircraft Engine Department, during calendar years 1962 through 1965.

Review of overhead costs paid by the Government to Wentworth Institute under Air Force research and development contracts.

Survey of research and development contract activities.

Survey of Government contracts at General Electric Company, Light Military Electronics Department.

Survey of Government contracts at General Electric Company, Avionic Controls Business Section, Light Military Electronics Department.

Review of the adequacy of technical data for competitive procurement of aeronautical spare parts.

Study of access to records problems with defense contractors and sub-contractors.

Review of the functions and management of the Defense Contract Administration Services (DCAS).

Review of the control and use of Government owned property in the possession of contractors.

Survey of value engineering.

Survey of problem areas in audit and administration, including retention of records, of cost reimbursement contracts.

Evaluation of policies and practices of DOD, NASA, and AEC for allowing general and administrative (G&A) charges to contracts performed at GOCO plants.

Examination of Various Aspects of Individual Procurement Actions or Major Procurement Programs (3)

Review of the procurement of ground handling equipment for the F/RF-4C aircraft.

Review of the F-111 aircraft program (Requested by Chairman, Senate Permanent Subcommittee on Investigations, Committee on Government Operations).

Review of the F-111 aircraft program (Requested by Chairman, House Committee on Appropriations).

In addition to the above assignments, we have 38 survey and review assignments currently being performed primarily at contractors' plants. We expect to devote about 13,000 man-days to these assignments during the current six-month's period ending June 30, 1967. These surveys and reviews cover various aspects of procurement including pre-award considerations, price negotiations, contract administration, and contractor performance and encompass a number of major defense contracts. It is our objective in these assignments to identify those areas requiring management improvement and the means of accomplishing such improvement.

Mr. HARDY. The GAO, by reason of its years of experience in the examination and study of Government procurement problems, has developed an unsurpassed expertise in this field and we want to make full use of this congressional asset.

In pursuing this study, we will use pertinent GAO reports, plus those which become available during the course of our study. In addition, that agency will be requested to explore ways of tailoring their normal audit and review functions to meet the requirements of this study or to examine matters of special interest to the subcommittee.

Preliminary to the establishment of an agenda, we have asked Mr. Elmer B. Staats, Comptroller General of the United States, to meet with us today to give us the benefit of his views on this undertaking and to tell us how he will approach this matter, indicating any foreseeable problem areas and, in such cases, suggesting possible solutions or alternatives.

Mr. Staats, I am delighted that your schedule would permit you to be here today, and I hope you can tell us how we can make the best use of your agency in arranging a series of hearings which will result in a sufficiently broad review of Defense procurement policies and practices to permit us to make valid judgments and appropriate recommendations.

I want to welcome also this group of GAO personnel. I understand you have quite a bunch of your supporters back there. It is nice to have your rooters here, but aside from that I would like to express a personal welcome to all of them, and I hope they find this hearing informative as well as interesting.

Mr. Staats, we are particularly pleased to have you. You have a prepared statement, I believe.

Mr. PIKE. Mr. Chairman, if I may—before Mr. Staats proceeds—I would simply like to join in your remarks about my high regard for the operations of the GAO. I couldn't be more serious. If there is an organization which has done a responsible and responsive job for Congress better than the GAO I have not met it.

I only hope, Mr. Staats, that the reason that you have brought all these younger troops with you today is not to discourage them from becoming career people in the GAO by pointing out that they, too, may some day have to appear before congressional committees, and this is one of the more onerous parts of your job.

Mr. HARDY. Mr. Staats doesn't find us the least bit scary, but I do appreciate your comments, Mr. Pike. You have expressed the feeling of all of us.

I am sure Mr. Gubser and Mr. Pirnie likewise share these views.

Mr. GUBSER. Yes, sir.

STATEMENT OF HON. ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES, ACCOMPANIED BY FRANK H. WEITZEL, ASSISTANT COMPTROLLER GENERAL; ROBERT F. KELLER, GENERAL COUNSEL; AND C. M. BAILEY, ASSISTANT DIRECTOR, DEFENSE DIVISION, GENERAL ACCOUNTING OFFICE

Mr. STAATS. Thank you very much, Mr. Chairman, for your remarks about the General Accounting Office. In the year and a half that I have been with the GAO, I have come to share, even more than previously, the high regard which you and Congressman Pike have expressed with respect to our staff. I know I speak for all of our staff in saying that we appreciate very much the kind of support we get from you gentlemen whom we try to serve.

I do have a prepared statement, Mr. Chairman, and with your permission I will read the statement. If you care to interrupt for questions at any point, I hope you will feel free to do so.

Mr. HARDY. Mr. Staats, if you will proceed with your statement, I think if we can refrain from questions—although I don't believe we can—I believe in the interest of time it might be better if we did. We will at least try.

Mr. STAATS. I appreciate the invitation to appear before your subcommittee today concerning your interest in improving the system of procurement in the Department of Defense.

The importance of your subcommittee's interest is overwhelmingly clear. Total military procurement in fiscal year 1967; that is, funds obligated for contracts, amounted to about \$45 billion, an increase of \$6.8 billion, or about 18 percent, over that of fiscal year 1966. Fiscal year 1968 estimates are not yet firm; however, Defense sources have indicated that the level of procurement during 1968 will probably

parallel that of 1967. Department of Defense officials estimate that Defense procurement represents about 80 percent of the total Governmentwide procurement.

I would like to present some of the more significant work of the General Accounting Office during the past 18 months in the area of Department of Defense procurement, to apprise you of some of the work we have under way, and to summarize our future plans.

Over the years the GAO has devoted a very considerable part of the time of its audit and legal staffs to the procurement field, particularly in the Department of Defense and the military departments. In performing this work, GAO has examined into many major areas of military procurement.

Of our audit staff of 2,200 in Washington and the field, approximately 1,100, or 50 percent, were assigned to Defense work for the 6-month period January 1 to June 30, 1967. Of the 1,100 staff members, about 275 were assigned to the Defense procurement and contracting area, and about 130 were assigned to supply management which in many respects is closely related to the procurement function.

This allocation of audit time was made after careful consideration of our overall accounting and auditing responsibilities in all areas of Federal expenditures. Approximately the same level of audit time for Defense procurement has been allocated for the 6-month period July 1 to December 31, 1967.

In addition, our Legal Division provides important services in the Defense procurement area. Decisions are rendered on the legality of agency procurement actions, rulings are issued on bid protests, legal reviews are made of our audit reports, and reviews are made of proposed Defense procurement regulations.

In the area of procurement, our underlying reporting policy is to report to the Congress any significant information obtained during our work which we believe or know to be of interest to Congress.

We have no rigid rules for determining significance when deciding whether a report should be addressed to the Congress. Generally, congressional reports are prepared—

- To communicate recommendations for legislative action;
- To show agency policies, procedures, and practices that are not in conformity with the intent of laws;
- To furnish our findings on new or broad problem areas involving significant costs or ineffective administration;
- And for other important reasons, on a case-by-case basis.

From January 1, 1966, through June 30, 1967, GAO issued 241 reports in the Defense procurement area. Of these, 21 were sent to Congress; 21 to committees of the Congress; 21 to Members of Congress; 90 to the Secretary of Defense; and 88 to local procurement officials.

Reports to the Secretary of Defense and local procurement officials are made on matters not deemed to be of immediate interest to the Congress. The contents of these reports, however, are reviewed periodically to identify matters for possible summary reporting to the Congress. A list of these reports is included in our annual report to the Congress.

The reports issued during the period January 1, 1966, through June 30, 1967, include the reports of our work in the areas of the negotiation of contract prices, Defense procurement practices and procedures, and

the administration of contract terms and performance. With regard to the weapons systems area, we have reported on several matters to the House Appropriations Committee associated with the planning, development, and production of F-111, F-4, and A-7 aircraft procurement programs.

Mr. Chairman, we would like to now discuss a number of these reports as well as some that are now in process. Initially, I will discuss our reports dealing with Public Law 87-653, enacted as a result of this subcommittee's extensive reviews of the negotiation and pricing of Defense contracts.

The Truth in Negotiations Act, Public Law 87-653, effective December 1, 1962, requires submission of cost or pricing data and certificates prior to the award of certain negotiated contracts and subcontracts expected to exceed \$100,000.

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 if the price is increased because the cost or pricing data submitted were inaccurate, incomplete, or noncurrent.

On January 16, 1967, we issued a report to the Congress on the first phase of our review of the extent that agency officials were complying with the intent of Public Law 87-653 in obtaining cost information and certificates in the award of 242 negotiated prime contracts and subcontracts.

We found in a total of 185 cases where certified cost or pricing data were required that, in 165 of these cases—102 prime contracts and 63 subcontracts—DOD officials and prime contractors had no record identifying the cost or pricing data submitted and certified by the contractors in support of significant cost estimates.

If data are not made a matter of record the Government's rights under the defective-pricing-data clause may be impaired since, in such cases, it may be impracticable for the contracting officer to establish that defective data were relied on in the negotiation.

The remaining 57 of the 242 contracts examined were considered by contracting officials to be exempt from the requirement for submission of cost or pricing data under the exceptions contained in the law.

In these cases, the procurement records, in our opinion, did not contain sufficient information to substantiate the correctness of these determinations.

In its reply to our report, DOD stated that a special group had been appointed to study the report. In May 1967, the Department submitted to us for comment proposed changes in its procurement regulations.

A draft report on the second phase of this review was issued on June 15, 1967, to the Secretary of Defense for comment. In this phase we evaluated the basis for establishing the prices of 127 negotiated prime contracts.

These 127 contracts included 101 contracts where certified cost or pricing data were required. In 33 of the contracts we believe agency officials would have had a sound basis for negotiating prices, lower by \$3.2 million, if they had obtained and/or appropriately evaluated information available to the contractor.

In addition, our report notes other procurement procedures and practices which, although not measurable in terms of increased costs

to the Government, in our opinion, require corrective action to adequately safeguard the Government's interest and provide a basis for negotiating fair and reasonable prices.

We have also reported our findings on each of the contracts examined to the responsible agency officials for their comments and corrective action. In total, we issued 67 letter reports which set forth several types of deficiencies in procedures and practices relating to the negotiation of the contracts.

We have also submitted a report to the Congress on the need to improve compliance with the intent of Public Law 87-654 in the award of contracts for construction work. On June 19, 1967, we reported that, in our examination of 237 contract actions, sufficient cost or pricing data in support of contractors' proposals, as required by law, were not obtained on 187 of these actions.

A primary reason for the agencies' not complying with the law appeared to be their belief that the law and regulations were not applicable to construction contracts, since contractors' proposals were evaluated on the basis of comparisons with Government estimates.

In a letter dated July 29, 1967, the Assistant Secretary of Defense for Installations and Logistics outlined several constructive steps which have been taken or are in process to strengthen the administration of the Truth in Negotiations Act.

We appreciate the response which has been made by the Department of Defense to our reports on this subject, and we will offer what constructive suggestions we can based on the wide experience of our own staff. In particular, we will be working closely with the Defense Department in resolving the very difficult issue as to the extent of documentation required to provide evidence that the contractors' known costs were in fact provided to the contracting officers in negotiated contracts where the law is applicable.

Because of the importance of the subject, I am attaching to this statement a copy of the July 29 letter from the Department of Defense.

On February 23, 1966, we issued a report to the Congress containing examples of negotiated contract prices that were higher than warranted on the basis of information available to contractors, which was not made known to Government negotiators. We stated that such undisclosed information may not be detected by a preaward audit of the contractors' records, but could be detected by a postaward examination. Under firm fixed-price negotiated contracts, however, agency representatives did not have the right to examine contractors' records of performance and incurred costs.

We recommended that the Secretary of Defense consider revising the Armed Services Procurement Regulation to require that a clause be included in all contracts negotiated on the basis of certified cost or pricing data granting agency officials the right to examine all data, including cost of performance, considered necessary for verifying that the data submitted and used in establishing the contract price were accurate, complete and current.

The Assistant Secretary of Defense (Comptroller) advised us that DOD agreed that there is a need for regularly scheduled postaward audits, that steps were being taken to implement our proposals, and that we would be informed of the results of actions taken. Department of Defense officials expressed the belief that access to contractors'

records could be provided contractually. Also, they pointed out that a congressional committee had reported that this probably should be a matter for consideration by the Congress.

Both Senator Proxmire and Congressman Minshall recently introduced bills to provide authorized agency representatives the right to examine all data related to the negotiation, pricing, or performance of contracts or subcontracts under which cost or pricing data are required.

Turning next to the need to strengthen reviews of Defense Contract Audit Agency, our report of February 15, 1967, on the operations of the Defense Contract Audit Agency concerned the need to strengthen DCAA's review of contractors' price proposals. Specifically, the report dealt with the need for:

A DOD program to assist DCAA in carrying out its responsibility for review of contractors' estimating systems for price proposals;

Action to insure adequate scope of review by DCAA of contract price proposals;

Procurement activities to feed back information to DCAA on results of negotiations and on how its audit services can be made more useful; and

More effective means by which to deal with DCAA access-to-records problems.

Although there has been some progress by contractors in improving and formalizing their estimating systems, DOD and GAO surveys show that further substantial improvements are necessary. For example, at many of the 19 locations included in our survey the contractor did not have formalized procedures, or they provided only limited guidance, for estimating basic elements of cost.

We brought this need to the attention of Defense officials in a preliminary report and in a special briefing in November 1966. In January of this year, the Department released a Defense Procurement Circular providing policy guidance to procurement officials and auditors as well as criteria for determining acceptable cost estimating systems. It was followed by a change to the ASPR in February 1967.

We consider the actions taken by DOD with respect to our recommendations to be responsive. Appropriate follow-through to determine that the corrective measures are properly applied will, of course, be necessary to obtain the desired results.

The next item involves the pricing of propulsion system for use in nuclear submarine.

We are currently processing a report involving the pricing of a propulsion system for use in a nuclear submarine. We expect to issue our report to the Congress during August 1967.

The report will illustrate how the Government can incur additional costs if significant cost or pricing data are not disclosed during contract price negotiations as required by Public Law 87-653.

In this case, a significant portion of the cost data which the contractor furnished to the Navy and certified as being accurate, current, and complete was based on processing certain castings in the contractor's own plant. We noted, however, that prior to the date that the negotiations were concluded, the contractor had requested, and received, price quotations from other suppliers for fully processed cast-

ings. Shortly after price negotiations were concluded, the contractor purchased fully processed castings from the suppliers at essentially the same prices as were quoted to it earlier.

These quotations were not disclosed to the Navy during price negotiations, even though the amounts quoted were substantially less than the amounts the contractor had included for fully processed castings in its price proposals. Thus, in our opinion, the Government did not have an opportunity to negotiate a potential reduction, which we estimate to be about \$564,000. This amount represents about half of that portion of the negotiated price related to these castings.

The Navy stated that action would be taken for recovery of an appropriate amount.

The next item has to do with the noncompetitive procurements.

We have been concerned for some time with the need to increase the extent of competition in military procurements. Highlights from some of the reports we have issued or plan to issue in this area are as follows:

Our report to the Congress on April 24, 1967, presented our findings on a review of facility construction and production contracts for critically needed missile fuel purchased from a sole-source supplier.

We reported that the Air Force acquired a \$15.6 million production plant that is completely surrounded by contractor property on which the Government has easement rights for access roads, utilities, and disposal facilities. Although the location of the fuel production plant resulted in economies in initial construction costs, it strengthened the contractor's position as the sole-source supplier.

With regard to the fixed-price production contract, we reported that certain of the contractor's costs were estimated primarily on its production experience at another plant where only limited quantities of the fuel were produced.

Other costs were estimated on the basis of anticipated performance at the new Government plant even though the contractor had no prior experience with the new production processes or the equipment to be used. The Air Force agreed to this arrangement because it considered it imperative to establish promptly a source for volume production of this fuel and because it believed this contractor to be the only one capable of satisfying the requirements in the time available.

In performing this production contract which eventually totaled \$28 million, the contractor realized a profit of \$9.2 million, or the equivalent of about 49 percent on total costs of \$19 million. This profit does not include an additional profit which we estimate at \$1.8 million that the contractor realized in the price of raw materials supplied by its own chemical plant.

We were advised that the Air Force could not have taken an alternative action and still have met its critical requirements. However, we believe our findings exemplify the high costs and other undesirable conditions military departments feel they are compelled to accept in situations where there is only one source capable of furnishing urgently required items for high-priority programs.

The next item has to do with the pricing of jet engine parts produced by Navy and Air Force prime contractors.

Our limited review of procurements of selected parts has indicated a need for strengthening the procedures used by certain prime contrac-

tors in awarding subcontracts and by the agencies in approving these subcontracts.

In 1963 and 1964, three Government prime contractors awarded a subcontractor at least 62 subcontracts for parts on a noncompetitive basis at prices totaling about \$20 million. This subcontractor is industry's largest independent supplier of jet engine parts.

The Government owns over 75 percent of the facilities and special tooling the company uses to produce jet engine parts. One of the facilities, an 8,000-ton precision mechanical forge press, is the only facility of its kind in the Government's equipment inventory. The Government has furnished the company's competitors with a relatively smaller number of mechanical presses and other production equipment and they have only limited precision forging capability.

We found that the prime contractors negotiated prices with the subcontractor either without requesting or obtaining certified cost or pricing data, or without evaluating the reliability of such data in those instances where data were furnished.

We found that prices totaling \$5,928,000 on 16 subcontracts awarded in 1963 and 1964 were about \$1,317,000, or 28 percent higher than costs the subcontractor had experienced on its most recent prior orders for identical parts. The pricing of these subcontracts was discussed with local Navy and Air Force officials and the prime contractors. Certain corrective actions were initiated. In addition, the subcontractor made a voluntary reduction of \$322,570 in the prices of three of the subcontracts we reviewed.

We could not examine into the prices of an additional 88 noncompetitive awards totaling about \$24.6 million made in 1963, 1964, and 1965 because the subcontractor contended that the awards were made under a "threat of competition" and denied us access to pertinent cost records. It is expected that this report will be issued to the Congress in November 1967.

The next item has to do with a survey of competition in procurement of aeronautical spare parts.

In 1961 and in 1963, we issued reports to the Congress on the procurement of aeronautical spare parts and the matters reported upon were discussed in hearings before this subcommittee.

Our recent survey covered about \$2 billion of aeronautical spare parts bought in fiscal year 1966 by four major purchasing centers. We found that the Department of Defense and the military services have programs that place increased emphasis on achieving competition. However, many of the problems identified in our previous work still prevail. A draft report on our survey was sent to DOD for comment on May 4, 1967, and we have not yet had a reply.

Our tests of \$174 million in procurements classified as noncompetitive showed that about \$103 million, or 59 percent, was purchased noncompetitively because of determinations that technical data were either not adequate or not available. For example: In March 1966, the Army awarded a contract valued at almost \$150,000 to a prime contractor for 879 filters for use on a helicopter.

This noncompetitive award was made on the basis that it was impossible to draft adequate specifications for competitive procurement of the part in the time allowed for the procurement.

We found that adequate technical data to support a competitive procurement was on hand. When we advised the contracting officer

of this fact, he canceled the contract and solicited bids from three companies. Two responded and a new contract was awarded at a saving of about \$69,000.

Other principal reasons given by the centers for awarding contracts without competition, although not nearly as predominant as inadequate technical data, included critical manufacturing techniques, urgency of requirement, and administrative expediency relative to awards of \$2,500 and under.

About \$425 million, or 21.5 percent, of the procurements made by the four purchasing centers was reported to have been purchased competitively. Of this amount \$114 million were advertised and \$311 million were classed as competitive negotiation.

Our review indicated that a large percentage of the actions which were classified as competitive procurements were, in our opinion, made without competition. It seems inappropriate to classify actions such as the following examples as competitive procurement actions.

A prime contractor and a vendor were requested to bid on May 12, 1966. The vendor responded with the low bid, and the bid of the prime contractor was based on procuring the item from the vendor and adding a markup.

On March 1, 1966, a prime contractor and a vendor were requested to bid; however, only the vendor quoted a price. The prime contractor advised the agency that company policy precluded it from entering into competition with its vendors, because it could not successfully compete against the actual manufacturers.

In another case, 14 firms were solicited. Only one firm responded and received the award on June 15, 1966. The procuring activity did not determine whether the other 13 firms solicited were qualified to bid. Further, two firms which previously supplied the item were not solicited.

The primary cause for misclassifying procurements as having been awarded on the basis of price competition appears to stem from the criteria in the Armed Services Procurement Regulation. The regulation permits a contract award to be classified as competitively priced, even when only one response is received, as long as two or more proposals were solicited and the accepted proposal meets certain other evaluation tests.

In addition, the regulation permits purchases in the amount of \$2,500 and under to be reported as competitive even though many are not competitive. The four purchasing centers reported in fiscal year 1966 a total of about \$80 million of procurement actions involving amounts of \$2,500 and under as being awarded on the basis of price competition. Of the total amount, however, an estimated \$55 million of purchases, or 69 percent, represented noncompetitive procurement.

After these matters were brought to their attention, DOD officials advised us that a reappraisal of the Department's reporting rules and procedures would be undertaken to insure that its competitive procurements would be accurately reported.

DOD has recently advised us of proposed changes in its reporting criteria which are intended to result in substantial improvement in the classification of procurement actions. Our initial review of the proposed changes indicates that a constructive effort is being made to correct the reporting problems disclosed in our survey.

Turning to the area of contract administration, the manner in which the military departments administer their contracts is also a matter of prime concern. A brief résumé of our recent work in this area follows.

We have completed a survey of some of the major activities of the consolidated Defense Contract Administration Services. We recognize that the establishment of a consolidated contract administration agency within DOD is a tremendous undertaking. Much has been accomplished in a relatively short period.

During our survey, however, we noted a number of areas which, we believe, warrant further management attention. These areas include (1) military departments' retention of plant cognizance and contract administration functions, (2) elimination of delays in payment of contractors' invoices and loss of cash discounts, (3) agency efforts to anticipate and minimize delinquencies in contract deliveries, (4) agency technical evaluations of contractors' price proposals, and (5) agency efforts to eliminate unneeded quality assurance inspection requirements imposed by procuring activities.

Turning next to the controls over Government property in hands of contractors, in a report released in May 1966, the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee recommended that the General Accounting Office cooperate with DOD in the development of an adequate contractor inventory accounting system and that a thorough review be made of any misuse or unauthorized use of Government property in the hands of contractors.

The records of the DOD indicate that Government-owned facilities and material in the possession of contractors approximate a value of \$11 billion, located at about 5,500 plants. This does not include the value of special tooling, special test equipment, and military property, since the Department does not require contractors to report the value of such property in their possession.

We found that there is a need to improve the system of property controls over Government-owned facilities, special tooling, and material in the possession of contractors. Generally, our review disclosed weaknesses with regard to effective utilization of industrial plant equipment, rental arrangements and accounting for and control of special tooling and material. Further, we found that certain aspects of the work of Government property administrators and internal auditors were in need of improvement.

With respect to utilization of Government-owned property, we were unable to determine the usage of equipment at many contractor plants that we visited because most property accounting systems did not include utilization records. At certain locations where limited utilization records were maintained, we questioned retention by contractors of 328 items of industrial plant equipment costing an estimated \$15.9 million. We questioned retention where little or no use had been made of the equipment over an extended period of time, or where 75 percent or more of the equipment use had been for commercial work.

None of this equipment had been reported as idle and available for relocation. Further, our examination of records at the Defense Industrial Plant Equipment Center revealed that 81 of the items we questioned were in critical or short supply at other locations.

We found a lack of uniformity in the rates charged the contractors for rental of Government-owned equipment. In some cases, this re-

sulted in inequities among contractors. We also found cases where negotiated rentals were below the prescribed rates.

We have proposed a number of recommendations for improvements in controls over Government-owned property in possession of contractors, and many revisions to the ASPR are in process to effect improvements. We will continue to cooperate with the Department in its efforts to implement the numerous changes to property regulations, which are now in process.

A draft report on our review was released to the DOD for comment on May 1, 1967, and again we are waiting for comment.

To turn, Mr. Chairman, to what you indicated in your opening remarks was your major interest today, our present and future plans for our procurement work, there are several ways in which we are now looking into the total system of procurement. I have seven specific comments on this, as follows:

First, one of the most important aspects in the system of procurement is the Armed Services Procurement Regulation which, as you know, prescribes uniform procurement policies and procedures for all Department of Defense purchases and contracts.

So that GAO has an opportunity to comment on proposed changes prior to their issuance, arrangements have been made with the Chairman of the ASPR Committee to send us all proposed changes to the ASPR which are sent to industry for comment. Our comments are usually furnished to the Committee within 60 days.

An important objective in our examination of various aspects of procurement is to evaluate and report on the manner in which the Department of Defense policies and procedures are being implemented. Examples of current GAO efforts to evaluate the ASPR policies and procedures include programs we have underway to review the Department of Defense value engineering program, and to review lease versus purchase practices of defense contractors.

Where, in our opinion, the basic causes of deficient procurement practices noted in our examinations could be attributed to inadequate regulations, we recommend changes. In many cases, recommended changes are accepted by DOD and corrective action is taken. Two cases in point are the ASPR changes mentioned previously in my statement concerning contractor estimating systems and administration of Public Law 87-653.

Second, a major portion of the Defense procurement budget will be spent in the procurement of weapons systems. We plan to review basic management concepts and techniques used in the acquisition of these major weapon systems with particular emphasis on advanced procurement planning. During this early period, when contract definition takes place, crucial decisions are made as to the performance, cost, and delivery of the weapon systems.

Other important areas involved in the procurement of weapon systems in which we will perform work are contract incentives and the relatively new management concepts of total package procurement and life cycle costing. These two concepts may have a considerable impact on procurement in the years to come.

Third, about 98 percent of all DOD procurement actions—some 14 million transactions—involve amounts under \$10,000. The bulk of the defense procurement personnel are engaged in making these procurements and dramatic breakthroughs are needed to reduce the procure-

ment workload. We plan to evaluate the procurement systems used where great volumes of small purchases are made as well as management decisions relating to:

Size and frequency of buys;

Automation of procedures;

Paper work routines; and

Their effect on administrative leadtime and each other.

Fourth, during the current Vietnam conflict the Department of Defense is following a policy of not building up high wartime inventories to avoid inflationary trends and substantial surpluses upon the termination of hostilities. The Defense Department is attempting to keep inventories at economic levels through close management attention to consumption, inventory, and production data.

We plan to review the DOD system for managing defense production in view of its potential impact on both the needs in Vietnam and on our own national economy. We also plan to review the effect of the DOD policy on the cost of the items being procured and the responsiveness of the supply system for the items.

Fifth, personnel recruiting, training, career development, and managerial selection provide the backbone for the success of procurement programs and greatly influence the competence of DOD contract negotiators. We plan, therefore, to give appropriate attention to this area in our future work.

Sixth, DOD expects to submit, in fiscal year 1968, to the General Accounting Office, for formal approval, procurement accounting systems for each DOD component. We plan to evaluate the systems and assist DOD in improving them to meet the principles and standards prescribed by our Office.

The next item has to do with Public Law 87-653, which I have already mentioned. In line with the subcommittee's continuing interest in all aspects of Defense procurement, we plan to continue our review, during fiscal year 1968, of selected contracts and subcontracts to evaluate the pricing of contracts, including compliance with regulations implementing Public Law 87-653 and the reasonableness of prices negotiated in relation to information available at time of negotiation and award. Our specific plans include evaluation of DCAA's progress in making postaward audits.

In addition, attention will be given to negotiated competitive contracts exempted from the cost and pricing data requirements of Public Law 87-653.

I have one other example, Mr. Chairman. As I emphasized, this is a selective list, not all inclusive, and one item I concluded to add to this list, particularly because of your interest in the recent helicopter review that the committee made, has to do with review of the contract definition technique, as it is called.

Because many years of valuable productive work are at stake, competition for R&D contracts has resulted in unrealistic salesmanship or buy-in bidding by contractors through overstating performance of the item and understating what the item would cost. This in turn led to performance disappointments, to budget disruption, to funding reallocations, and program stretchouts or cancellations.

During the contract definition phase introduced by DOD in the early 1960's, the contractor must develop the performance, delivery, and price factors for the desired weapon, and if he wins a development

contract these factors become contractual commitments that are subject to incentive features. The incentive features will reward or penalize the contractor to the extent that he varies from his contractual commitments.

We plan to give some special attention to the use of the contract definition technique in our future work in the procurement area to see what its full implications might be.

Mr. HARDY. If I may comment on that, Mr. Staats. Because of its importance, I am awfully glad that you brought that one up. This is a difficult area, it is a difficult one to understand and, as you point out we just recently issued a report on one such contract which unquestionably was a buy-in proposition.

I hope—and it is the reason I am bringing this up—that in your examination of that particular type of problem you will concern yourself with follow-on procurements, not only with respect to sole source, which results from this type of procedure, but also from the standpoint of trying to determine whether there is an actual, built-in recoupment of losses resulting from the buy-in.

Sometimes it has seemed to us—and this is something that I think we need to determine—that having established a sole source a fellow doesn't need any more protection against losses or to recover losses sustained in his buy-in, if he succeeds in establishing himself as a sole source.

Secondly, if in working out a contract, an initial contract, he has built-in change orders which permit him to recover any losses entailed in the buy-in, that is another nice, neat little possibility.

A third one is whether there might be follow-on contracts, not necessarily of the original item but of a related item or modified item, which would be of a sole-source nature, and which would permit recovery of any losses sustained in the initial contract plus, perhaps, some substantial profits.

Do you want to comment on that one, Mr. Pike?

Mr. PIKE. I would like to, Mr. Chairman, since you have brought up a subject very dear to my heart.

In this particular procurement on which the committee has issued a report and which we are all very interested in—and I know you are, too—there has now been a directive issued by the Secretary of the Army to the effect that there shall be a two-step competitive procurement of additional light observation helicopters, and an invitation for bidders' proposals will be sent out.

Now, in my opinion, this is a rather meaningless political exercise in that it offers to somebody who has not built the bird a chance to compete with somebody who is 1,100 helicopters down the production scale. Would this not, under current ASPR's, then qualify as a competitive contract?

Mr. KELLER. I think it is possible. I would like to refrain from a definite conclusion on that, but I think it is possible it would comply as a competitive contract.

Mr. PIKE. So they could then, having allowed two companies to bid on a helicopter that one company is currently building and has built a lot of, they can then claim that this was a competitive procurement at that stage, is that correct?

Mr. KELLER. I think that is correct, and probably even exempt from the price certification required by Public Law 87-653.

Further, if this is to be what we call a two-step procurement in its true sense, it might even be classified as a formally advertised procurement and therefore in that case you would have no cost information, you would have no right to look at their records later on.

Mr. HARDY. That makes it doubly interesting.

Mr. PIKE. I find that this is what is going on at the present time in this particular procurement, and we are going to keep an eye on that.

Again in this particular procurement, and in connection with your policy, Mr. Staats, of regulation and review, it is my further understanding that there is currently floating around—and whether it has been consummated yet or whether it is still in the negotiating stage, I don't know—something called a product improvement program on the bird which is to be conducted on a cost-plus-fixed-fee basis.

Now obviously, if it is necessary to do a great deal of product improvement on the light observation helicopter on a cost-plus-fixed-fee basis, this is a delightful way for a contractor who has bought into the procurement in the first place to get himself relatively healthy in a hurry.

Mr. STAATS. Your remarks reinforce the importance of our proceeding in this general area. I know we will want to work with the committee as we develop those studies.

Mr. HARDY. Very definitely they tie into it so completely that the question that comes to my mind—in view of Mr. Pike's comment—is, who is kidding whom?

We had a letter from the Secretary of the Army which announced rather proudly, I thought, and as a matter of fact, I confess that I was very pleased by it initially—

Mr. PIKE. It took me in, too, Mr. Chairman.

Mr. HARDY (continuing). Announced that he was going into a two-stage procurement of follow-ons, competitive procurement.

Now, if this turns out to be a device which merely gives the existing contractor all of the advantage so that nobody else can compete with him, I would hate to think that a Secretary of the Army was being led down this primrose path by somebody down the line. I almost felt myself being led down there by the Secretary of the Army, and I enjoyed it for a while.

I see Colonel Jones back there is enjoying this discussion. Would you like to testify on this?

Colonel JONES. No, thank you, Mr. Chairman.

Mr. STAATS. This substantially completes my statement, though there are two brief paragraphs I might read for the record.

Our overall objective is to explore all significant areas of procurement and to identify the areas that offer the most opportunity for constructive improvements in Defense procurement. To the extent that the problems identified are applicable to other Government agencies having a significant procurement function, we will, of course, perform our review work on a Government-wide basis.

In order that our services may be of maximum benefit to the subcommittee, we will keep you informed of the progress we are making in these areas and participate in any further hearings you may wish to hold. We welcome any suggestions you may have as to priorities or other areas which should receive the attention of our Office.

(The attachment to Mr. Staat's statement reads as follows:)

ASSISTANT SECRETARY OF DEFENSE,
Washington, D.C., July 29, 1967.

HON. ELMER B. STAATS,
Comptroller General of the United States,
General Accounting Office,
Washington, D.C.

DEAR ELMER: I have been concerned, as you know, about a rather widespread misinterpretation of some of the points raised in your recent reports and draft reports related to Department of Defense implementation of Public Law 87-653.

Your reports have identified some specific instances wherein improvements could be made in our implementation procedures. We appreciate these constructive suggestions and want to assure you that we are taking prompt and vigorous action to realize all possible benefits from adopting suggestions your staff has made.

As you know, the Defense Department supported the passage of PL 87-653. We felt then as now, that within the scope of its intended application, the government negotiator would be assisted by being brought more nearly on a par with the contractor in negotiating a proposed noncompetitive award. Our implementing coverage in the Armed Services Procurement Regulation (ASPR) was immediate. Additional coverage in ASPR was provided later together with appropriate forms to assist our personnel in the difficult implementation task. Special seminars were developed and given on this subject and coverage was incorporated into our Defense Procurement Training Program. Our Defense Procurement Management Reviews have given special attention to this subject. We have given recurring management emphasis through both our formal and informal channels of communications.

The subject is, as you know, very complex. We are of the opinion that we are in substantial compliance with the basic elements of the law. First, we are requiring contractors to submit cost or pricing data necessary to do an effective cost and price analysis. This data is being audited. It is being analyzed by functional specialists and by contracting officers as a basis for negotiating fair and reasonable contract prices, which is the primary purpose of getting this data in the first place. Second, we are requiring and obtaining certificates of cost or pricing data from contractors. Third, we are including clauses in contracts which give us the contractual right to request price adjustments from contractors in cases where it is subsequently determined that they did not furnish accurate, current, and complete data.

The central issue seems to revolve around the question of what kind of data is required for compliance with PL 87-653 and how best to assure that such data is readily identifiable and available in the contract file. Since such questions are reasonably subject to varying opinions, discussions between our senior staff members were considered useful in identifying issues and hopefully developing a mutually acceptable approach to this problem. Such meetings are proving fruitful and several points of agreement have already been reached. For example:

1. *Policy Guidance*—There was general agreement that the over-all policy contained in our ASPR is adequate. The ASPR revisions which have been developed as a direct result of your January report are currently being reviewed by your office and several industry associations. There was a general feeling that these revisions will further improve our policy guidance.

2. *Documentation*—Both our staffs are fully aware of the need for the adequate documentation of our contract files. They both understand the difficulty of achieving adequate documentation with respect to cost and pricing data in those types of noncompetitive contracts over \$100,000 to which the law applies. This is an area where additional effort is required on the part of Department of Defense personnel. There apparently was general agreement that, for data submission purposes under PL 87-653, it would be acceptable to document the contract files with a short narrative statement by the contractor explaining the factual basis underlying his cost estimates. We concur that such a narrative which would be the basis for the contractor's certificate would be perfectly adequate. I am hopeful that should this remedy be adopted, it would be found by your office to be satisfactory in future reviews of transactions involving this Public Law.

3. *Training*—It was the consensus that the current and planned intensification of our training effort is in the right direction. In addition to added emphasis in our regular training activities, we currently have underway the

development of a special one-day seminar devoted exclusively to PL 87-653. We plan to conduct this seminar at all of our major buying offices throughout the United States over the next several months. The special Procurement Management Review of current implementation of PL 87-653 now in progress will provide additional data for our training program. This subject will receive special emphasis in connection with a Department of Defense-wide conference which will take place in October. We have developed a "self help kit" which we plan to publish as soon as possible in a Defense Procurement Circular. Your staff has been most helpful to us in the development of this document.

In addition to all of these things, I have discussed this problem area on several occasions recently with the responsible Assistant Secretaries of the Military Departments. They are devoting a great deal of attention to the subject and the prospects of overcoming such remaining deficiencies as may exist are very favorable. Among other things, we have agreed to bring the requirements of PL 87-653 to the attention of our major contractors as we have found that part of the documentation problem stems from the form of contractor submissions.

I am encouraged by the progress made as a result of the interchange between our staffs and I believe our future course of action will produce beneficial results in the months ahead. I hope you will agree. Notwithstanding the progress that is being made, I believe it would be mutually beneficial to continue the staff discussions. Further, I would like to meet with you personally from time to time on this question until such time as we might mutually agree that all feasible steps are being taken to accomplish our mutual objectives.

Sincerely,

PAUL R. IGNATIUS,
Assistant Secretary of Defense
(Installations and Logistics).

Mr. STAATS. This concludes my statement, Mr. Chairman.

Mr. HARDY. Mr. Staats, the committee is deeply grateful to you. I am sure there are other questions coming up, and I knew you were about at the end of your statement before I interrupted you there, but it was on such an important point and it was one that was so fresh in my mind that I couldn't resist the temptation.

Mr. Pirnie, I believe, had some questions.

Mr. PIRNIE. It was a comment that was related to the subject then at hand.

I, for one, don't profess to be conversant with the various gimmicks that can be employed in order to defeat this purpose. This is just an illustration, and I would hope that our efforts would be devoted toward a study of the complete relationship so that we can put our finger on those practices which can lead to sidestepping competitive situations.

This illustration which has just been mentioned is one that, of course, is very dear to the heart of those who have tried to run down this particular project, and we would hate to have the impression created in our minds that instead of a constructive solution it has been white-washed through the introduction of a gimmick.

We are after both the relationship and the saving, and we welcome your suggestions as to how this can be best achieved.

Mr. STAATS. We feel, Mr. Pirnie, that the objective of the legislation on this subject—thinking here about the Armed Services Procurement Act and the Truth in Negotiations in particular—is very clear, and that is to achieve the maximum of competition considering the nature of the procurement involved in each particular case. It is going to be our intent to seek out, to the extent we can, whether or not this intent is being fully met or complied with.

Mr. PIRNIE. Thank you. I do want to join in the compliments that have been paid with respect to the character of the work and the ob-

jectivity that you have displayed. I particularly commend you for the approach as indicated by this excellent statement.

Mr. STAATS. Thank you.

Mr. HARDY. Mr. Gubser.

Mr. GUBSER. No questions.

Mr. HARDY. Have you anything further?

Mr. PIKE. I would like to ask a few questions.

Mr. Staats, I, too, want to join Mr. Pirnie in commending you for this statement. I think it is both eloquent and understandable, and this is a rare combination.

I need a little background on law which I probably ought to know. I gather that the Truth in Negotiations Act is limited to transactions over \$100,000.

Mr. STAATS. That is correct.

Mr. PIKE. You have also cited the fact that 98 percent of the number of the procurements are items under \$10,000. Is there anything magic about this number \$10,000? Is there a different kind of procurement allowed under \$10,000?

Mr. KELLER. There is no magic in that number, Mr. Pike. It was the cutoff point we used to show significance—

Mr. PIKE. Is there any legal distinction in procurements anywhere under the \$100,000 figure?

Mr. KELLER. Well, there is the figure of \$2,500 under which you can negotiate.

Mr. PIKE. And what can you do under \$2,500 that you cannot do above?

Mr. Keller. Well, a procurement under \$2,500 falls in one of the exceptions in the Armed Services Procurement Act which allows you to negotiate. In other words, you can negotiate any procurement under \$2,500, as distinguished from competitively, formally advertising.

Mr. PIKE. In other words, under \$2,500 you don't even have to look for competition, is that correct?

Mr. KELLER. You don't have to; no, sir. You can do it by telephone.

Mr. PIKE. By telephone?

Mr. KELLER. You can.

Mr. PIKE. And, I presume, frequently do?

Mr. KELLER. I think that is done on occasions, certainly.

Mr. HARDY. But even in that case, aren't you supposed to get more than one price?

Mr. KELLER. I think that is correct. You should contact two or three suppliers. It is a negotiation as distinguished from a formally advertised bid.

Mr. WEITZEL. Mr. Chairman, there is no requirement in the law that they competitively negotiate. The requirement for competitive negotiation starts under Public Law 87-653 at the contracts in excess of \$2,500. That is a carryover from the former law which had exemptions from the requirement for advertised competitive bidding. This is on the theory that the expenses of advertising might exceed the saving that you would make and that you can go out into the open market and buy. This is why we took exception to the practice that we found in this report or draft report that Mr. Staats referred to of the Defense Department classifying all purchases under \$2,500 as competitive because, in fact, they are not.

The regulation that they are proposing now, or the reporting procedure that is under consideration would differentiate to a larger degree between those things that are in fact noncompetitive, and I think under \$2,500 they will propose to classify them simply as noncompetitive, and over \$2,500 they will attempt to find out if they are really competitive. If they are competitive, they will classify them as such, otherwise as noncompetitive.

We feel that this will be an improvement, because you will have the information as to what is really competitive and what is probably noncompetitive.

Mr. PIKE. Now, is there any distinction, legally, in procurements at any point between \$2,500 and \$100,000?

Mr. WEITZEL. I don't know of any. There are some classifications in reporting and, as was indicated, statistics are prepared on the basis of \$10,000 up to \$100,000, I believe.

Mr. PIKE. All I am trying to do is get for myself some background here.

Under \$2,500 there is no requirement for competition whatsoever. From \$2,500 up to \$100,000 and past \$100,000 there is a requirement for competition when you can get it, and above \$100,000 there is this requirement for disclosure of cost data except, as I understand it, in cases where it may operate to the detriment of the contractor with a competitor. Is that the way I read your statement?

Mr. KELLER. The exception in the law on that, Mr. Pike, is that you do not have to get cost information or certified pricing data under a contract or subcontract where the price negotiated is based on adequate price competition, established catalog or market prices, or commercial items sold in substantial quantities to the general public, or prices set by law or regulation.

Mr. PIKE. And that is above \$100,000?

Mr. KELLER. That is above \$100,000.

I think, if I could comment just a minute on this, any of your contracts from \$1 on up are subject to negotiation if they fit within one of the exceptions laid out in the Armed Services Procurement Act. The key to the \$100,000 is that Public Law 87-653 says if the contract is in excess of \$100,000, then you must get certified cost or pricing information, coupled with the certificate of the contractor that it is current, accurate, and complete, and there must be included in the contract a clause giving the Government the right to a price adjustment in the event that the price data certified to is not accurate and complete.

Mr. PIKE. The reason I am pursuing this, Mr. Chairman, is that each of the examples that I cited on the floor the other day fell into this category of under \$2,500, and I just wanted to find out what the rules are on these things.

Now, assume a contracting officer or purchasing officer calls one company and in the same phone call to the same company orders three separate items, each of which costs less than \$2,500. Is this still considered to be three under \$2,500 items on which he doesn't have to look for any competition?

Mr. KELLER. Well, I expect it has happened that way—I think it is suspect when that does happen.

Mr. HARDY. You couldn't prove he didn't order them separately.

Mr. WEITZEL. We have had a number of decisions in the past, as the chairman knows, that it isn't proper to evade the requirement, what-

ever it is—\$1,000 or \$2,500. You should not go out and buy things successively that you need all at the same time, of the same general character, in the same place, simply to stay under this limitation.

As you have indicated, sometimes this is a hard thing to prove in the order.

Mr. PIKE. Mr. Chairman, I have a lot of questions to ask, but we have a problem here, I recognize.

I want to ask one more, just on this subject.

Mr. HARDY. Go ahead.

Mr. PIKE. Is there any penalty in the law against a contractor who, at a price under \$2,500, sells an item to the Government at, say, 10 times his own catalog price?

Mr. KELLER. No, sir.

Mr. HARDY. On that point, actually the catalog price—and I think the statute needs to be modified in connection with that, because there are a lot of catalog prices that automatically carry a discount to anybody. You can go right down here in Washington and come out with a jewelry catalog where you have a price that is a catalog price, but if you know how to read the number on the thing you will find out that actually it may be 40 percent different.

Mr. KELLER. I think in a number of Government procurements the contractor even with a catalog does offer the Government a discount from the catalog price.

Mr. PIRNIE. May I ask one question in regard to your quantities? This frequent ordering, is that followed up? In other words, suppose you are having requirements of a given item. By ordering quite frequently, you could keep below the limitation figure. Is that studied at all to see whether that is a method of evasion?

Mr. KELLER. I don't believe we have done any work in that area.

Mr. STAATS. The answer is "No."

Mr. GUBSER. Public Law 87-653 sets \$100,000 as the cutoff point below which cost data for pricing purposes is not required, but as a practical matter aren't almost all Department of Defense contracts being written today so that \$25,000 is the cut off point?

Mr. HARDY. Not for this particular purpose, I don't think.

Mr. KELLER. I am not aware of that, Mr. Gubser.

Mr. GUBSER. That was my impression. I may be mistaken, but I think as a practical matter they have gone way below the \$100,000.

Mr. HARDY. You mean in requiring the costs on everything above \$100,000?

Mr. GUBSER. That is right.

Mr. KELLER. The law requires—

Mr. GUBSER. I think as a practical matter they are writing the effect of Public Law 87-653 into all contracts above \$25,000.

Mr. HARDY. That would be interesting to know.

Mr. GUBSER. I think I am right.

Mr. KELLER. I can check that out.

Mr. HARDY. Mr. Pike.

Mr. PIKE. Mr. Staats, while you are here, I would like to have your views on a concept which I have heard expressed many times to the effect that the ASPR's, in attempting to take care of all of these situations, have gotten so terribly complicated that neither the contractors themselves nor the average contracting officer really understand them.

I have looked at some of these ASPR's, and in my opinion there could be something to this. I would like to have your views.

Mr. STAATS. Our view is, Mr. Pike, that there is a great deal to this point. I think you have to look at this point in relationship to the rotational system that is prevalent in the Defense Department, with many new people coming into the procurement area. One of the reasons we want to emphasize in our future work here the training problem is precisely this, and this problem obtains outside the procurement area, also, and includes particularly the supply management area, where inexperienced people cannot really be expected to master the details of the Armed Services Procurement Regulation, and the contractors themselves have somewhat the same problem.

Still there must be some answer to meeting the intent of the Congress in this area because of not only the importance of competition to our society, but also because of the amount of money that is involved here. If we ever allow ourselves to get in the position where there is widespread noncompliance—and I won't say violation of the law, but noncompliance—then I think we are in trouble, and seriously in trouble.

Mr. HARDY. This brings up a question in my mind. Isn't there enough competence in the Department of Defense to write these things simpler?

Mr. STAATS. This might be something that could be reviewed by our Office. It had not occurred to me that this might be something we ought to look at. It is only fairly recently that we have had a regular procedure, Mr. Chairman, for seeing these drafts—

Mr. HARDY. I understand that, but if you take a look at what is already in existence, let alone the change they propose, every time they come up with a change—and I am not suggesting that they don't need to change them—when they come up with a change they make it that much more complicated. They pile complication on complication.

Mr. KELLER. There are too many lawyers involved.

Mr. HARDY. You know, I think that may have a lot to do with it.

Mr. STAATS. In the letter attached to my statement, from Mr. Ignatius, which relates to the changes that they plan to make with the objective of better compliance with Public Law 87-653, they mention specifically a training program for procurement officials to bring the procurement in line with the 87-653 law.

Mr. HARDY. I think you would need a training program to just get people to understand the doggoned ASPR's.

Mr. WEITZEL. Mr. Chairman, I would like to cite one example of what we think is a fairly simple change. After we made our review of the compliance or lack of compliance in the award of construction contracts by the Department of Defense with 87-653, you will find from our report to the Congress of June 19, 1967, the Deputy Assistant Secretary of the Department of Defense agreed or concurred with our suggestion that a particular paragraph of ASPR, "Preparation for negotiation of fixed-price type contracts, procurement of construction and contracting for architect-engineering services," be more explicitly related to another paragraph requiring price analysis. He stated this could be accomplished simply by changing the reference in the Armed Service Procurement Regulation—in other words, to bring engineering contracts or construction contracts under this requirement—so it can be done simply, on occasion, but on other occasions it requires a pretty complicated amendment.

Mr. HARDY. I am awfully sorry that we have a quorum call on, because I had a number of questions that I wanted to ask, and since you brought up this construction thing I want to raise one in connection with that.

Does this report deal only with construction contracts in the continental United States?

Mr. BAILEY. No, sir, worldwide.

Mr. HARDY. I would presume most of them are outside the continental United States.

Mr. BAILEY. It is pretty general, both in continental United States and outside, Mr. Chairman.

Mr. HARDY. We will want to take a look at it.

Mr. STAATS, I want to express the appreciation of the committee for this concise review of your current projected activities. Undoubtedly your programs can be coordinated with the subcommittee requirements in connection with this study and ought to lead us to a series of hearings and reports which, when completed, will give an in-depth review of procurement policies and practices, indicating the area of deficiencies and suggesting such changes and improvements as might be necessary.

The details of this can be worked out at the staff level, and I think over a period of time we will need to hold a series of hearings as we get these details worked out.

We may well start, and I think it is important perhaps that we do start, with a look at the administration of Public Law 87-653. I recall so well when this was a matter of consideration by this committee, under the chairmanship of Mr. Hébert. There may be need for some changes in it, but certainly the purpose of it is as valid today as it was when we argued about it several years back.

I want you to know how much we do appreciate what you are doing in this area. I think if our staffs can just work together to coordinate their efforts, we will be able to develop a series of hearings which ought to really accomplish a great deal.

Mr. STAATS. Needless to say, Mr. Chairman, we will be most happy to cooperate with the committee and render any help we can in connection with further hearings.

Mr. HARDY. We certainly thank you.

We will let the committee stand adjourned, subject to the call of the Chair.

(Whereupon, at 11:23 a.m., the subcommittee was adjourned.)

REVIEW OF DEFENSE PROCUREMENT POLICIES, PROCEDURES, AND PRACTICES

Part I—Introduction and Truth in Negotiations (Public Law 87-653)

MONDAY, SEPTEMBER 25, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ARMED SERVICES,
SUBCOMMITTEE FOR SPECIAL INVESTIGATIONS,
Washington, D.C.

The subcommittee met at 10 a.m. in room 2212, Rayburn House Office Building, the Honorable Porter Hardy, Jr., chairman of the subcommittee, presiding.

Members present: Congressmen Porter Hardy, Jr., Otis G. Pike, Alton Lennon, Charles S. Gubser, and Alexander Pirnie.

Staff present: John T. M. Redden, special counsel; Richard A. Ransom, professional staff member; and Phyllis M. Seymour, secretary.

Mr. HARDY. Let the committee come to order.

Let the record show the presence of Mr. Pike and myself constituting a quorum under committee rules.

I believe there will be some other members of the subcommittee here shortly, but in the interest of time we will start.

Mr. Reporter, I shall appreciate it if, when the other members do arrive, you will let the record so indicate.

I have a brief statement I would like to read to start the hearing.

On March 10, 1967, Chairman Rivers directed this subcommittee to undertake a broad review of military procurement policies, procedures, and practices. The dollar volume of such procurement amounts to approximately \$45 billion a year, which is about 80 percent of all moneys spent for Government purchases.

(At this point, Mr. Gubser and Mr. Pirnie arrived at the hearing.)

Never in the history of our Government, or anywhere in the world for that matter, have there been greater single procurement transactions in such volume as those accomplished in the daily operations of the U.S. Department of Defense. Many of these transactions involve the procurement of weapons and equipment never manufactured before—exotic, sophisticated, and undreamed of 10 years ago. A central problem confronting the Government buyers in making these purchases is that few people, if any, have a very accurate picture of the cost at the outset of such ventures. To obtain the best possible estimates of costs for many of these transactions, the Government is largely dependent upon the contractor's intimate knowledge of production, experience, and cost trends in his own plant. Obviously, such data from the contractor cannot be accepted without a thorough review, otherwise, the Government would be placed in a position much the same as a person

writing a blank check—leaving the amount to the sole discretion of the other party.

Frequently, in the course of large purchases, the buyer and the seller do not see eye to eye as to the estimated costs of the projects, and where this occurs, negotiation or compromise is necessary to establish a price agreeable to both parties. Herein lies the rub. Truth in negotiations is absolutely essential to arrive at a fair and reasonable price.

(At this point, Mr. Lennon arrived at the hearing.)

To provide some means of assurance that the negotiations are conducted properly, the Armed Service Committee, in 1962, recommended the passage of Public Law 87-653, which requires contractors to certify that cost data submitted for use in negotiations are complete, accurate, and current where a negotiated contract is in excess of \$100,000. Since that enactment, the Subcommittee for Special Investigations has, as a part of its regular duties, had the task of monitoring the effectiveness of the legislation. As a result of these reviews, it has become evident that the essentials for fair negotiations are not always present. Mistakes, misunderstandings, half truths (and, in some cases, even various shades of fraud) have crept into the establishment of prices to the Government.

I think I would like to emphasize the mistakes and misunderstandings, rather than the others.

Today's hearing will be confined to the operation of this particular Public Law, generally known as the Truth in Negotiations Act. The report which follows, therefore, will be the first of the series of interim reports which, when completed, will comprise our overall report on military procurement policies, procedures and practices. Based on these reports, the subcommittee will recommend such administrative and legislative changes as may be appropriate and warranted. Other facets or areas of procurement which will be the subject of follow-on interim reports, together with the dates of hearings, will be announced from time to time.

To assist us this morning, we have asked the General Accounting Office to give us their views concerning negotiations between the Government and contractors. These views derive from the investigation of literally hundreds of cases. Time will not permit a detailed examination of particular cases today; however, should it be necessary to pursue these, it can and will be done at a subsequent hearing.

We have also asked representatives of the Departments of Defense, Army, and Navy to be here today so we may have their comments on the cases presented by GAO and the Air Force.

We will hear first from Mr. Bailey, of the General Accounting Office, who will be accompanied by Messrs. Hammond and Shnitzer.

I'm glad the other members of our subcommittee are present now, so we have the entire subcommittee members present.

Mr. Bailey, you have a prepared statement, I believe, also?

Mr. BAILEY. Yes, sir.

Mr. HARDY. The committee appreciates your presence. Suppose you just proceed with your statement.

My present thinking is we will try not to interrupt you, although I'm not sure. It is a long statement and it may be necessary to interrupt you, so we will have to sort of play that as it comes.

Mr. BAILEY. All right, sir.

STATEMENT OF CHARLES M. BAILEY, DEPUTY DIRECTOR, DEFENSE DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JAMES M. HAMMOND, ASSOCIATE DIRECTOR, DEFENSE DIVISION; PAUL SHNITZER, DEPUTY ASSISTANT GENERAL COUNSEL; AND CHARLES KIRBY, ASSOCIATE DIRECTOR, DEFENSE DIVISION

Mr. BAILEY. Mr. Chairman and members of the subcommittee:

I am pleased to appear before your subcommittee today to discuss certain problem areas related to the administration of Public Law 87-653, the so-called Truth in Negotiations Act.

During the 18-month period ended June 30, 1967, we issued 241 reports to the Congress and agency officials in the defense procurement area. Of these, 104 contain findings relating to the manner in which agency officials are implementing this law in the award of negotiated prime contracts and subcontracts. As you know, Public Law 87-653, effective December 1, 1962, provides that prime contractors and subcontractors shall be required to submit cost of pricing data and to certify that data submitted are accurate, complete and current prior to the award of certain negotiated contracts and subcontracts expected to exceed \$100,000.

The law also requires, as a further protection of the Government's interests, that a defective pricing data clause be inserted in each contract negotiated on the basis of cost data to provide a contractual basis for a price adjustment if the price is increased because the cost or pricing data submitted were inaccurate, incomplete, or noncurrent.

We estimate that, in fiscal year 1966, negotiated procurements totaling about \$18 billion were awarded subject to the law's requirements for submitting cost or pricing data. I might add here, our estimate for fiscal year 1967 is in the area of \$21 billion. We estimate that in the same period negotiated procurements over \$100,000 totaling about \$6.5 billion were determined by contracting officials to be exempt from the law's requirements for certified costs or pricing data because proposed prices were based on adequate price competition or on catalog or market prices of commercial items sold in substantial quantities to the general public.

Our estimate for 1967, for that comparable figure, is \$7.7 billion.

Our selective postaward examinations of negotiated contracts and subcontracts over \$100,000 indicated that improvements were needed in Department of Defense policies and practices for negotiating reasonable contract prices. As you know, we examine a very small percentage of the negotiated contracts awarded annually. In 59 of the reports issued we found that, had agency officials obtained or appropriately evaluated pertinent information available to the contractors at the time of negotiations they would have had a sound basis for negotiating lower prices that would have resulted in savings to the Government of about \$12 million.

Contracts awarded by negotiation are subject to Department of Defense policies and instructions to contracting officials relating to negotiation. Generally these instructions cover requirements for (1) proposals for negotiated contracts, (2) evaluation of proposed prices, and (3) negotiation of contracts.

The 104 reports issued since January 1966 contain 451 examples of various types of deficiencies. They indicate the need for improvements in the following general areas which I will discuss hereafter :

Contractor's submission of cost or pricing data in support of proposed prices_	357
Evaluations by agency officials of contractor's price proposals-----	43
Actions by contracting officials in establishing negotiated prices-----	51

Total -----	451
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I. Need for Improvements in Contractor's Submission of Cost or Pricing Data in support of proposed prices

In administering Public Law 87-653, the Department of Defense has defined the cost or pricing data that is required to be submitted and certified as that portion of the contractor's submission which is factual. It includes all facts, reasonably available to the contractor up to the time of agreement on price, that might reasonably be expected to affect the price negotiations. It is that type of information which can be verified.

The contractor's certificate covers the cost or pricing data submitted by the contractor in support of his estimates of future costs of contract performance. The certificate does not pertain to the estimates, but applies to the data upon which the contractor's estimate is based as well as other pertinent data available to the contractor.

The Department of Defense has issued a contract pricing proposal form to provide a standard format by which the contractor submits to the Government a summary of estimated costs and supporting information. Instructions on the form state that the contractor is expected, in good faith, to incorporate in and submit with the form any additional data, supporting schedules, or substantiation, which are reasonably required for the conduct of an appropriate review and analysis of the proposal in the light of the specific facts of the procurement.

The instructions provide that the contractor is expected to make disclosure of the existing verifiable data and the judgmental factors applied in projecting from known data to the estimate, as well as the contingencies used in the proposed price; in short, the contractor's estimating process itself needs to be disclosed. These instructions provide further that, when attaching supporting cost or pricing data to the form is impracticable, the data be described with schedules, as appropriate, and be made available to the contracting officer or his representative upon request.

In our reviews we have found that improvements are needed to insure that contractors are submitting, or identifying in writing, the cost or pricing data that they certify to be accurate, current, and complete. The contractor's submission should show prior cost experience even though he did not use it as a basis for his cost estimate. The contractor's estimating procedures should provide that all pertinent cost information available at the time of proposal and at the time of negotiation are submitted to procurement officials.

(a) Improvement needed in submission and identification of cost or pricing data

On January 16, 1967, we issued a report to the Congress on the first phase of a review into the manner in which agency officials were administering the cost or pricing data requirements of Public Law 87-653 in the award of 242 negotiated prime contracts and subcontracts.

We found in 165 out of a total of 185 cases where certified cost or pricing data were required that DOD officials and prime contractors had no record identifying the cost or pricing data submitted and certified by the contractors in support of significant cost estimates.

If data are not made a matter of record, it may be impracticable for the contracting officer to establish what data were relied on in the negotiation or that the contractor fully complied with the requirements of Public Law 87-653. In addition supervisory reviews and post-award audits may be hampered, and the Government's rights for price adjustment under the defective pricing data clause may be impaired.

In its reply to our report, DOD stated that a special group had been appointed to study the report. In May and June 1967, the Department submitted to us for comment proposed changes in its procurement regulations. These changes have also been furnished to various interested Government agencies and industry groups for comments.

We have held discussions with DOD officials and, although we are basically in agreement with the proposed changes, we are making some recommendations for further revision that we believe are required. The proposed changes also may be further revised on the basis of comments received from others. Officials of both DOD and GAO recognize that changes in regulations, in themselves, will not be effective unless agency procurement personnel receive adequate training in implementing the regulations.

To this end, DOD and GAO have now agreed on certain material illustrating adequate compliance with Defense regulations implementing Public Law 87-653 to be used in a training program.

On June 19, 1967, we also reported to the Congress that, in our examination of 187 contract actions for construction work, where cost or pricing data were required by Public Law 87-653, we found 155 actions where sufficient cost or pricing data in support of contractor's proposals were not obtained.

The construction agencies—Army Corps of Engineers and Naval Facilities and Engineering Command—had considered that the law was not applicable to construction contracts. Instead, the construction agencies placed primary reliance on comparisons of the contractors' proposals with their own cost estimates as a means of evaluating the reasonableness of prices. We were 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 when appropriate.

(b) Requirements for submitting prior cost experience not used as a basis for the contractors' estimate of costs

We noted that contractors had estimated significant costs apparently without using or submitting to agency officials available prior cost experience in producing the same or similar items. Estimates were stated in the proposals to be based solely on opinions and judgments, as if the proposals were for the initial production of the item and no prior cost experience was available. We believe that the failure to submit or identify such prior cost experience represents a failure to disclose complete and current cost or pricing data required to comply with the purpose and intent of the law.

We recognize that prior cost experience in itself does not represent the costs that the contractor can reasonably expect to incur in perform-

ing a subsequent contract. It must necessarily be modified to fit current circumstances. Nevertheless, prior cost experience should play an important part in estimating future costs. It is factual, verifiable, and generally the most reliable information available. Used in conjunction with other current factual information, it should serve as the basis for judgments on future costs.

Furthermore, an analysis of prior cost experience is a valuable guide for evaluating a contractor's current cost estimates. It may disclose significant trends in costs, nonrecurring costs that need to be eliminated, and changes in the product, its production, or the contractor's operations that need to be considered.

For example, a contractor proposed certain labor hours for a prime contract on the basis of engineering estimates. We found that the contractor had produced identical equipment under a subcontract with deliveries completed about 2 months before the negotiation at hand. Our comparison of actual hours incurred under the subcontract with the hours proposed and accepted on the prime contract indicated that the proposed hours were substantially higher than prior experience. Consequently, estimated costs were increased by about \$80,000.

In order to insure that agency representatives are aware of and have access to all pertinent information when evaluating a contractor's proposal, we believe that prior cost experience should be required to be submitted with the proposal even when not used as a basis for the estimated costs. Therefore, we have recommended that the DOD regulation be revised to require that the contractor identify and disclose prior cost experience.

(c) Cost and pricing information submitted by the contractor in support of proposed costs

We noted in our reports instances where contractors have submitted certain information available to them at the time of the proposal while other available information which was clearly pertinent to the proposed price was not submitted or identified by the contractor.

In those instances where available information is not submitted by the contractor it is frequently not feasible to detect such information even if the contractor's supporting information is subject to a pre-award audit.

Under Public Law 87-653, a contractor is responsible, on the basis of the certificate, to submit accurate, complete, and current cost information. We feel that agency officials performing analyses of the contractor's proposed costs should not have to seek out pertinent supporting data. Our findings indicate a continuing need for Defense officials to obtain improvements in contractors' submissions of cost data.

For example, a negotiated unit price of \$4.44 for certain fuses included \$1.79 for six parts required for the fuse. Our review disclosed that the contractor had on file vendor quotations for these six parts at unit prices that were about \$0.57 lower than the prices it had used in its proposal. These lower quotations were from vendors that subsequently supplied the parts at the quoted or comparable prices.

Had the contractor submitted to the Government the lower price quotations for these fuse parts, there would have been a sound basis for reducing the contract price by about \$388,000.

In this connection, in a report to the Congress of February 15, 1967, we showed the need for major contractors to improve and formalize

their estimating systems, and for DOD to establish criteria for determining acceptable estimating systems. DOD has now established criteria that are responsive to our recommendations.

An integral part of such systems is the establishment of procedures for the orderly flow of documentation to build up and support the estimate, and for management review to establish that such documentation used and submitted to the Government is accurate, complete, and current.

(d) *Disclosure of information that becomes available between the time the contractor submits his proposal and the time of price negotiation*

Reliance is placed on the contractor or subcontractor to disclose significant information that becomes available after the proposal is submitted up to the time of negotiation. Furthermore, there may be considerable delay between the time of the agency representatives' evaluations of the proposal and the time of the negotiations. Again, reliance is placed on the contractor to submit the most current information at the time of negotiations. Our postaward audits of negotiated prices have revealed numerous instances where complete and current information, becoming available after the proposal was submitted, was not made known to agency officials by contractors.

For example, in August 1964, a contractor submitted a price proposal to the Navy which included material costs of about \$49,000 for visicorder paper. An agency audit of the material estimate was performed in August 1964. Subsequent to the audit the contractor became aware, in September 1964, that the requirement for visicorder paper would be reduced to about one-eighth of the amount previously required.

Although negotiations were not conducted until November 1964, the contractor did not revise its proposal or in any other way inform the Navy of the change in requirements for visicorder paper. We believe that had the contractor submitted the more current data, the Navy would have been in a position to negotiate a reduction of about \$47,200 in the estimated cost of the material.

Increased emphasis by Defense officials to require contractors to update supporting data is needed. We have recommended that where contracting officers believe that the data submitted by the contractor were not complete or have not been adequately verified, they should request a postaward audit.

We believe that the Department of Defense has taken actions to improve compliance with the spirit and intent of the law through revision and clarification of its regulations, and through training of its personnel. Also DOD has emphasized to contractors the need for them to establish or improve their estimating systems and has stepped up its review of these systems at major contractors. We believe that further improvements in this direction can be attained by putting greater stress on and by providing contractors with specific illustrations of what constitutes adequate compliance.

The provisions of Public Law 87-653, requiring the submission of cost or pricing data certified to be current, complete, and correct, are not self-executing in that the failure to comply must be detected and acted upon by the Government. However, we believe a program

of preaward and postaward reviews of the data available to the contractor when the contract price was established, and continued surveillance of the practices of contracting officials will help in attaining the objective of the law.

II. Need for Improvements in Evaluation of Contractors' Proposals by Agency Officials

A major factor in the negotiation of fair and reasonable prices of contracts awarded on the basis of cost or pricing data is the evaluation of elements of the contractor's price proposal.

Various agency personnel assist and advise the procurement contracting officer in the review, evaluation, and analysis of pricing proposals. These include price analysts, technical specialists in engineering, production, and quality assurance, and contract auditors.

Our reviews identified 43 cases indicating a need for improvement in the evaluation of contractors' price proposals by agency officials. Those areas which we found needed improvement included (a) the technical evaluations of contractors' proposed costs, (b) the preaward audits and related reports, (c) recognition of the need for postaward audits, as well as the right of access to contractor records to perform such audits, and (d) evaluation of subcontractor estimates included in prime contractor prices.

(a) Technical evaluations of proposed costs

We found that significant cost estimates, included in prices of fixed-price-type contracts, were based on contractors' engineering estimates for which there were little or no factual supporting data. Furthermore, evaluations of such estimates by agency technical personnel generally did not disclose the scope of their work, the bases for the conclusions contained in their reports to contracting officers, and evidence of supervisory review.

Generally, engineering estimates are the primary basis for proposing costs under cost-type contracts. Because such contracts frequently cover items requiring research and development, or items for which firm specifications are lacking, cost or pricing information is seldom available.

We found, however, that significant costs included in the prices of fixed-price-type contracts that we examined were also based on engineering estimates. Contractors used engineering estimates in proposing labor hours, material quantities, material costs, scrap and rework provisions, and tooling. Generally, they had little or no supporting documentation for their engineering estimates. As a result, in our examinations of such estimated costs, we frequently could not evaluate the validity of the engineering estimates in the light of available factual information.

Therefore, we were especially interested in determining the scope of the technical evaluators' reviews, the methods used by them in evaluating the contractor's engineering estimates, and the bases for the conclusions and opinions contained in their reports.

We found numerous instances of ineffective reporting, inadequate documentation of the work performed, and the absence of supervisory review. Accordingly, there were strong indications that the technical evaluation practices and procedures did not provide adequate assurance that effective and reliable technical reviews were being performed.

We found that many of the technical evaluators' reports lacked adequate explanation of the conclusions reached and the recommendations made. The reports often included the evaluators' conclusions that the hours, quantities, or costs proposed were considered reasonable, without explanation of the bases for making this determination. The technical reports also contained recommended adjustments or exceptions to contractors' estimates without adequate explanations of the bases for the recommendations.

These technical evaluation reports seldom disclosed the scope of the evaluation or the methods used by the evaluator. Furthermore, agency files generally did not contain evidence of either the work performed or the conclusions reached and reported by the technical evaluators. In those cases where a record of the work performed had been retained, the documentation consisted of informal notations or scratch notes which generally were not prepared in a manner to clearly disclose the scope of the evaluation or the bases for the evaluator's conclusions. For a number of technical evaluations, agency representatives informed us that documentation had been prepared but either had been destroyed or could not be located. In other instances, agency representatives advised us that they either had not prepared supporting documentation or could not recall whether such a record had been prepared.

Further, agency files did not contain evidence that supervisors had reviewed the technical evaluations. We were informed that such supervisory reviews were seldom made. Since the technical evaluation of a contractor's proposal often plays a major role in the price negotiation, it seems that the work performed and the conclusions reached by technical evaluators should be adequately documented, reported and independently reviewed.

For example, a contractor estimated requirements of 63,378 labor hours and quantities of three raw materials on the basis of engineering judgments. The labor and material estimates with applicable burden and profit accounted for about \$1,167,000 or 95 percent of the total proposed firm fixed-price contract.

A technical evaluation of the contractor's estimate was performed by an agency industrial specialist. The industrial specialist's report consisted of a listing of the labor and material quantities proposed by the contractor, his conclusion that the proposed labor and material estimates were reasonable, and a recommendation that the contractor be awarded the contract. The report did not disclose the bases or methods used by the industrial specialist in reaching his conclusion. There was no indication of any supervisory review of the technical evaluator's work.

With respect to technical evaluations, we have recommended that the Department of Defense establish adequate procedures for technical evaluations of proposals and require uniform application of these procedures by those responsible for performing such evaluations. Further, we have recommended that supervisory personnel should review the work performed and assure themselves that reports resulting from these evaluations are adequately prepared.

(b) Audit and audit reports on contractors' price proposals

We found that the prices negotiated for certain contracts were higher than indicated by available cost or pricing data because of the inadequate scope and depth of the preaward audit performed.

In several of the contracts we examined, we found that the auditors did not consider the most current experienced data available at the time of their review, such as current vendor quotations, or the most recently experienced labor hour data. In other cases various arithmetical and duplication errors in contractors' supporting data were not disclosed by the audit.

In addition, certain other matters, pertinent to the price negotiations, and known to the agency auditor, were not reported to contracting officers. These matters included pending agreements on new overhead bidding rates; use of noncurrent price quotations in support of proposed material costs; and refusal of a contractor to allow auditors to examine data considered pertinent to the proposed price.

Instructions in the Defense Contract Audit Agency Manual issued subsequent to award of the contracts we examined, if properly followed by the auditor, should result in improvement in the above areas.

(c) Need for postaward defective pricing data audits and right of access to the contractor's records to perform such audits

A number of our reports show that significant cost information available to or known by contractors prior to the negotiation of contract prices was not submitted to Government negotiators. As a result, estimated costs upon which contract prices were based were substantially higher than the costs that should reasonably have been anticipated on the basis of information known to the contractors.

In some of these cases, agency auditors and other personnel had, prior to price negotiations, performed audits and reviews of available contractor records and of other data submitted to them by the contractors. However, because certain cost information was not disclosed by the contractors or became available after the audits were performed, especially where delays in negotiations occurred, the preaward audits were not effective in disclosing cost information available at the time of negotiations.

In other words, because of the urgency of the procurement a preaward audit was not requested.

In October 1965, we recommended to DOD that, as a basis for providing the Government the protection afforded by the defective pricing data clause, some organized procedures should be established for a postaward review of major contracts, at least on a selective basis, to insure that significant cost or pricing data used in negotiating the contract prices were accurate, complete, and current. As a result, the Defense Contract Audit Agency has provided for a program of regularly scheduled selective postaward reviews of contracts containing defective pricing provisions.

Our findings resulted from our examinations made after the contracts were awarded—postaward audit. These examinations included comparisons of estimated costs accepted in negotiations with actual costs of performance that we have a contractual right to examine. We have found that such comparisons are an effective method of detecting cost information available to the contractor at the time of negotiation that may not have been made known to procurement officials.

However, for firm fixed-price negotiated contracts, the current Armed Services Procurement Regulation does not provide for the inclusion of a clause granting agency representatives the right to

examine a contractor's records of performance and incurred costs under the contract. We have recommended that such a contractual right be granted to agency personnel to provide them an effective means of verifying the data submitted by the contractor.

Bills have now been introduced in the House and the Senate to provide authorized agency representatives the right to examine all data related to the negotiation, pricing, or performance of contracts or subcontracts where cost or pricing data is required.

We have reported favorably on these bills to both the chairman of your committee and the chairman of the Senate Committee on Armed Services.

(d) Need for evaluations of subcontract price estimates included in prime contract price proposals

We noted that substantial subcontract and interdivisional cost estimates have been accepted by contracting officials in negotiating fixed-price type contracts without assurance that proposed subcontract price estimates were reasonable on the basis of cost or pricing data available to the subcontractor.

We found instances where prime contractors had not obtained cost or pricing data from subcontractors to evaluate the reasonableness of substantial proposed subcontract prices although competition was lacking. Further, the agency evaluation of the prime contractors' proposals did not include a review of information supporting the subcontract prices.

In accepting the subcontract price estimates, the prime contractors either performed no evaluation or compared the current price with previous prices or with internal estimates. The agency evaluation of these subcontract prices consisted of a verification of the subcontract price quotation and a comparison with prices under prior contracts.

For example, a fixed-price incentive prime contract was negotiated for periscope systems by the Navy for about \$3,067,000 on the basis of cost or pricing data submitted by the contractor. About \$891,000, or 29 percent of the prime contract price, was based on fixed-price quotations from four sole-source subcontractors. We found that the subcontract prices were accepted as proposed as part of the prime contract costs without the prime contractor or the agency performing a cost analysis of the subcontractors' proposals. Both the prime contractor's and the Navy's basis for accepting these costs was a verification that the prices included in the prime contract were the current price quotations of the subcontractors and a comparison with previous prices actually paid for similar items.

However, there was no assurance that current price quotations were reasonable in relation to the subcontractors' current cost information. Under such conditions we believe a review of the cost data in support of the subcontractors' price quotations should have been made.

ASPR provides that the agency contracting officials should assure themselves that significant subcontract price estimates included in prime contract proposals are reasonable by evaluating whether such prices are based on adequate competition, or an analysis of estimated costs supported by cost or pricing data. We have recommended that these regulations be reemphasized to contracting officials, and to contract auditors, so that significant subcontract cost estimates are given adequate evaluation prior to acceptance in the prime contract prices.

Where the urgency of the procurement does not permit adequate evaluations of significant subcontract cost estimates, prior to the award of the prime contract, provisions should be made for adjustment of the contract price after an evaluation has been made of the reasonableness of such estimates.

III. Need for Improvements in Actions by Contracting Officers for Establishing Reasonable Negotiated Prices

The contracting officer is responsible for obtaining evaluations of elements of the contractor's proposal and giving appropriate consideration to these evaluations in negotiating the contract.

Defense regulations require the contracting officer, at the conclusion of each negotiation, to promptly prepare 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 is to be in sufficient detail to reflect the most significant considerations controlling the establishment of the negotiated price. It is to include an explanation of why cost or pricing data was, or was not, required 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 and a certificate were required, the memorandum is to reflect the reliance placed upon the factual data submitted and the use of these 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 is to explain this difference.

In our reviews we found 51 instances indicating a need for certain improvements in the actions of contracting officers for establishing reasonable negotiated prices.

These areas which we found needed improvement included (a) failure to request a preaward audit, (b) failure to adequately consider and/or document negotiation files on consideration given to findings and recommendations contained in advisory reports, (c) failure to recognize the need for and to request postaward audits, and (d) questionable determinations that proposed prices are based on adequate price competition or catalog prices and that cost or pricing data need not be obtained.

Mr. HARDY. Let me interrupt just a minute, Mr. Bailey.

The subcommittee has a distinguished guest here.

I want to call a brief recess.

(Discussion off the record.)

Mr. HARDY. Go ahead, Mr. Bailey.

Mr. BAILEY. Thank you.

(a) Requests for audit

The prices negotiated for certain contracts we reviewed were higher than indicated by available cost information, because the contracting officers had either not requested auditors to perform a preaward audit or had requested audit of only a portion of the proposals.

The reasons generally given for not obtaining an audit were (1) there was insufficient time available for an audit of the contractor's

proposal, because of the urgency of the procurement, and (2) the contracting officer did not believe an audit was necessary because he was able to satisfy himself as to the reasonableness of the proposed price by other means. For some contracts we found that the audits requested were restricted to certain portions of the contractor's proposals, such as labor and overhead rates. Generally, the contracting officer's records did not contain sufficient information for us to determine whether valid reasons existed for waiving or restricting the scope of the audit.

Defense regulations now require that prior to negotiation of a contract or modification resulting from a proposal in excess of \$100,000 where the price will be based on cost or pricing data submitted by the contractor, the contracting officer shall request an audit review by the contract audit activity. The requirement for audit may be waived by the contracting officer whenever it is clear that information already available is adequate for the proposed procurement. In such case, the contract file shall be documented to reflect the reason for such waiver.

Increased emphasis in this area should help reduce instances where contracts are awarded without benefit of a review and analysis of cost data. However, in those instances where preaward audits are not requested solely because of the lack of time in an urgent procurement, we believe that a postaward audit should be requested to assure the reasonableness of the price.

(b) Documentation of negotiation files on consideration given to findings and recommendations contained in advisory reports

Our examinations have revealed instances where contractor's proposed costs that we questioned were also questioned in reports submitted to the contracting officers by agency evaluators. The contracting officer's records did not contain an explanation of why the costs questioned by the agency representatives were not eliminated in negotiations, or even whether any consideration had been given to the evaluator's report.

For example, a \$171,000 firm fixed-price contract was negotiated for the production of spare parts for a communication system. An advisory report by a price analyst to the contracting officer stated that the overhead rates used by the contractor were the approved rates for the prior calendar year. The report stated, however, that the contractor had submitted generally lower rates for the current year that were then being reviewed by the resident auditor. After the price analyst's report, but prior to price negotiations, new bidding and billing rates for the current year were agreed to. Our review of the negotiation records did not show that the contract price was adjusted to give consideration to the lower overhead rates. The negotiation record contained no indication that the contracting officer considered the comments in the price analyst's report concerning the negotiation of generally lower current overhead rates that would have reduced the contract price by about \$10,200.

In situations such as this, where contracting officials do not prepare a record for the basis for the negotiated contract price, a later attempt to review the reasonableness of the contracting officer's actions or to obtain a price adjustment relating to inaccurate, incomplete, or noncurrent data could be greatly hampered by the incomplete records.

Mr. HARDY. Mr. Bailey, could I interrupt so I can understand what we are talking about on this "overhead rate" proposition that you are discussing here? If the contracting officer who was negotiating this contract didn't look at these overhead data, what did he have to determine the overhead?

Mr. BAILEY. He had the higher rate for the prior year that the contractor had used as a bidding rate for his overhead.

Mr. HARDY. He was using the previous year's overhead rate?

Mr. BAILEY. He was using the previous year's rate but the current year's rate was being negotiated at the time, and prior to negotiations, new bidding and billing rates that were lower than the prior year's rate had been agreed to by the contractor and the auditor.

Mr. HARDY. There is no certification required with respect to overhead rates, I take it.

Mr. BAILEY. Yes, sir. The certification should also cover the overhead rates—that is, that they are the current rates.

Mr. HARDY. Factual, that they are accurate?

Mr. BAILEY. Of course, what happens in a number of these cases, and particularly where you have a contract of this kind for spare parts, the agency and the contractor will agree on a rate to be used in pricing proposals for a given period of time, such as a year, and then at the conclusion of that time, they will negotiate another rate to be used for a given period of time. They apply this rate, this negotiated rate, to most of their proposals.

Mr. HARDY. Is there a requirement in the regulations that the negotiating personnel undertake to make certain that the overhead rates being considered are the most recent?

Mr. BAILEY. I don't think I can answer that question specifically, Mr. Chairman. Perhaps one of my associates can. But, they are required to evaluate all costs, of course, to see they are current, complete, and accurate.

Mr. HARDY. The question that arises in my mind is, in connection with this, during the period of negotiation, the overhead rates were under revision. If that were the case, it seems to me rather strange there wouldn't be knowledge of it, or the regulations wouldn't require consideration of the revised rates.

Mr. BAILEY. I think the regulation does.

Mr. Weinfeld, would you like to comment on that?

Mr. WEINFELD. I am Charles Weinfeld, Assistant Director, Defense Division. It is just the general proposition that the contractor is certifying to the current information that he is submitting, and, if he has negotiated a more current rate than the one he has proposed, this is what he should submit, and certify as accurate, complete, and current.

Mr. HARDY. What you are saying is, then, that if the contractor submitted a false certification—

Mr. WEINFELD. In that sense, yes.

Mr. HARDY (continuing). If the contractor submitted a false certification, what violation of law has he committed other than this particular one? Does this constitute perjury, for instance?

What does it constitute? Is it fraud of some kind?

Mr. BAILEY. Mr. Shnitzer, our Deputy Assistant General Counsel, will answer.

Mr. SHNITZER. Mr. Chairman, I would say, on the basis of the facts as you have presented them——

Mr. HARDY. I did not present them.

Mr. SHNITZER. Excuse me, as they have been postulated.

Mr. HARDY. That is a good word.

Mr. SHNITZER. I would say there would not be a basis for making out a case of fraud because there would have to be an intent on the part of the individual.

Mr. HARDY. What you are saying is, the individual contractor made a certification that these are the most recent cost figures, and then before the negotiation is completed, they were not the most recent cost figures, and he didn't say anything about it. You still say it was a truthful declaration, is that what you are saying?

Mr. SHNITZER. Oh, no, sir. I am not suggesting there is not the right on the part of the Government to make recovery under the certification.

Mr. HARDY. The Government has to catch them, is that what you are saying? He is not guilty of fraud even though he did not tell the whole truth, and he certified the figures he presented were the up-to-date figures, didn't he?

Of course, the fact that he got a report the next day excused him. So, we are dealing with half-truths. Is that what you are saying?

What is the difference? This brings up a real interesting speculation. I have often understood that a lie is a falsehood with the intent to deceive.

What is a half-truth with intent to deceive; is that also a lie?

Mr. LENNON. Mr. Chairman, would you yield for a minute at that point?

Mr. HARDY. Surely.

Mr. LENNON. I would assume that this was the fault of the auditor, if your statement is correct.

After the price analyst's report, but prior to price negotiations, new biddings and billing rates for the current year were agreed to—agreed to by whom? The contractor and the agency?

Mr. BAILEY. The contractor and the Government; yes, sir.

Mr. LENNON. Unfortunately, during this negotiation period, your review did not show that the contract price was adjusted to give consideration. The Government agency knew——

Mr. BAILEY. Yes, sir, I think this is the point.

Mr. LENNON (continuing). But they did not take advantage during the negotiations for this lower overhead rate.

In other words, the contractor says, If you do not have sense enough to carry out your mandate under this law, of course we will take this extra \$10,200.

Mr. HARDY. What you are saying is my postulation is incorrect?

Mr. LENNON. I would say your postulation is based on the predication the contractor was guilty. However, if the GAO's certification to us, or statement to us, is accepted as fact, it was the fault of the agency which knew of this change during the period of negotiations, but did not insist upon the adjustment of the new rate based on the new change in the overhead rates.

Is that what you are saying? That is what you do say?

Mr. BAILEY. Yes, sir.

Mr. HARDY. I think your distinction is well made. The position that I was outlining a moment ago did not really apply to this particular situation, but this raises another question in my mind. I did not mean to get into it this far, but this raises another question in my mind as to who had the responsibility for calling this to the attention of the negotiating personnel?

Mr. BAILEY. Well, the contracting officer was on notice from a member of his team that this adjustment was in process.

Mr. HARDY. The contracting officer was on notice?

Mr. BAILEY. From a member of his team.

Mr. HARDY. Then somebody ought to pin his ears back.

Mr. BAILEY. Of course, that wouldn't preclude the contractor, also, from disclosing the fact.

Mr. HARDY. The contractor can hardly be expected, in this kind of a situation, to call attention to something which the negotiating personnel should have known.

Mr. BAILEY. This is correct.

Mr. GUBSER. Mr. Chairman, this brings out a point I would like to clarify.

What is the determining factor in the eyes of the contractor, the price analyst's report or events which occurred subsequent to the price analyst's report?

In other words, all the contractor is obligated to do is to submit the information contained in the price analyst's report, to make sure that it is accurate and honest. If events subsequent to the submission of that report change the overhead, then he isn't necessarily obligated. A deal is a deal.

Mr. BAILEY. Well, the contractor is supposed to update information up to the time of negotiation.

Mr. GUBSER. Oh, this is a fact I did not know.

In other words, it is part of the agreement that he is supposed to update this information?

Mr. BAILEY. He certifies, in his certificate, that the data are current, accurate and complete, up to a certain date.

Mr. GUBSER. That straightens it out.

Mr. HARDY. Is that date up to the time of the award?

Mr. BAILEY. No, sir. Generally, to the time of the negotiation, or just prior to the time of the negotiation.

Mr. GUBSER. Let's pin that down.

Mr. BAILEY. Prices agreed on, I should say, rather than negotiation.

Mr. GUBSER. At the conclusion of the negotiation?

Mr. BAILEY. The consummation of the negotiation.

Mr. GUBSER. Fine. Thank you.

Mr. HARDY. Go ahead, Mr. Bailey.

Mr. BAILEY. We believe that existing regulations dealing with this matter are adequate, and have therefore recommended that the conditions we found be brought to the attention of contracting officials to demonstrate the type of information that is needed to fulfill the requirements set out in the regulations.

(c) Need for requesting postaward audits

Certain procurements we have examined point up instances in which, under specific circumstances, contracting officers should have recognized the desirability of requesting postaward audits. In some instances a lengthy period had elapsed between the time of pre-

award audit and the time of contract negotiation. In other instances, the urgency of the procurement did not permit the delay that would result from requesting and performing a preaward audit.

In addition, several contractors have made voluntary refunds to the military departments after the contractor's personnel determined, subsequent to contract award, that the price negotiated had been increased because the data submitted by the contractor was defective. The contracting officers accepted these refunds without determining whether the refunds were adequate by requiring a postaward audit.

Our examinations indicated that in several cases the refunds should have been substantially greater and such determinations could have been readily made by agency postaward audit.

Mr. LENNON. Mr. Chairman, could I have a point?

Mr. HARDY. Yes.

Mr. LENNON. The postaward audit, is that not a condition precedent in the contract between the agency and the contractor, either sub or prime?

Mr. BAILEY. No, sir, not a postaward audit.

Postaward, after the award of the contract.

Mr. LENNON. I mean during the negotiations and the subsequent contract, doesn't it provide for a postaward audit with a refund to the Government if it is determined that any factors entered into the negotiations and the ultimate contract that should be reflected back in favor of the Government? Don't all of these contracts provide for a postaward audit and a refund to the Government?

Mr. BAILEY. It provides a vehicle.

Mr. LENNON. Vehicle for it?

Mr. BAILEY. Yes, sir. There is a contract clause that permits the agency to make a postaward audit of the information——

Mr. LENNON. It is up to them to make a determination?

Mr. BAILEY. Sir, I didn't follow you.

Mr. LENNON. It is up to the agency to make the determination, if there should be a postaward audit, and then what action it should take?

Mr. BAILEY. Yes, sir.

Mr. LENNON. Apparently that hasn't been done too often, as you read this statement.

Go ahead. I am sorry.

Mr. BAILEY. A currently proposed revision to Defense regulations would require the contracting officer to request an audit if, after the award of a contract, he obtains information that leads him to believe that the data furnished may not have been accurate, complete, and current.

(d) *Questionable determination by contracting officials that proposed prices are based on adequate price competition or catalog prices and that cost or pricing data need not be obtained*

Mr. LENNON. Mr. Chairman, I hate to interrupt so much, but this, I think, is so important.

At the top of page 25 you say :

A currently proposed revision to Defense regulations would require the contracting officer to request the audit if, after the award of a contract, he obtains information that leads him to believe that the data furnished may not have been accurate, complete and current.

In other words, there is no Defense regulation now which requires the contracting officer to request the audit if, after the award of the contract, he obtains information that leads him to believe that the data furnished is not accurate, complete or current?

Mr. BAILEY. To my knowledge, this is so; yes sir.

Mr. LENNON. What is the status of the so-called currently proposed revision of the Defense regulations that would require the contracting officer to do this? In other words, I am asking you, what is the benefit of Public Law 87-653, if there is no regulation in the Defense Department now that would require a contracting officer, if he is satisfied that information has not been accurate, complete, and current, to call for a postaward audit?

Mr. BAILEY. I couldn't answer the current status. Perhaps the Defense representatives, who are here, could tell you the current status of the Defense—the amendment to the Defense regulation.

However, up to this point—

Mr. LENNON. In other words, the act, itself, just sets general guidelines and it does not require DOD to establish and promulgate regulations which would meet the situation that I have just described and quoted from the top of page 25?

Mr. BAILEY. The Defense Department has the responsibility for this, to implement the law, to establish these regulations.

Mr. LENNON. This act was passed in 1962.

Mr. BAILEY. Yes, sir.

Mr. LENNON. It is now near the end of calendar 1967. So far, they have not proposed regulations that would require a contracting officer to request such an audit?

Mr. BAILEY. Mr. Lennon, it has always been permissible for the contracting officer to do this.

Mr. LENNON. I understand that, but it isn't being done.

Mr. HAMMOND. The Defense Contract Audit Agency does have an established program for postaward audits, and is making these audits on a planned basis. This is speaking to a particular case where a contracting officer should have an additional audit made based on the information that has come to his attention.

Mr. LENNON. A contracting officer goes to his superior officer and says, "The data furnished is neither accurate, complete, or current, one or the other; in the awarding of this contract, would you permit me now to have a postaward audit?"

The DOD would say, "No, we don't think it is necessary."

Is that right?

Mr. BAILEY. They could do that.

Mr. LENNON. But they could say "No," because the regulation does not require that audit, even though the contracting officer asked for it—

Mr. BAILEY. Well, yes—

Mr. LENNON. What is the purpose of this proposed revision of Defense regulations that would require the contracting officer—

Mr. BAILEY. I think the purpose is to put the contracting officer on notice that when he has reason to believe there may be some deficiency in the data that has been submitted by the contractor, he should avail himself of the opportunity of a postaward audit.

Mr. LENNON. Shouldn't it be mandatory if the contracting officer makes the representation that you referred to in your language, on

line 5 of paragraph 1 of page 25? It seems to me it ought to be mandatory.

Mr. BAILEY. Yes, sir.

Mr. GUBSER. Will the gentleman yield?

Mr. LENNON. Yes, sir.

Mr. GUBSER. This colloquy suggests something that makes me shudder to even think of. Perhaps we will have to pass an administrative code of procedure to go along with all legislation, if we truly want to implement it.

Mr. HARDY. You might have something there.

Go ahead, Mr. Bailey.

Mr. BAILEY. Public Law 87-653 provides that the requirements for obtaining certified cost and pricing data, in support of a proposed price, need not be applied to contracts or subcontracts where the price negotiated is based on (a) adequate price competition, or (b) established catalog or market prices of commercial items sold in substantial quantities to the general public. ASPR provides the criteria for making such determinations and requires the contracting officer to include a statement setting out the basis for such determinations in the record of negotiations.

We found, however, that generally where cost and pricing data was not obtained, the procurement records did not include an explanation by the contracting officer of the basis for his determinations.

ADEQUATE PRICE COMPETITION

Defense regulations stipulate that price competition exists if offers are solicited with the understanding that the contract is to be awarded to the responsive and responsible offeror submitting the lowest evaluated price and at least two offerors who can satisfy the Government's requirements independently contend for the contract by submitting priced offers responsive to the expressed requirements of the solicitation.

If these criteria are met, price competition may be presumed to be adequate unless contracting officials determine that (a) the solicitation was unreasonably restricted, (b) the low offeror had such an advantage over other competitors that he was immune to the stimulus of competition, or (c) the lowest price was not reasonable.

With respect to determinations of adequate price competition, we have noted instances in the procurement of complicated defense systems, and their component parts and services where the competition obtained was less than adequate for establishing reasonable prices.

For example, a firm fixed-price contract was awarded for the overhaul, refueling, and missile retrofit of nuclear submarines at a total fixed price of \$46.8 million. The justification by the Navy for negotiating the contract was that the work was extremely complicated and of highly technical and specialized nature which required detailed knowledge of and familiarity with the construction of nuclear submarines. Only two private shipyards had such experience and capability.

The two shipyards were solicited for proposals and both responded. Both offerors had prior experience in the performance of work on nuclear-powered submarines; however, one of the offerors had an advantage over the other because it had prior experience in planning

and performing the same work on two nuclear submarines of the same class. The higher offeror submitted a fixed price of \$62.7 million, while the low offeror proposed \$46.8 million. The large difference in proposed prices reflects the difficulty in estimating the cost of performing complex work that is not clearly defined. The high offeror advised the Navy of this difficulty, and suggested the Government's best interests would be better served by contracting on a cost-plus-a-fixed-fee basis instead of a fixed-price basis.

In view of the facts, it seems evident that the high offeror could not submit a realistic estimate for the work required, and there appeared to be no assurance that the low offer was reasonable.

We believe there is a need to revise existing criteria in ASPR for the guidance of contracting officials in determining whether adequate price competition exists.

Under circumstances such as discussed above we believe cost or pricing data should be obtained for use in evaluating the reasonableness of the proposal. We also believe that where two offerors are within a competitive range, negotiations should be conducted with both offerors, as required by Public Law 87-653.

Mr. HARDY. Mr. Bailey, on this subject of competition, have you run across any case where competition was alleged to be adequate because there was a threat of competition?

Mr. BAILEY. Yes, sir; we have.

Mr. HARDY. So, actually, there was no literal competition but somebody made a finding that a threat of competition existed and, therefore, considered that to comply with the requirement for competition?

Mr. BAILEY. Yes, sir.

Mr. HARDY. Do you have some cases of that kind?

Mr. BAILEY. We have some that we can discuss with the committee.

Mr. HARDY. We will get to those a little later.

Have you also had situations where there has been competition between a prime contractor and his subcontractors?

Mr. BAILEY. Yes, sir. For the same item.

Mr. HARDY. That is what I am talking about, for the same item.

Mr. BAILEY. Yes, sir.

Mr. HARDY. In that case, would the prime contractor make any part of it, or would it all be acquired from the subcontractor?

Mr. BAILEY. Well, in the particular cases involved, the prime contractor was to purchase the item from the subcontractor and furnish it to the Government.

Mr. HARDY. So there had to be two profits on it instead of one?

Mr. BAILEY. Yes, sir.

Mr. HARDY. Go ahead.

Mr. BAILEY. Catalog prices.

With respect to contracts awarded, without obtaining cost or pricing data, on the basis of catalog prices, we have found instances where the items so designated were not in fact commercial items sold in substantial quantities to the general public. As a result, it appears that the contracting officers' determinations, that these procurements were not subject to the cost or pricing data requirements of Public Law 87-653, were not valid.

Mr. GUBSER. I would like to interrupt at that point, if I may, Mr. Chairman.

Mr. HARDY. Yes, I know which one you are thinking about.

Mr. GUBSER. No. This commercial item business bothers me, because we know that as a matter of practice, the Federal Government has pretty generally followed the procedure in some items, particularly electronics items, of specifying, and at times actually copying the specifications for a commercial-off-the-shelf catalog item, and then saying, for example, that the case should be black instead of gray, or adding some little feature which adapts it to particular Government use, and then calling it a noncommercial item.

I would like to know if you ran into any of this in your investigation.

Mr. BAILEY. Nothing of this kind has come to my attention, Mr. Gubser.

Mr. GUBSER. Well, for example, if you had an electronic gadget, just to construct a hypothetical case, which was identical to the off-the-shelf catalog item, but it was required that for Government use it be packaged in a different sort of a case, would you call that a catalog off-the-shelf item?

Mr. BAILEY. It seems to me there would be a difference here, because of the fact that the case is different. It may affect the cost. It may result in differences in price.

Mr. GUBSER. I'm not going to belabor this point, but Mr. Chairman, this is the thing that I think the General Accounting Office, this committee, and everyone on it should be alerted to. There is a widespread practice among Government procurement officers, of taking off-the-shelf items and making some little insignificant change in them, and calling them a Government specified item.

Mr. HARDY. Are you suggesting that is the brainchild of the contracting officer, or the contractor?

Mr. GUBSER. It could be both, I don't know. But I'm just curious to see whether or not in your investigation of commercial items you ran into this. I won't belabor it any further.

Mr. HARDY. I think we will need to consider this, and this is one of the items we will pursue when we get a little further on.

But while we are on this catalog thing, there have been known to be such situations of a catalog actually showing prices that are sometimes 40 to 50 percent in excess of what the items generally sold for. As a matter of fact, some of them have a little guide to this in the front of them. It will tell you that you get the price that you have to pay, not by the dollar price that is listed in the catalog, but by reading certain figures into the number of the item.

When you get a catalog like that, it would hardly be appropriate to consider it as a substitution for competition. Do you run across that kind of a situation?

Mr. BAILEY. Well, specifically, that particular type, where the catalog prices are subject to certain reductions, and so on, the answer is "No." We have, as I will indicate later in my statement here, run into situations where items are published in a catalog that are strictly Government items. They are sold to the Government alone.

Mr. HARDY. That is covered in your statement?

Mr. BAILEY. Yes.

Mr. HARDY. Go ahead.

Mr. PIRNIE. Mr. Chairman, I was interested in the response to Mr. Gubser's inquiry about the off-the-shelf item being changed in the category because of packaging. That would have to be quite an unusual type of package for it to be appropriate, isn't that correct?

Mr. BAILEY. I perhaps misunderstood Mr. Gubser, but I was thinking in terms of the case for an electronic item. In other words, the package for the chassis, rather than the box that it goes in.

Mr. PIRNIE. Is that what you meant? It doesn't make it clear it must be that type of situation, and not ordinary packaging.

Mr. BAILEY. Yes, sir.

Mr. HARDY. That is a case that fitted a particular installation?

Mr. BAILEY. This could be, yes, sir.

Mr. HARDY. Go ahead.

Mr. BAILEY. Under these circumstances, there was little assurance that the prices to the Government were fair and reasonable.

For one of these awards, the contracting officer's memorandum of the negotiation indicated that he considered the price fair and reasonable because it was included in a published commercial price list, and because the contractor stated the price was based on established catalog prices of commercial items sold in substantial quantities to the general public.

We were informed by agency officials that no written evidence was obtained in support of the contractor's statements, nor was any attempt made to verify the information. Our review of sales data at the contractor's plant disclosed that the contract items had not been sold previously to commercial sources, or to the general public. The contractor denied that he had informed Government contracting officials that the item had been sold commercially to the general public.

We brought our findings to the attention of the contracting officer who stated that he believed he had obtained adequate support for his determination and that, under current regulations, he is not required to obtain sales history data or other evidence to assure that the item being procured is a commercial item sold in substantial quantities to the general public.

The regulation does not specifically provide that the contracting officer require the contractor to submit the facts needed to support a reasonable conclusion that the prices proposed meet the ASPR criteria for catalog or market prices of commercial items. Nor does ASPR require verification if such data were submitted. Under these circumstances there is a lack of assurance that this exception to obtaining certified cost information provided by Public Law 87-653 is being properly implemented.

We therefore believe there is a need to strengthen existing requirements relating to the award of negotiated contracts expected to exceed \$100,000 for items represented by contractors to be based on established catalog prices. To achieve this objective, we have recommended to the Department of Defense that the provisions of ASPR be revised so that contractors are required to submit factual data in support of proposed prices over \$100,000 that they represent to be based on established catalog or market prices of commercial items sold in substantial quantities to the general public, that such data be independently verified, and that the contractor be held accountable for submission of incorrect information.

In summary our findings indicate a need for revision of existing regulations and increased training of procurement personnel so that they are fully cognizant of the regulations implementing Public Law 87-653.

In addition, it appears that a greater effort will be needed to communicate to contractors and subcontractors what is expected of them by the Department of Defense in the way of cost or pricing data submissions in support of noncompetitive price proposals. Finally, there is a need to augment existing programs for surveillance to insure that the Government officials responsible for the various aspects of procurement are carrying out their responsibilities in full compliance with the intent of the law and the implementing regulations.

NEED FOR GREATER INTERNAL AUDIT COVERAGE OF PROCUREMENT ACTIVITIES

In May 1967, we submitted to the Secretary of Defense a preliminary draft of a report to the Congress on our review of the internal auditing organizations of the Department of Defense. Internal audit organizations of the individual military services, DOD, and DSA are responsible for auditing the procurement activities within their agencies.

As of February 1967, some of the audit organizations had not yet conducted, or made plans to conduct, audits specifically directed to evaluating (1) the extent of compliance with Public Law 87-653, the Truth in Negotiations Act, or (2) the activities of procurement and administrative contracting officers. Also, the internal audit of the Defense Contract Audit Agency, for determining how well contractors and subcontractors had complied with the requirements of the law, had not made any evaluations of the work of this large and important audit agency. While the audit programs and the reports on audits performed by the other audit organizations indicated coverage of the essential provisions of the law, the extent of audit work performed in this important area seemed inadequate.

We concluded that substantially increased attention and effort should be given by the audit organizations to determining the manner in which procurement officials are complying with Public Law 87-653 and how well they are discharging their responsibilities under Defense procurement regulations.

We also concluded that, since the audit responsibility for the total procurement process, and the evaluation of performance is so widely spread among the separate internal audit organizations which appear to function largely independent of each other, there is a vital need for the Assistant Secretary of Defense (Comptroller) to exercise close coordination and overall control and direction of the total audit effort to broad objectives.

The Department of Defense agreed with these conclusions and informed us that increased audit coverage would be given to procurement area.

Mr. Chairman, that concludes my prepared statement, and I will be happy to try to respond to your questions.

Mr. HARDY. Thank you, Mr. Bailey.

You have given us, I think, a very clear statement.

It seems to me that running all through it is the suggestion of some widespread need for improvements in the regulations.

You have not, as I recall it, made any suggestions for statutory change. Does this mean that you haven't found any defects in the

statute itself, but rather that the problems are in the implementing regulations?

Mr. BAILEY. Well, sir, of course we have mentioned the need for statutory—recognized or suggested the need for statutory authority for access to contractors' costs of performance for the audit agency of the Department of Defense. But outside of that, you are correct, we have made no recommendations for statutory revision. We believe that it is in the implementation of the statute that we need these additional safeguards, corrections, and training.

We think that this is the important thing, to insure a full understanding on the part of all administrative personnel as to the objectives of the law, and the need for the Government to have the data that should be available to it at the time of the negotiation of these important contracts.

Mr. HARDY. The only legislative comment that you made, that I recall, has to do with H.R. 10573. You did indicate you have sent a report back to the committee on that, and I presume you recommended its enactment.

Mr. BAILEY. Yes, sir.

Mr. HARDY. Do you know approximately when that report was sent back?

Mr. BAILEY. No, sir, I can't give you the exact date. We can supply it, if you like, for the record.

Mr. HARDY. That is all right. Really, it doesn't matter too much. I'm going to try to inquire a little bit later whether we have gotten a report from the Department of Defense, because these bills are never referred by the chairman of the committee until after the reports have come in.

I notice that this bill was introduced on June 6. It seems to me there should have been ample time for the Department of Defense to submit a report, if it has not done so. We will pursue that with them.

Mr. GUBSER. Has the Senate passed the Proxmire bill?

Mr. HARDY. No.

Mr. BAILEY. Mr. Chairman, our report was sent to your committee on July 27, 1967.

Mr. HARDY. July 27, and Defense still hasn't sent its report. We will ask about that when we get them up here. I think Mr. Malloy has an answer. Do you want to answer it now, Mr. Malloy?

TESTIMONY OF JOHN M. MALLOY, DEPUTY ASSISTANT SECRETARY FOR PROCUREMENT, DEPARTMENT OF DEFENSE

Mr. MALLOY. Mr. Chairman, I would be glad to answer it now.

I'm John M. Malloy, Deputy Assistant Secretary of Defense for Procurement. The position of the Department on Congressman Minshall's bill has not been provided as yet.

Mr. HARDY. You are a little slow, don't you think, Mr. Malloy?

Mr. MALLOY. This is much slower, Mr. Chairman, than in a normal situation.

This is a bill we are giving very careful consideration to, and I believe that our report will be submitted in the very near future.

Mr. HARDY. Maybe you can jack them up a little bit.

Mr. MALLOY. I will do my best, Mr. Chairman. I have been working on this.

Mr. GUBSER. Mr. Secretary, has the Senate passed the Proxmire bill?

Mr. MALLOY. No, sir; they have not. I do not believe they have considered it. Of course, the Senate is in the same position with respect to the bill as the House, since they have not received Defense Department comments.

Mr. HARDY. Maybe we are going to have to start acting on this bill without your comments, if you don't speed up a little.

That brings up something that I recognized running through your statement, Mr. Bailey. You talked about urgency in procurement, but there is no urgency on the part of DOD about getting a report back to the Congress on the bill. They have urgent procurements coming up all the time. You talked about deficiencies in the negotiating process that come about because of administrative processes.

I don't know whether this would come within your province, but did you undertake to analyze the validity of some of these urgent procurements.

Mr. BAILEY. We have not, Mr. Chairman, questioned the need for urgency in the cases that have come to our attention to this point.

However, we do contemplate, as part of our future program, looking into the total procurement process in some of these cases to determine the timespan that was involved from the determination of need for the item, to the time when the contract was actually let, to see if it would be possible to shorten the administrative leadtime involved in letting these contracts. Such a reduction might provide more time for the negotiation of the contract and the review of contractor's proposals.

Mr. HARDY. I had in mind one claim of urgency that occurred to me. Last year, we had an urgent request to provide an authorization, a supplemental authorization, for the procurement of some light observation helicopters. It was so urgent that we had to do that in a special bill. But this was at a time when they weren't even getting any of their original orders. So subsequently the procurement was canceled entirely on that particular authorization.

There was another thing in your report. You spoke of situations where the lowest price might be rejected because it was unreasonably low, or something to that effect. This one was accepted even though it was unreasonably low. We have had some rather strange follow-ons. I couldn't resist that observation.

Mr. PIKE, do you have any questions?

Mr. PIKE. Yes, Mr. Chairman, I have. Thank you.

This item that you referred to on page 8, Mr. Bailey, in which these 57-cent overcharges mushroomed into a \$388,000 charge.

Has the Government made any attempt to recover this money from Bell & Howell at this time, and, if so, what is the status of the recovery effort?

Mr. BAILEY. The Army agreed with our findings in this case, and took steps to obtain the money from the contractor, but the contractor has appealed the Army's determination that there was overpricing in this case to the Armed Services Board of Contract Appeals.

Mr. PIKE. So at the moment this is still in administrative, rather than judicial litigation, is that it?

Mr. HARDY. "Limbo" is a good word.

Mr. BAILEY. Yes, sir.

Mr. PIKE. Does the Truth in Negotiations Act cover a contract in excess of \$100,000, which was executed prior to the date of the act, but for which there have been follow-on contracts for spare parts, say, or something of that nature?

Mr. BAILEY. If the follow-on work is covered by another contract, no. If it is an amendment to the original contract, made after the effective date of the act, the amendment would be subject to its provisions.

Mr. PIKE. So the contract for spare parts itself would come under the act, if it were over \$100,000, but the basic contract could not be reviewed under the Truth in Negotiations Act?

Mr. BAILEY. It could be reviewed by the General Accounting Office, if it is a negotiated contract, but it would not be subject to review by the agency or subject to the provisions of Public Law 87-653.

Mr. PIKE. I'm very curious. People ask me all the time how much money was wasted in this particular manner, and in an effort—I know you can't answer the question, I'm not going to ask you the question—but in an effort to get some feel for it, you discuss here reports on 241 procurements to Congress, and of these, 104 contained findings relating to the manner in which the Truth in Negotiations Act was involved.

Does this mean that in 104 cases out of 241 there was a failure to comply with the Truth in Negotiations Act in some manner?

Mr. BAILEY. Well, actually, of the 104 cases involved the types of things that are covered on my statement here; yes, sir. Whether these could be characterized as failures or not—in some cases, it is lack of documentation, failure to—

Mr. PIKE. I'm trying to get down to this: In your statement, you say that in 59 of the reports issued, had agency officials obtained the proper information they would have saved \$12 million, or they could have negotiated—you don't say it quite that boldly—but they could have negotiated contracts which would have resulted in a saving of \$12 million.

Does that mean that in the other 45 cases, the Government didn't lose any money, or what does it mean?

Mr. BAILEY. No, sir; what it means is we can't put a price tag on what happened.

Mr. PIKE. You can't put a price tag on it.

All right, now, of the 59 cases in which you can find a saving potential of \$12 million, what was the total amount involved? Can you tell us that?

Mr. BAILEY. We do not have that information. We might be able to supply it for the record, sir.

Mr. PIKE. That, to me, would be a meaningful figure, if we can get some sort of an idea of the percentage of waste involved in those 59 cases.

(The Department of the Army subsequently advised the subcommittee that the total amount involved in the cases under discussion was \$766 million.)

Mr. PIKE. Were the 241 reports which you issued to Congress, reports on situations which you investigated on a random basis, or were they reports on investigations which you went into because somebody smelled something wrong?

Mr. BAILEY. I think we would have to say both.

Mr. HAMMOND. I think they are both.

Mr. PIKE. Both?

Mr. BAILEY. Yes, sir.

Mr. PIKE. Well, it is rather difficult to pin down the amount of waste involved in these things.

Mr. BAILEY. Yes, sir; it is very difficult.

Mr. PIKE. I have noted, personally, a rather pervasive attitude on the part of the Pentagon—and by this I mean not just the Department of Defense, I mean the Army, the Navy, and the Air Force—whenever one of these smelly situations arises, to put the entire blame on the corporation which has one way or another juiced the Government.

I would like you to tell us whether, in any of these 59 situations in which you found an actual failure on the part of either the company or the contracting officer—and in my opinion both—to do their job properly, any contracting officer ever got canned?

Mr. BAILEY. Not to my knowledge, Mr. Pike.

Mr. PIKE. Would you think that it would be a reasonable action to take in some of these cases, to fire the contracting officer who was responsible for the waste of these millions of dollars?

Mr. BAILEY. Mr. Pike, this is a very difficult question for an outsider not in the Department of Defense to answer. For one thing, we don't know what other work this particular man may have done in other circumstances. This would be a very difficult conclusion for us to reach.

Mr. PIKE. Have you ever found a case in which the contracting officer responsible for these millions of dollars wasted was demoted?

Mr. BAILEY. No, sir; not to our knowledge. Of course, I might say that we—

Mr. HARDY. That doesn't happen anyway, does it?

Mr. BAILEY. We don't look for this type of thing, for one thing.

Mr. PIKE. I know it doesn't happen, Mr. Chairman, but I want to get on the record it doesn't happen.

Have you ever found a case in which one of the contracting officers responsible for this waste of millions of dollars was, when you got around to auditing the situation, actually serving in a higher office than he had been when he was responsible for the waste?

Mr. BAILEY. Well, my associates tell me the answer to this is yes. I know of no specific instances.

Mr. PIKE. Have you ever found a situation where, when you got around to auditing some of this waste you found that the contracting officer who was representing the Government at the time of the contract, which turned out to be wasteful, was, at the time of the audit, working for the contractor?

Mr. BAILEY. Yes; we have found some of this.

Mr. PIKE. That is all I have, Mr. Chairman.

Mr. HARDY. Mr. Gubser.

Mr. GUBSER. In these cases that you have investigated, have you ever found a situation, or any number of situations, where it later turned out the price perhaps was lower than it should have been, and perhaps the Government got a pretty good deal.

Mr. BAILEY. Yes, I think that there have been cases of this kind; yes, indeed.

Mr. GUBSER. Let me say my intent here is not to discredit the cases that you have cited. But I do think, in fairness, and to serve objectivity, that perhaps we ought to make some notation of situations which are the reverse of those that you have described, and perhaps consider the fact that it might average out, as most business deals average out. You make a good deal today and a bad deal tomorrow, and perhaps you average out doing pretty well.

Mr. BAILEY. There are unquestionably cases where the contractors don't make a good deal, and the Government gets a low price.

Mr. GUBSER. I am sure of that.

In conducting these investigations, you have, in effect, conducted postaudits; isn't that correct?

Mr. BAILEY. Yes, sir.

Mr. GUBSER. Have you had any difficulty, at any time, in getting contractor cooperation for the information that you required in conducting your postaudits?

Mr. BAILEY. Yes, sir; we have.

Mr. GUBSER. Maybe you can't speak generally about it, but I would like to hear a little bit about your difficulties, if you can summarize them.

Mr. BAILEY. Well, we have had problems in obtaining access to records that we felt were necessary to properly evaluate a procurement.

We have had cases where contractors have denied us records on the basis that they were not used as a part of the negotiation, and therefore were not pertinent as defined in our particular clause.

Mr. GUBSER. Has that been one or two cases, or a lot of cases, that refused on that basis?

Mr. BAILEY. It has been more than one or two. I would not want to say it has been a lot, but there have been—oh, there have been more than just a few, I would say. But I would not say a lot.

Mr. GUBSER. What other bases—

Mr. BAILEY. Most contractors are quite cooperative.

Mr. GUBSER. On what other bases have they refused information?

Mr. BAILEY. Sometimes they refer to the records as proprietary—that is, it is information for their use only and they don't feel that the Government is entitled to access to them.

Mr. GUBSER. Even though it may have been pertinent to the negotiations?

Mr. BAILEY. Well we feel it was pertinent or we would not have asked for it; yes, sir.

Mr. GUBSER. What I am trying to get at is, do they ever refuse on the basis that this is corporation confidential-type information instead of—even when it was pertinent to the negotiation, and when they admitted it was pertinent?

Mr. BAILEY. Well, they generally take the position it is not pertinent. This is generally the position.

Would you like to add something?

Mr. SHNITZER. We have one instance in which I understand this is precisely what happened: There was a concession, at least, on the part of the counsel for the company, that this data was pertinent, but there was a reluctance to disclose it on the basis that it was proprietary data—that it might jeopardize their position in the industry.

Mr. GUBSER. The reason I am asking this question is, I would really like to know whether a bill like H.R. 10573 would give you any authority to demand the production of this information that isn't already clearly implied in Public Law 87-653, with the provision that a defective pricing data clause must be inserted in each contract, negotiated on the basis of data provided by a contractor.

Isn't the sense of H.R. 10573 implied in that portion of Public Law 87-653?

Mr. BAILEY. It is to cover an entirely different area, Mr. Gubser.

This legislation that you refer to, the Minshall bill, is to grant to the administrative audit agencies of the Department of Defense a right to look at performance costs, which they do not now have, under the contract clause that is incorporated under Armed Services Procurement Regulation the right to look at performance costs as well as other information in connection with postaward or preaward audits, whereas we operate under another provision of law which is incorporated by law in the contract.

Mr. GUBSER. That, to me, is a very important point. Let me restate my understanding of what you just said, because I think it is pertinent here.

You feel, under the terms of Public Law 87-653, the Defense Department does not have the legal right today to demand the production of performance costs after the fact; is that correct?

Mr. BAILEY. Yes, sir.

Mr. GUBSER. And the Minshall bill, as you understand it, would give you that right?

Mr. BAILEY. It would give them that right; yes, sir.

Mr. GUBSER. Let me ask somewhat along the same line: Let's take a hypothetical case of some very expensive vacuum tube, for example. We have a spoilage problem. Costs at the time of the negotiation were determined upon the past history and the previously existing ratio of spoilage.

Let's assume, however, during the performance of the contract they either got lucky or, through their own devices, developed a new production technique which lowered the spoilage rate and consequently lowered the cost itself. Would that situation require a rebate to the Government?

Mr. BAILEY. No, sir; not if it occurred subsequent to the negotiation. In other words, the Truth in Negotiations Act is designed to make available to both parties the facts as they exist on the date of negotiation. If subsequent to the negotiation of a firm-fixed price the contractor improves his technique, gets lower prices for his materials, the market goes down, he is lucky.

Mr. GUBSER. He gets the advantage.

Mr. BAILEY. If it goes up he is unlucky.

Mr. GUBSER. He gets the advantage?

Mr. BAILEY. Yes. If the material is available to both sides at the time of negotiation.

Mr. GUBSER. On page 29—

Mr. HARDY. It looks like Mr. Malloy has a comment he wants to make.

Do you, Mr. Malloy?

Mr. MALLOY. Mr. Chairman, just to be sure that there is complete understanding of our postaward audit rights, I would like to observe

that in all types of contracts, other than firm-fixed price types of contracts, we, today, have a right after the contract is awarded to audit anything and everything.

In the case of a firm-fixed price type of contract, today, we have a right to audit after award, at any time after award, anything that was used up until the time of the agreement on the negotiated price.

What we do not provide by contract today, and that which is the subject of Congressman Minshall's bill, is in the one instance of negotiating sole-source, firm-fixed price contracts, to audit the actual cost of performance. We do, as I say, audit, postaudit, anything that was available to the contracting officer up to the time of the negotiation.

Mr. HARDY. Thank you. I think that clears it up.

Mr. GUBSER. Yes.

On page 29 of your statement, you say, in the second sentence of the last paragraph:

To achieve this objective we have recommended to the Department of Defense that the provisions of ASPR be revised so that contractors are required to submit pertinent factual data in support of proposed prices over \$100,000 that they represent to be based on established catalog or market prices of commercial items sold in substantial quantities to the general public * * *

Doesn't that recommendation, in effect, amount to the removal of the catalog item exemption?

Mr. BAILEY. No, sir. The catalog item exemption says they don't have to submit cost or pricing information. In other words, how much it costs them to make the catalog item—so that the price can be negotiated by the contracting officer on the basis of, let's say, the cost data that are submitted.

What it does say is you allege this to be a catalog item. Show us the basis for your—

Mr. GUBSER. Calling it a "catalog item."

Mr. BAILEY (continuing). Calling it a catalog item, and the fact you do sell it to someone other than the Government.

Mr. GUBSER. The way I read it, I get the impression you were going to require the submission of cost data—

Mr. BAILEY. Not if it is a true catalog item.

Mr. GUBSER. You are going to require more proof that it is not a catalog item?

Mr. BAILEY. Not only what is printed in the catalog, but what is sold to the Government.

Mr. GUBSER. One more question, Mr. Chairman:

I am interested in two statements that are related on pages 6 and 7 of your statement. On page 6, you say:

Nevertheless, prior cost experience should play an important part in estimating future costs.

And then you say on page 7:

We believe that prior cost experience should be required to be submitted with the proposal even when not used as a basis for the estimated costs.

Aren't those two statements, contradictory?

Mr. BAILEY. No, sir; we don't feel that they are.

We feel that where a contractor has had experience in producing an item he should make those costs known to the negotiator even though he may project his price on the basis of estimates only.

In other words, engineering estimates, or some other form of estimating. We feel the contracting officer should be aware of the fact that the contractor had previously produced this item. Perhaps he has changed his production processes, but this would be disclosed by the fact that he has previously produced the item at a cost of so much. If he has changed his processes, then the contracting officer would be on notice that perhaps the price should be lower because of his change in the production processes.

Mr. GUBSER. All you are asking, or suggesting, is that if a contractor has made this item prior to the negotiation, he should be required to submit his cost data for that prior production?

Mr. BAILEY. This is right.

Mr. GUBSER. Even though his production techniques may have changed to the point that they are not even related.

What purpose does that serve?

Mr. BAILEY. Well, for one thing, I think it serves the purpose that where there is prior cost information it will be used in appropriate circumstances. I think it also serves the purpose of putting the contracting officer on notice as to what the prior costs were. The contracting officer has a better basis on which to judge the contractor's estimates, even though the contractor himself may not have used that as a basis.

Mr. GUBSER. That I can understand.

Mr. BAILEY. Or claims he does not use it as a basis.

Mr. GUBSER. It would not be pertinent to the negotiation. It would be helpful to the Government negotiator; isn't that about what it amounts to?

Mr. BAILEY. That is right.

Mr. GUBSER. Thank you.

Mr. HARDY. Mr. Lennon.

Mr. LENNON. I note you say that the Corps of Engineers and the Naval Facilities Engineering Command do not consider this act as applicable to them in construction contracts.

When did you make the determination that they did not recognize Public Law 87-653 as applicable to their construction contracts?

Mr. BAILEY. This was during a review—what was the date of that?—about 1966—

Mr. KIRBY. I am Charles Kirby, Associate Director, Defense Division. Our report was issued in June 1967.

Mr. BAILEY. The formal report was issued in June 1967. But when was the draft report sent to the agency?

Mr. KIRBY. About a year before that.

Mr. LENNON. What information did they give you as to why they, in their judgment, were not covered by this act?

Mr. BAILEY. I am going to ask Mr. Kirby to respond to your question on that. He handles our work in the construction area.

Mr. KIRBY. They used their own estimates. Generally in construction contracts of over \$10,000, they are required to prepare an estimate in such cases.

Mr. LENNON. You say the DOD has not advised them that in the judgment of their general counsel the act is applicable to them?

Mr. KIRBY. No, sir; not specifically, as far as we know they had not made this clear.

Mr. LENNON. What caused them to finally recognize it was applicable to them? Who advised them it was?

Mr. KIRBY. I can't answer that directly. I presume, as a result of our audit work and our report.

Mr. LENNON. It is obvious the legal department of the DOD made the decision.

Mr. KIRBY. The internal auditors did not look at this aspect at all, as far as we can find.

Mr. LENNON. I think we have a right to assume, since this became a legal question, that the DOD general counsel finally advised the Army, early in 1967, or late in 1966, that they did come under the act.

Then there were no cases that were investigated in this interim period, since the passage of this act, of contracts made by the U.S. Corps of Engineers or the Naval Facilities and Engineering Command, were there?

Mr. BAILEY. To determine compliance with the law, no, sir, we had not made any.

Mr. LENNON. With respect to the colloquy you had with the gentleman from California, it is the clear judgment of the General Accounting Office that without language suggested in the legislative draft of H.R. 10573, which the General Accounting Office has approved, you have no way, now, of going beyond the negotiation level, or the contract level, for investigations?

Mr. BAILEY. On a firm-fixed price, negotiated contract, yes, sir. The contract clauses that are now used by the Department of Defense permit the review of data up to the date of negotiation—the contractor submission of data. But they do not permit the agency auditors to audit performance costs under those firm-fixed-price negotiated contracts.

We have that authority in the GAO, but the agency auditors do not.

Mr. LENNON. Have you discussed this with DOD?

Mr. BAILEY. Yes, sir.

Mr. LENNON. They apparently do not feel there is any real requirement for the language with respect to performance of the contract and subcontract—is that the part they do not go along with you on?

Mr. BAILEY. They have it under consideration. They have not replied formally.

Mr. LENNON. I know they have it under consideration. They have since July.

But, the gentlemen who responded to the question by the chairman of the committee indicated they had authority to examine all books, records, documents, and other data, up to and through the negotiation period, and the signing of the contract, and any data, records, and documents, for a period of time thereafter, but only up to the point of the signing of the contract.

Do I understand you correctly, sir?

Mr. MALLOW. Yes, sir, I believe you stated that accurately. Just to restate it, to be sure everybody understands: We can audit at any time with no time limit, the data which was used by the contractor and the negotiator, up until the date of agreement on price, and what we do not provide contractually for now is to be able to, after the contract has been performed, ascertain from examining the contractor's records his total cost of performance. That we do not have

authority for, today. That is the area that Congressman Minshall's bill is addressed to.

Mr. LENNON. What is the attitude of the counsel of the Office of the Secretary of Defense on the language of performance of contracts, or certain contracts, which authority you do not have, but which GAO is suggesting that DOD should have?

Mr. MALLOY. I am not exactly sure I am understanding, but let me try to answer you.

It is quite clear in our minds that what is being proposed is to provide to our own agency auditors the same type of access to records that the Congress has now made available to the General Accounting Office. We do not now have that in this firm-fixed-price area. We could provide it by contract. That is the recommendation of the General Accounting Office. That is the recommendation we are considering.

Mr. LENNON. Mr. Malloy, let me ask you this question:

How could this bill do anything in the world except, hopefully, help the taxpayer?

Mr. MALLOY. Well, sir, we are talking about a firm-fixed-price contract. Perhaps if I would here now try to provide some indication of the matters that we are considering to indicate that it is not just an easy matter to resolve, it would help. You were talking about firm-fixed-price contracts, and you are also talking about audit of those contracts to insure compliance under Public Law 87-653.

I think that it would go without saying, to observe that from the standpoint of our auditors it would provide them with an easier, possibly more efficient method of auditing, for compliance with Public Law 87-653, if they could come along after the fact, see those contracts as the General Accounting Office does, exactly the same way—see those contracts in which a high profit is made. They trace the original estimates against the actual costs logged on the contractor's books and then go and examine the data that was made available up to the time of negotiation.

Having that right of audit brings into question the very basic integrity of a firm-fixed-price contract in which the contracting parties sit down and agree on a deal. The danger is, if we don't do this right, that we could provide a mechanism whereby a deal would not be a deal. It could result in second-guessing after the fact by one of the parties. If this happened very often, obviously a firm-fixed-price contract, which provides the best incentive that we know how to devise for reducing costs, might itself come into question.

Contractors might well be reluctant to take more of these contracts if the possibility exists they would be repriced or second-guessed thereafter.

What we are trying to do is to get the best of both worlds.

We would like to devise the very best method we can to have the most efficient audit approach, and at the same time to be sure that the integrity of fixed-price contracts does not come into question.

These are the matters that are being considered, and I believe it is not just an open and shut case on either side. I think there are good reasons, good rationale, for both positions and it is a weighing of these two good objectives that has taken us more time than usual in arriving at our position on the bill.

Mr. LENNON. Thank you, sir. Time won't permit detailed discussion of your statement. But on page 31—

Mr. BAILEY. Pardon?

Mr. LENNON. On page 31 you comment on the need for greater audit coverage for procurement activities. In the second paragraph on that page you said:

As of February this year, some of the audit organizations had not yet conducted, or made plans to conduct, audits specifically directed to evaluating (1) the extent of compliance with Public Law 87-653, the Truth in Negotiations Act, or (2) the activities of procurement and administrative contracting officers.

Did General Accounting Office suggest that the audit organization of the several services, and DOD, make a study of plans to conduct audits specifically directed to evaluating the extent of compliance with Public Law 87-653, or to the activities of procurement? Did you all make those recommendations?

Mr. BAILEY. Yes, sir; we made those recommendations.

Mr. LENNON. When did you make those recommendations?

Mr. BAILEY. In the May 1967, draft of our report to the Department of Defense, we made those recommendations.

Mr. LENNON. I understand that. That is the time you found out they had not made it, according to your statement?

Mr. BAILEY. Yes, sir.

Mr. LENNON. Had you previously recommended that these determinations for audit—

Mr. BAILEY. We had in several of our reports made recommendations along these lines; yes, sir.

Mr. LENNON. You find now, generally speaking, that there is a greater effort being put forward by DOD to try to live up to, specifically, if they can, the statutory and legislative, and congressional intent of this act?

Mr. BAILEY. Yes, sir. I think we could answer that question very definitely; yes.

Mr. LENNON. That is all. Thank you.

Mr. HARDY. Mr. Pirnie.

Mr. PIRNIE. Mr. Bailey, I don't assume there is any way of an audit disclosing the cases where procurement may have been broken up so as to not go over the \$100,000 limitation, is there?

Mr. BAILEY. Well, it would be possible, I presume, but it would be very difficult to do, and be very time consuming to do.

Mr. PIRNIE. It wouldn't be very practicable?

Mr. BAILEY. No, sir.

Mr. PIRNIE. But that is a factor, is it not, or could be?

Mr. BAILEY. Yes, sir.

Mr. PIRNIE. I am interested in that, with respect to procurement investigations, where you have found this failure to carry out what you consider to be the spirit of the act. When those have been disclosed has there been any enthusiasm over the findings that your observations were picked up and implemented so as to derive some benefit for the Government?

Mr. BAILEY. I think that we have had very good response on the part of the departments to our findings in this area, Mr. Pirnie.

Mr. PIRNIE. I am glad to hear that.

Mr. BAILEY. I think they have recognized in many cases the need for increased surveillance, the need for changes in their regulations, and I think—

Mr. PIRNIE. I am not talking about generalities. I am talking about the specific episodes.

Mr. BAILEY. Well, in many of the cases where we have disclosed what we considered to be overpricing, because of deficiencies in data submitted, and so on, they have taken action and agreed with us, and attempted to get refunds.

Mr. PIRNIE. But in your response to the question here, you haven't any instance where there had been any change of personnel so as to eliminate incompetent, inaccurate handling of the procurement?

Mr. BAILEY. No, sir. But I think we might point to the fact that the Department of Defense is conducting seminars, classes, in attempts to get more recognition on the part of procurement personnel of their responsibilities under the law. I think this is a step in the right direction.

Mr. PIRNIE. Well, I would assume that. But I am more interested in those situations where commonsense would have indicated other types of action than the path which was pursued. You understand what I mean?

Mr. BAILEY. Yes, sir.

Mr. PIRNIE. It is a case of competency and not dishonesty that I am pursuing here. If a person has a title of "contracting officer," it is presumed he knows how to negotiate a contract.

Mr. BAILEY. That is right.

Mr. PIRNIE. And he ought to have comprehension of the factors involved.

What was your observation in regard to the existence of that competency in these cases?

Mr. BAILEY. This is a very difficult question to answer, Mr. Pirnie, on the basis of a look at a limited area of an individual's performance.

Mr. PIRNIE. Yes. I am not trying to put anyone on the spot.

I have had a little practical background in regard to this area, and I know that you can, through conversations with individuals, ascertain whether or not they have a grasp of the scope of their responsibilities so as to be discerning, and so as to properly evaluate these factors. If a person doesn't possess that approach they are bound to blunder, aren't they?

Mr. BAILEY. Yes, sir.

Mr. PIRNIE. I am just wondering whether or not there is sufficient emphasis upon the type of preparation and competency of the individual discharging the responsibility, and I am not interested in just mass production. You can send all the people who are engaged in the work to a seminar, you can tell them, "Now, go and be educated," but when they come back from that seminar they will only absorb what they were capable of appreciating; isn't that true?

Mr. BAILEY. Yes, sir. There is another factor involved here, Mr. Pirnie, and this is a personal observation over the years I have been in touch with the procurement area, as well as other areas of agency operations, and that is, I think that a good deal of the recognition of responsibilities in the performance of assigned functions and duties in discharging responsibilities is related to the amount of supervision or interest on the part of the boss, shall we say, in the job that is done.

If the supervisor gives sufficient interest or evidence of interest in a particular area, that area will be emphasized. If he tends to slight

an area, that area will be slighted on the part of the individual who does the work.

So I think there is a direct ratio here.

Mr. PIRNIE. Then what you are saying is the objectivity of the supervision is bound to have a tremendous impact upon the performance?

Mr. BAILEY. Yes, sir.

Mr. PIRNIE. Now, of course, Mr. Malloy is talking about the study of the Department. I can appreciate the desirability of not developing a system that harasses industry and the contractors. We don't want to be picayune and difficult and add to the cost of the article by the overhead we impose by our audit and regulations and details.

Mr. HARDY. If you will permit, I think we have to recognize there is a rather wide variation sometimes in the grade of contracting officers. Some of them are at a much higher level of competency than others, depending pretty much on the specific type of work they engage in; is that correct?

Mr. BAILEY. Yes; that is correct.

Mr. PIRNIE. I agree, Mr. Chairman, that is bound to be true, but we are talking here about contracts in excess of \$100,000. It isn't a small item that is being negotiated, as I see it. And I just wondered whether there was this capability and imagination so as to devise an approach that would be beneficial to the Government and yet fair to the industry, because if the contracting officer is only qualified to take orders, then you are only to have efficiency if there is minute supervision, because in the area that he is operating unsupervised, he just doesn't have the capability to proceed with objectivity, is that correct?

Mr. BAILEY. I think that has a lot to do with it; yes, sir.

Mr. HARDY. On the other hand, if he doesn't have the capability of taking orders, considering the chain of command that runs through the military, he would be in a sad fix, and wouldn't be very long on that particular assignment.

Mr. PIRNIE. I am not talking about things that are specific work. I am talking about things we discussed here: that regulations, if they are going to be so specific and minute they cover all areas of judgment, they are going to be so comprehensive they are useless.

Mr. BAILEY. I don't think we will ever reach the stage where law or legislation can substitute for many of these judgment areas.

Mr. PIRNIE. To sum up, the purpose of my inquiry, Mr. Chairman, is to see whether it is due to carelessness or misconduct, or lack of understanding of the correct approach on the part of the contracting officers.

Mr. HARDY. Sometimes I think you might even expand it a little to cover the question of the qualifications of these people.

Mr. PIRNIE. That is what I am talking about.

Mr. HARDY. When they are selected, actually, their descriptions and qualifications go along with it. This is an area we have had problems with all these years. Sometimes when you get a contracting officer whose experience has been comparatively limited, and put him across the table from the industry people he has to deal with, he may not be capable of coping with them.

Mr. BAILEY. That is correct.

Mr. PIRNIE. That is another way I was trying to develop, as to what he found as to the ability of the contracting officer to hold his own, and to truly represent the Government in negotiations.

Mr. BAILEY. I think there are many competent contracting officers in the Government service.

Mr. PIRNIE. There is no doubt about that; but I was talking about these areas where we find the deficiencies. I wondered whether you could comment on that. Whether you thought greater care should be taken in selecting the contracting officer, or whether more instruction, supervision, or what it was that was needed.

Mr. BAILEY. I think there is a certain amount of all of these things involved.

Mr. PIRNIE. That is all.

Mr. LENNON. Mr. Chairman, may I have one more question?

Mr. HARDY. Go ahead, Mr. Lennon.

Mr. LENNON. Mr. Bailey, you indicated that the 104 reports issued since January of 1966 contained 451 examples of various types of deficiency. The largest item was 357 out of the 451. Referring to contractors' submission of costs or pricing data in support of proposed prices, you say, there were deficiencies, in the judgment of the General Accounting Office, in that category in 357 instances?

Mr. BAILEY. Yes, sir. I would like to make it clear at this point, many of these lacked identification of information submitted by the contractor.

Mr. LENNON. Is it your judgment and the judgment of the counsel for the General Accounting Office that the 357 deficiencies you indicated are covered by Public Law 87-653? In other words, if Public Law 87-653 had been complied with to the letter, you would not have had the 357 deficiencies in the contractors' submission of costs or pricing data in support of the proposed prices? That is a big item.

Mr. BAILEY. Yes, sir; I think we could say that.

Mr. LENNON. You are saying now, out of 451 examples of deficiencies, 357 of them, in your judgment, would not have occurred had the spirit, letter, and intent of the law been complied with. Is that a fair statement of the fact?

Mr. BAILEY. I think that is true.

Mr. LENNON. That is your judgment?

Mr. BAILEY. Yes, sir.

Mr. LENNON. Your job is to convey that judgment over to DOD.

Forty-three deficiencies in evaluation of contractor price proposals—you are talking about audits now, before you get to the negotiating stage, aren't you, on page 2?

Mr. BAILEY. Yes, sir.

Mr. LENNON. Do you mean that there was a deficiency in the agency officials—the audit sections—on the contractor's price proposals?

Mr. BAILEY. Not alone auditing, Mr. Lennon. The various processes that are used to determine this.

Mr. LENNON. Yes. When you come down to the question of actions by contracting officials, as discussed by Mr. Pirnie, you only have 51 instances out of 451.

Mr. BAILEY. That is correct, sir.

Mr. LENNON. You have indicated that there was a question of judgment.

Now, I get the impression that in some of the cases you cited there were instances, however, where the contracting official simply ignored or brushed aside the determinations and the procedures used by the

various agency officials, including the auditing section, and arbitrarily or summarily made the judgment that, in his opinion, it did comply with this act?

Mr. BAILEY. Well, the actions, as we indicate in our statement, sometimes were where he disregarded, let's say, some information that was furnished to him, or there was no evidence that he took this into consideration, or what he did about it in the negotiation of the contract price.

Now, some of the items in the 357 category could be moved down into that category in terms of inadequate information available to show what was actually submitted and what was considered by the contracting officer—submitted by the contractor and considered by the contracting officer.

Mr. LENNON. Thank you, Mr. Chairman.

Mr. BAILEY. But—

Mr. LENNON. Go ahead, but what?

Mr. BAILEY. But the 51 items are of the categories we summarized in the third section of this statement.

Mr. LENNON. I see.

Mr. HARDY. Thank you, Mr. Lennon, and thank you, Mr. Bailey.

The committee would like to reconvene this afternoon at 2 o'clock. I would like to start off with Mr. Malloy. We will try to conclude this particular phase of the hearing this afternoon, if we can.

Let the committee stand adjourned to reconvene at 2.

Mr. BAILEY. Thank you very much, Mr. Chairman.

Mr. HARDY. Thank you, Mr. Bailey.

(Whereupon, at 12:20 p.m., a recess was taken until 2 p.m., of the same day.)

AFTERNOON SESSION

Mr. HARDY. Let the committee come to order.

Let the record show the presence of Mr. Lennon and myself, constituting a quorum.

We are pleased to have Mr. Malloy with us.

Mr. Malloy, this is the first time I have had the privilege of meeting you. I haven't heard you testify, I believe, before our committee. We appreciate your presence with us this afternoon.

I understand the statement which was presented this morning by the General Accounting Office witnesses had been presented to you the latter part of last week, I believe, and, of course, you heard the statement this morning. You don't have a prepared statement?

TESTIMONY OF JOHN M. MALLOY, DEPUTY ASSISTANT SECRETARY (PROCUREMENT), DEPARTMENT OF DEFENSE

Mr. MALLOY. No, I do not, Mr. Chairman.

Mr. HARDY. I think, then, it might be most helpful if you would care to comment on any specific points that the report dealt with. Specifically, the committee would be interested in having the reaction of the Department of Defense to the points made by the General Accounting Office, and any comments you have we will be very glad to hear.

Mr. MALLOY. Mr. Chairman, I would be delighted to comment on the GAO statement which was provided to us last Friday, September 22.

I would like to comment on several aspects of the statement, beginning with the discussion with respect to Public Law 87-653. There are many portions of the statement which dealt with pricing matters, and other matters that do not necessarily tie in to Public Law 87-653.

With respect to the basic law itself, I suppose that we have been spending as much or more time on the proper implementation of this particular statute in the past year or two than any other single element of our work in the procurement business.

This, in our judgment, is a good statute. It gives us a tool for negotiating contracts that is very helpful. By its provisions, as the General Accounting Office people have stated, it requires contractors to submit certain kinds of information. It requires them to certify it, and it requires that a clause be put in contracts authorizing recapture if the data submitted was not current, accurate, or complete.

These are the basic provisions of the law, and these are the things we have been doing. We were doing these kinds of things even before the law was passed, because we had provisions very similar to the law in our regulations since, I believe, about 1959.

Mr. HARDY. I don't think you had any certification procedure, though, did you?

Mr. MALLOY. Yes, sir, I believe we did.

We had a certification procedure. It was not exactly the same as the present one, but I am now going back in my memory quite a bit, and I wouldn't be absolutely sure.

Mr. HARDY. I didn't recall it. I recall so well when this statute was before the committee. My memory doesn't recall any certification requirement or anything which would provide the assurance which this statute was intended to provide. I don't know that it makes too much difference.

(Mr. Pirnie came into the meeting.)

Mr. MALLOY. I really don't think so, because I was only referring to the fact we had these regulations to indicate that this in its basic thrust was something that we had been doing. Of course when the statute was passed, there now arose the need to interpret the statute and implement the statutory language, which we did promptly after the passage of the act in 1962.

Since that time we have been getting experience, we have been changing our regulations, we have been training our people, and the General Accounting Office has been out looking around. They have turned in many reports to us, and these reports, Mr. Chairman, are extremely valuable to us. We use these reports like we use our own internal audit reports. They tell us where there are soft spots. We go after those soft spots and try to do something about them.

One of the soft spots that has developed over the past couple of years in respect to this law insofar as our activities are concerned has to do with this area of documentation. The General Accounting Office has said that when they looked at a pretty good sample of cases they found no record identifying the cost or pricing data that was submitted. They are not saying cost or pricing data was not submitted. There was a record but no neat little package listing the various data that we had obtained from the contractor so that we could better tie that into the certificate that the contractor was required to give us.

Mr. PIRNIE. May I interrupt just a minute on that before you finish that statement?

You say they didn't get that. Are you saying now that there was cost data, or that you don't know?

Mr. MALLOY. No. We were getting cost data, Mr. Pirnie, but our own people, the Department of Defense people, and the contractors actually, were not identifying specifically the data that was furnished, bearing in mind often in a negotiated transaction there are literally mountains of data. We were not, according to the GAO, doing a good job of documenting, and I don't think we were doing a very good job of documenting, but the question of documenting any kind of a situation is how far do you go? If you overdocument, you are wasting time and you are wasting the taxpayers' money. If you underdocument, you run into the problem of reviewers later on who can't precisely tell what you did, and you may—and I think the General Accounting Office uses this term—you “may” impair the utility of the certificate that you get from the contractor.

Actually, we can enforce our contract clauses without the certificate in some instances, but when you tie it down with better documentation, then you have a better chance of success if you ever find some of this data is not current, accurate, and complete. That is the area we have identified as the problem.

Mr. HARDY. When you spoke of not finding it in a neat little package, the whole size of it is they didn't find it at all, apparently.

Mr. MALLOY. Mr. Chairman, I don't think the General Accounting Office would go so far as to say they didn't find any documentation. They didn't find the specific reference that linked the documentation, which was there, in varying degrees, depending on the deal, and the certificate. We have looked at the same thing, and we agree with them. We think we ought to do better. We have done a lot of things to tighten up in this regard.

Mr. HARDY. Unless there is some documentary evidence that the data was provided, it is pretty difficult for anybody to know whether it was done or not. It reminds me just a little bit of one of the investigations I was involved with almost 20 years ago. There was one document from a member of the Maritime Commission, a telegram, which he sent, when he was out in Oregon, to his office in Washington, which said, “I approve of such and such a subsidy. In this particular case please advise me what convinced me.” The law required convincing evidence, and I don't know whether you have this situation over in Defense or not.

Mr. MALLOY. Well, sometimes we have some analogous situations. If you visualize a pretty-good-sized procurement, and if you visualize the way we negotiate the prices; namely, to ask for proposals—we send out a request for proposals and ask for a cost breakdown. We demand a lot of information along with it, which sometimes is very, very voluminous. Then we take that and we give it to our auditors and we send the auditors out into the plant. We don't just take something that is handed to us. We send our auditors right out into the contractor's plant. They have access to all of the contractor's accounting and other records. They do an independent evaluation of the material that the contractor has provided us and send that back to the contracting officer. He then gets advice from a lot of other people—technical people, lawyers, and others—and goes ahead and negotiates the contract.

Now, there are plenty of records involved in that whole process. But the thing that we are working on is to find ways to select out those key records, and identify them very precisely, so that we can know later on what was tied to the certificate.

Mr. HARDY. I want to join with you in the recognition that this can be overdone insofar as gathering a lot of papers is concerned. This is one of the things that bothers a lot of us, the way Government does business. Maybe they have to, I don't know, because of the profusion of paperwork that is involved. But it seems to me we could save a lot if we could cut down on that a little bit.

Mr. MALLOY. Mr. Chairman, I completely agree. I testified in the Congress last year, before a different committee, about the amount of paperwork involved in Government procurement, and I must say I don't feel very comfortable about that. I have been trying to do something about it. I think we have entirely too much paperwork. We ought to be able to find some shortcuts. That is, I think, a very basic complaint that we hear from time to time. We have to keep that in mind when we are talking about this very law, because we could be talking about a perfection in records, rather than a perfection of data that is current, accurate, and complete.

But hopefully we can come up somewhere in between.

Mr. HARDY. Do you have any specific questions?

Mr. REDDAN. No.

Mr. HARDY. In the GAO presentation, reference was made to a number of recommendations which they had made—and I believe the statement was also made that a good many of the recommendations which the GAO had presented had already been put into effect—but I did understand, however, there were some which had not been acted on. I don't know whether I can distinguish between them all or not. You pursue this, Mr. Reddan.

Mr. REDDAN. Mr. Secretary, you referred to the GAO statement. I will give you the page number and you can see their recommendations there, and then you comment on it as you wish.

On page 7: the GAO recommended in 1967 that contractors be required to identify and disclose prior cost experience, even when not used as a basis for the estimated cost.

Is that recommendation still pending in your office?

Mr. MALLOY. I believe, Mr. Reddan, that that is still pending, but that recommendation is not something that I take any exception to at all. I feel that our present regulations cover the point, because a contractor is required, under the regulations and under law, to provide us with all data that is significant as to the price. Now, "all data" that can significantly affect the negotiation of the price could very often include prior cost experience, even if the contractor said that he didn't use it in his estimate. I don't think that has anything to do with it. I think what has to do with it is whether it makes any difference in the negotiation of the price. If we find that there are enough situations like this to warrant making this a specific part of the regulation, we will do it. But I have no conceptual disagreement whatsoever with this notion.

Mr. HARDY. Well, then, in the case which GAO cited, would you say somebody in the contracting office failed to carry out what you had expected of them?

Mr. MALLOY. I am not sure—as a matter of fact I am not familiar with the actual facts beyond the ones in this statement. But I would say, speaking generally, that in any given case if the item that I am negotiating for in a sole-source situation has in fact been manufactured before, then as a negotiator I want to know about it. I think the contractor ought to tell me about it.

Mr. HARDY. If I am reading this correctly, this specific case was brought to the attention of the Director of Procurement on September 13, 1966.

Mr. MALLOY. Again, Mr. Chairman, I am not familiar with that.

Mr. Chairman, I am informed by one of my associates that this was an Air Force case.

Mr. HARDY. Do you want us to take it up with the Air Force?

Mr. MALLOY. I see that the Air Force has been in touch with the General Accounting Office on it, and that a settlement has been arrived at, and beyond that I am not familiar enough with it.

Mr. HARDY. Settlement may have been arrived at, but this is one that we probably will want to explore with the Air Force. A settlement wouldn't necessarily constitute a procedure for avoiding a current problem.

Mr. MALLOY. Mr. Chairman, I agree completely. Our whole effort is to get contracts negotiated correctly initially. We don't want to be looking for ways to have to go back later. But in those cases where the contractor did not provide current, accurate, and complete information, the law, 87-653, covers that situation and he has to give it back. When we go back now we have a contractual right to do it. The mere fact that there are situations in which we go back against a contractor and say, "You owe us money," and he agrees, and gives us money, the mere fact that happens does not mean that Public Law 87-653 is not operating properly. It means it is operating properly, although the contractor may not have operated properly in the first instance.

I should make a generality here, Mr. Chairman, to indicate that in my experience the kind of situations that turn up later on are more of the inadvertent nature; one can't just generalize and say that contractors aren't cooperating in supplying us information. They all want to do that. But they have large organizations, and they have very often hundreds and thousands of different proposals that are being negotiated by their people with many, many different customers. It becomes quite difficult for them at times to insure adequate internal communication within their company.

We say that is their business, and they should have it. That is what this law is about, and that is why we try to be sure that we get contractors to give us the information, all of it, right in the beginning. That is where you save the money.

Mr. HARDY. I can appreciate the problem of a company keeping its line of communications the way it ought to be, but on the other hand it would seem to me it would be most unusual for a contractor, negotiating for a new contract on an item identical to one which had been produced just 2 months before, to send in somebody that was unaware of that.

Mr. MALLOY. I think that is a little unusual. I think, as I already said, that is pretty pertinent information.

Mr. REDDAN. Mr. Secretary, do I understand you to say that you interpret this particular law to require the disclosure of prior cost experience even when that cost experience is not used as a basis for the estimated cost?

Mr. MALLOY. I so interpret the law, with maybe one qualification, that there needs to be some tie between the prior cost data and the new contract. There would be no point in just shoveling in a lot of cost experience if all concerned were to agree, faced with the knowledge there was prior cost experience, that it wasn't pertinent to the matter before us. But aside from that, I think it is quite significant, and I am very sure that the law applies to it.

Mr. PIRNIE. Could I interrupt there?

Mr. HARDY. Yes.

Mr. PIRNIE. Excuse me.

Mr. REDDAN. Yes.

Mr. PIRNIE. But where there has been prior experience wouldn't that be some suggestion that instead of a negotiated contract it might be subject to competitive bidding?

Mr. MALLOY. It might well, Mr. Pirnie.

Mr. PIRNIE. Failure to disclose that would have a little bearing on your determination wouldn't it?

Mr. MALLOY. It could. Once an item has been manufactured there is the possibility that the next time we buy it we might be able to buy it competitively. This is the way we go about our business. But it doesn't follow automatically. In other words we may be locked into—

Mr. PIRNIE. No, but I am pointing out that the information is significant not only from the standpoint of cost but also to the method of procurement.

Mr. MALLOY. It might give us a little better knowledge of the item if we got the actual cost.

Mr. PIRNIE. Wouldn't your answer be "yes, it would be significant for both purposes"?

Mr. MALLOY. Yes, I think it could be.

Mr. HARDY. I was just trying to check out the statute here on this. That is something we may have to determine. What is your view of that, Mr. Reddan?

Mr. REDDAN. I would appreciate it if the Secretary could read us the part of the act which he feels requires the submission of prior cost experience.

Mr. MALLOY. I don't believe this is covered at all in the act, Mr. Chairman. The act uses very broad language; it says the contractor will be required to submit cost or pricing data, and will be required to certify that data are current, accurate, and complete. The law doesn't describe cost or pricing data. We have had to do that in our regulations as we get experience.

Mr. HARDY. This is done by regulation, then?

Mr. MALLOY. This is true, as it is with many other interpretations. As you get into a field of this kind it is extremely difficult to tie it down in legislative language and I doubt if you would really want to.

Mr. REDDAN. Has it been done, Mr. Secretary, in the ASPR?

Mr. HARDY. If you would like to have your folks come up there with you, feel free to do it.

Mr. MALLOY. Mr. Chairman, I don't believe that this particular item is pinned down in ASPR. We have a description of cost or pricing data. The general description of cost or pricing data is any factual data that has a significant impact on the contract price. That is pretty broad in its coverage.

Mr. HARDY. It could include past experience in making the identical item?

Mr. MALLOY. Certainly. I don't know how it could not include it.

Mr. PIRNIE. Mr. Chairman, I thought the language must relate to the procurement process and not just the negotiation of that one contract. That is the intent of the act, which will guide all the information you get in your procurement activity; isn't that true?

Mr. HARDY. You have to make an application to the individual contract you are negotiating.

Mr. MALLOY. That is right.

Mr. PIRNIE. They are negotiating that item—all I am saying is, in procuring that item, you are relying on the information that is given you.

Mr. MALLOY. That is right. It operates on a contract-by-contract basis. But Public Law 87-653 also is an amendment to the Armed Services Procurement Act, and so to that extent it fits right in with the totality of the Procurement Act itself.

Actually, Public Law 87-653, when it was passed, covered many other matters, including some things on competition, other than that which we are talking about today.

Mr. REDDAN. Mr. Secretary, on page 4 of the GAO statement, the penultimate paragraph says, "We found in 165 out of a total of 185 cases where certified cost or pricing data were required that DOD officials and prime contractors had no record identifying the cost or pricing data submitted and certified by the contractors in support of significant cost estimates."

I believe you addressed yourself to this in part just a little while ago?

Mr. MALLOY. Yes.

Mr. REDDAN. But I just wanted to make it clear on the record what the exact situation is.

Are you saying that there was a record at one time, and the GAO couldn't find it, or just what is the situation?

Mr. MALLOY. Mr. Reddan, the point I was making is that in these situations—in these 165 situations—there was a great deal of information that was a matter of record that we had in our files. The thing that we did not do—and if you will read the GAO report you will see that they say that there was no record identifying the cost or pricing data submitted. So obviously even this language states cost or pricing data was "submitted" and "certified" to by contractors.

Now, the record did not describe the specific listing of items that were submitted, so that they could look at that file and say that that is precisely what the contractor certified to. We had a contractor's certification. He certified that everything he gave us was current, accurate, and complete. So we are not defenseless, even if we have left somewhat less of a documentation trail than might be best to have in these cases.

Mr. HARDY. Let me interrupt just a minute off the record.

(Discussion off the record.)

Mr. HARDY. We will take a brief recess.

(There was a short recess taken.)

Mr. HARDY. Let the committee come to order.

Mr. Reddan.

Mr. REDDAN. I don't believe we covered the matter on page 14, did we, Mr. Secretary?

There is the recommendation that the DOD "establish adequate procedures for technical evaluations of proposals and require uniform application of these procedures by those responsible for performing such evaluations" and that "supervisory personnel should review the work performed and assure themselves that reports resulting from these evaluations are adequately prepared."

Mr. MALLOY. Mr. Reddan, that recommendation as well as many others in this statement are contained in a draft General Accounting Office report which is before us.

Mr. REDDAN. Yes.

Mr. MALLOY. And we have not reached our conclusions and have not responded to the General Accounting Office. So these recommendations are before us now.

Mr. REDDAN. Can you give the committee any feel for your personal evaluation of this recommendation?

Mr. MALLOY. Well, the recommendation as to technical evaluation is twofold, Mr. Reddan.

The first has to do with documentation, and I counted from pages 11 through 14 I believe nine places where the statement calls for or mentions that there was no supporting documentation for their engineering estimates. GAO found numerous instances of ineffective reporting, inadequate documentation of the work performed, and so forth.

There is a basic recommendation here that goes into documentation. If the situation is completely without documentation, which seems to be the thrust of this discussion, it seems to me that we would have to do something about it. Just how much documentation we ought to put on top of our already overloaded engineering people is something that would have to receive our serious consideration. But I believe out of this will come some improvement in documentation.

The other point made here is there be supervisory review of an engineer's work. Here, again, is an interesting question because you can go too far. It may well be that a supervisory engineer might have to completely duplicate the engineering work already done by his subordinate, and that well may not be good management. But there needs to be proper supervision of our engineers, there is no question about that. Whether each and every estimate on a proposal needs to be reviewed by engineering supervision is, I think, an open question. We would have, and are having, our technical people evaluate this at the present time.

Mr. REDDAN. Could you give the committee any idea of when you might resolve this problem?

Mr. MALLOY. Yes, I think our reply is due within 2 weeks time on this whole report.

Mr. REDDAN. In that same report, I think they recommend that the ASPR provisions be reemphasized to contracting officials and the contract auditors so the significant subcontract cost estimates can be

given adequate evaluation prior to acceptance in the prime contract prices.

Your response to that will also be included in your response?

Mr. MALLOY. Yes. That is the type of recommendation made frequently by the General Accounting Office. We have ways of reemphasizing these items, and will certainly reemphasize this one.

We always look into the subcontract structure when we are negotiating a prime contract.

Mr. REDDAN. On pages 10, 22, and 25, there are references to GAO recommendations for postaward audit when the contracting officer believes that the data submitted by the contractor were not current, complete or have not been adequately verified; and in those instances where preaward audits are not requested solely because of lack of time in an urgent procurement.

Could you give the committee your reaction to that recommendation, sir, and tell us whether an answer will be coming up in the near future?

Mr. MALLOY. Yes. We have adopted that recommendation of the General Accounting Office. It is part of a revision to the Armed Services Procurement Regulation, which is in its final stages now. That will be published within weeks.

Mr. REDDAN. On page 27, GAO refers to its recommendation that ASPR be revised so that determinations of adequate price competition can be made for the procurement of unique or complex items when the work to be performed is not clearly defined and there is little assurance the lowest price is reasonable.

Is that recommendation presently under consideration?

Mr. MALLOY. I don't believe it is, because I feel our present definition for "adequate price competition," for purposes of this statute, is adequate, and I really don't know of a specific recommendation to change it that we have before us,

Mr. Chairman, I would appreciate the opportunity to check that, because I am not absolutely certain of it, and I could supply that for the record.

Mr. HARDY. I wish you would, please.

Mr. MALLOY. I know we are in substantial agreement with the General Accounting Office on our definition of "adequate price competition." There may be something in the nature of a refinement I am not personally familiar with in this record.

Mr. HARDY. If you would submit that, please.

Mr. REDDAN. On the point of competition, Mr. Secretary, is there anything further you might want to tell the committee which would help us understand what the meaning is or what the import is of the threat of competition in procurement?

Mr. MALLOY. Yes. That is a situation that comes up from time to time where, in the normal case, you might have three or four bidders actively bidding for a particular procurement, and we might be going out to make a purchase and receive only one bid. Those situations are often highly competitive, in that if the bidders do not know that the others are not going to bid, they are bidding in a competitive atmosphere. I think these have to be very carefully judged. I don't think it is a prima facie case of competition, but it can be evaluated and can be competitive.

We have some situations in which we procure by formal advertising, for example, in which we only get one bid. We don't upset the formal advertising because that happens. Formal advertising is not used unless the competitive environment is present. So you sometimes have a truly competitive environment when you only receive the one bid.

Mr. HARDY. Of course, on that sort of a theory, Mr. Secretary, you could have a single bidder creating a situation like that, couldn't you, if he had somebody who was going to threaten to bid, that could be staged very handily, it seems to me.

Mr. MALLOY. I suppose it could in a given instance. That is why I said it wasn't *prima facie*. You have to study these and have a judgment based on all the circumstances. The people who have to have the judgment are the people familiar with that particular industry, the past history of procurements, and the information they have from bidders. There are some situations in my judgment that qualify, but, as I say, they are not too usual.

Mr. HARDY. It is a little difficult for me to understand how you really get competition if you have only one bidder. It is a little difficult for me to absorb.

Mr. REDDAN. Mr. Secretary, have there been any cases where awards have been made to a historical sole source, and it has been considered there is a threat of competition?

Mr. MALLOY. I don't know of any that meet that. Those stipulations would seem to me to almost rule out the notion of competition, where the award is to a historical sole source.

Mr. HARDY. We even had one not too many years back where you had a second source, and alleged competition in the procurement of M-13 personnel carriers. Do you remember that one?

Mr. MALLOY. I am not familiar with it.

Mr. HARDY. FMC bought the plant up in West Virginia; it competed with the plant in California, and the Department of Defense accepted that as competition. Of all the crazy determinations I ever saw, that was one of them.

Mr. MALLOY. I am not familiar with that, Mr. Chairman.

Mr. HARDY. Go ahead.

Mr. REDDAN. On page 29 of the GAO statement, they state that they recommended the "Armed Services Procurement Regulation be revised so that contractors are required to submit pertinent factual data in support of proposed prices over \$100,000 that they represent to be based on established catalog or market prices of commercial items sold in substantial quantities to the general public, that such data be independently verified, and that the contractor be held accountable for submission of incorrect information."

Mr. MALLOY. That is in the draft report, and like the others, is being considered. I might just say what my own view of it is. I think that it goes without saying that we should not accept some supplier's statement that his item is a catalog item. This remains to be demonstrated. It is up to our buyers to satisfy themselves that the item qualifies. That means they have got to do some asking of questions, and they have got to do some verifying. As a matter of fact, our pricing manual tells them, even today, they have to go out and verify this.

In addition to that, each of our negotiators must write a negotiation memorandum putting forth his rationale for his decision. If he has made a decision this is a catalog item, he has to put his rationale for

it. In my judgment it has to be more than the contractor said it was a catalog item.

In substance, what the General Accounting Office is talking about I agree completely as to that.

Mr. REDDAN. How does the contracting officer determine that it is a bona fide catalog price, and that the item is being sold to the general public?

Mr. MALLOY. I don't think there is any particular single one blueprint that he could use to do that.

Mr. REDDAN. Do they do it in every case, sir?

Mr. MALLOY. Yes, they must, if the procurement is sole source, and is over \$100,000, and they are not calling for cost or pricing data, they have to decide in each case that it is a catalog item.

Now, you could visualize a very large segment of the universe of catalog items would be perfectly known to everybody to be a catalog item and there would be no question about it. This would be knowledge that everybody would have. Then you will have your gray areas, catalog items, where there will be some close cases in which the contractor will have to demonstrate that the item is, in fact, a catalog item. There are many ways one could go about doing it. He could obviously say to the contractor, what is your rationale? And he might well say, well, we have sold this to a lot of customers. Where is the evidence that you have sold it to a lot of customers? Give me six customers, and give me some sales volume to those six customers. If there was still doubt, one might call two or three of the customers, and say, "Have you purchased this item and at what price and in what volume?"

Mr. HARDY. Is that done, Mr. Secretary?

Mr. MALLOY. Very often; yes, sir.

Mr. HARDY. Very often? More often than not?

Mr. MALLOY. Well, actually, I was describing a hypothetical case pretty much the way I would go about doing it, and I have to assume—

Mr. HARDY. That is the way you would go about it, and this makes sense, but I wonder whether or not this is really a procedure that is generally performed?

Mr. MALLOY. I really couldn't say one way or the other, Mr. Chairman, but this is the way I believe that our people are going about doing this.

Mr. HARDY. Mr. Pike is just about to pop. Go ahead.

Mr. PIKE. Mr. Chairman, I am about to pop, but I hadn't planned to jump in right here, but I would like to.

Mr. HARDY. This is a good place for you.

Mr. PIKE. What would you do, Mr. Malloy, in the case of a purchasing agent who accepted the word of a contractor that this was a catalog item, and bought it for the contractor's price, and then you found that it wasn't a catalog item, or, if it was, they paid 20 times what the catalog called for?

Mr. MALLOY. What was your question, sir?

Mr. PIKE. What would you do about such a purchasing agent?

Mr. MALLOY. That is a pretty difficult question to answer in such broad framework as that. I would have to know more particularly the circumstances.

Mr. HARDY. Do you want to give him some now, Mr. Pike; you have a bunch of them?

Mr. PIKE. Well, I have a lot of them, as a matter of fact. But let us be specific. Let us say you find a purchasing agent who pays 20 times what a manufacturer's catalog calls for, for an item. He has the catalog available; doesn't bother to look at it. Doesn't bother to check it out in any manner, just goes ahead and makes a telephone call, say, and is told that the price ought to be such-and-such, and it is actually 20 times what the catalog calls for, and goes ahead and pays for it at 20 times what it ought to be. What do you think ought to happen to a purchasing agent like that?

Mr. MALLOY. Well, here, again, I have great difficulty answering that question because it is associated with, in my mind, a given situation. In that given situation we had, I think quite an unusual situation, where a supplier was quoting considerably higher than the prices that were in his catalog.

Mr. PIKE. But the catalog was available. They had it in their hands. They had it in the shop. All they had to do was open it and read the catalog prices.

Mr. MALLOY. I think that some of our buyers in that case had the catalog, some of them did not. Hopefully, we wish they all had it, and we wish that they had all read it.

Mr. PIKE. Yes; but they didn't.

Mr. MALLOY. I take it they did not.

Mr. PIKE. What have you done about the buyers that didn't even bother to look at the catalog price?

Mr. MALLOY. We have, as a result of this incident, taken several actions.

Mr. PIKE. I know you have taken actions against the seller. I'm asking you what actions you have taken against the purchaser?

Mr. MALLOY. Well, I should preface this by saying we have not finished our analysis of this situation yet. But thus far we have looked quite broadly beyond this one case to see if we had other similar situations. We are undertaking a complete review of our entire small purchase procedures. We have sent teams out to the buying offices that were involved. We have interviewed the individuals that have been involved. We have tried to reconstruct the procurement as best we could, and our conclusions thus far are that there was no action that should be taken of a disciplinary nature against the individuals that were involved in these procurements.

Mr. HARDY. Let me make this one observation.

Maybe these people were assigned to procuring items of too small a cost. When are you going to promote them to a job where they buy larger items? Just to put it in another framework.

Seriously, I don't know whether these were working on real small items, the items we are talking about, but maybe they just weren't suited for that. Maybe they weren't competent in that.

Mr. PIKE. Let's proceed a little further. Suppose there is a noncatalog item, it is available in somebody's catalog, but they go to somebody else, and they buy for \$33,000 an item they could have bought for \$210. I'm sure you are familiar with the situation that I'm talking about. You have determined in the catalog items that it is not worthy of discipline in any manner.

Do you think it is worthy of any form of discipline where they buy an item for \$33,000 that they could have gotten for \$210?

Mr. MALLOY. Mr. Pike, thus far that is our judgment. I should point out—I believe I'm correct—that in that series of three or four procurements, there was more than one buyer involved. In other words different personnel handled these purchases.

Mr. PIKE. Oh, yes; this one company has buyers all over the place.

Mr. MALLOY. And as you know, the matter has been referred to the Department of Justice—

Mr. PIKE. To prosecute the seller?

Mr. MALLOY. That is correct. That may turn up other bits of information we don't have. But we have been unable to find any evidence of wrongdoing on the part of our own personnel in those situations.

Mr. PIKE. In other words, in Government procuring, you do not consider it wrongdoing to pay 50 times what an item is worth unless there is an intent to pay more than you ought to?

Mr. MALLOY. Well, Congressman Pike, in using the term "wrongdoing," I was talking to a different aspect of culpability that might have involved. For example, complicity between our own people and the contractor for some remuneration.

Mr. PIKE. In other words, you don't consider it wrongdoing unless there is a kickback, to put it in plain language; is that it?

Mr. MALLOY. I'm not saying that sir. I'm trying to indicate that was what was in my mind when I used the term "wrongdoing." When you look at the procurement as a procurement, this is, of course, a situation that in our judgment is most unfortunate that it happened.

Now, whether there should be disciplinary action in the case of that one procurement is a matter that is before us. As I indicated, up until now, we have felt that this was not apparent. This may turn out to be so.

Mr. PIKE. You can't have it both ways, Mr. Secretary. Now, you are talking about that one procurement. A while back, you mentioned the fact that there are many purchasing agents who had paid up—there was one which was 50 times what it could have been bought for. But I have given you an awful lot that were from 20 to 25 times. And in none of these cases have you done anything, isn't that the fact of the matter, to any of the people who made any of these purchases, or who agreed to pay any of these prices?

Mr. MALLOY. Congressman Pike, I indicated earlier we had not finished our review of this matter. Up until this point, we have not taken any disciplinary action against individuals.

Mr. PIKE. Why does it takes so much longer to review what the purchaser did than it does to review what the seller did? It is all one transaction, isn't it? You have already turned the seller over to the Justice Department.

Mr. MALLOY. That is correct.

Mr. PIKE. And done nothing as far as the purchaser is concerned?

Mr. MALLOY. We have done a lot of things.

Mr. PIKE. None of them involved discipline?

Mr. MALLOY. None of them involved discipline, that is right.

Mr. PIRNIE. Would you yield for just one question?

Mr. PIKE. Yes.

Mr. PIRNIE. I would like to follow up that term "disciplinary action." It seems to me corrective action at least could be taken, and there

should be some response to this question of Mr. Pike's as to whether or not this individual is still processing procurement, or these individuals. When you develop a case like this, that is the point I think Mr. Pike is making, that it seems as though there has been time for the Department to react along the lines of protecting the Government before you would take action to prosecute the other party, if it is that plain. Isn't that what you meant?

Mr. PIKE. I won't say before, or I won't say simultaneously. But I can't see how you can complete your review against the seller, get your data, and turn it over to the Justice Department, and the seller has been selling all over the place. But as far as the purchasers are concerned to whom they sold, you haven't completed your study and you haven't found it fit to take any disciplinary action. Don't you consider the purchasers are just as guilty as the seller?

Mr. MALLOY. I don't know how to answer that. You had here a firm who was selling to commercial accounts on one basis, and selling to the Department of Defense on a completely different basis. We had buyers who were taking the statements by this seller in good faith, and got results that they did not want.

Mr. PIKE. And not looking at his catalog?

Mr. MALLOY. In many instances, not looking at his catalog. It is difficult to equate the two. You had the possibility of fraud on the part of the contractor, which is the reason the matter is before the Department of Justice. In a situation like that, it is extremely difficult for any buyer to protect himself.

Mr. PIKE. Mr. Secretary, all he had to do to protect himself in all of the cases but one was open the catalog and read it.

Mr. MALLOY. That is true with respect to the catalog items. I was thinking to the noncatalog items.

Mr. PIKE. There was only one noncatalog item and there were about a dozen catalog items, Mr. Secretary.

So the seller is blacklisted, and the purchasers, as of right this minute, are continuing to purchase.

Mr. MALLOY. Whether the individuals are continuing to purchase, I just do not know, Mr. Pike.

Mr. PIKE. No disciplinary action has been taken against them.

Mr. MALLOY. That is right.

Mr. HARDY. I would like to return now to where we were on this question of what a purchasing officer is supposed to do with respect to catalog items.

Mr. Secretary, you gave an illustration of his picking up a telephone and calling some people to find out whether or not they had bought this item. As a matter of fact, that is not what the ASPR says they should do, is it?

Let me read it to you. That isn't what your ASPR says at all. Your ASPR approaches this in an entirely negative way. If you don't change this one to conform with the kind of expression that you made a minute ago, then it seems to me there is something wrong with this whole exercise we are going through. Here is what your ASPR says:

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.

Now, it says as a general rule you won't do it.

Mr. MALLOY. That is right, that is what the law requires. That stems right from the statute.

Mr. HARDY. This is directly contrary to what you said a while ago, in the answer you gave, or my understanding of what you said. This is directly contrary to it, because he wouldn't go out and try to find out if he had a catalog. He wouldn't find out whether or not it was sold commercially or not, unless he had some reason to suspect it, and even then he can't do it unless he has a finding at a higher level, unless I misread this. Maybe I don't read it right.

It continues:

Where, however, despite the willingness of a number of commercial purchasers to buy an item at such a catalog or market price, the purchaser finds that the price is not reasonable and supports such findings 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.

You have put a lot of strings on that, Mr. Secretary; you ought to be real proud of that one.

Mr. MALLOY. Mr. Chairman.

Mr. HARDY. The ASPR Committee should be real proud of that one, too.

Mr. MALLOY. We may be talking about two different things; maybe we are.

Mr. HARDY. Maybe I can't read. That is what it says to me.

Mr. MALLOY. I believe you are reading the section of the regulation in regard to getting information on pricing information, and I thought we were talking about catalog items. Where it is established the item is a catalog item, we do not get cost and pricing data, because the law doesn't require it.

Mr. HARDY. This is in the cost and pricing data section, we are talking about procurement. We are talking about buying items that are catalogued, and this is the question as to whether you are going to require cost or pricing data.

Mr. MALLOY. Well, we do not require cost or pricing data if the item is a cataloged item. The point the GAO was making, the point that we took off from it, how do you know it is a catalog item for the purposes of Public Law 87-653?

Mr. HARDY. That is right. Under this language, in your ASPR, the man who is buying it has strings tied on him, so that he can't go out and ask for cost or pricing data, even if he believes the information is incorrect, unless it is approved by somebody above him.

Mr. MALLOY. Mr. Chairman, I really don't believe, unless I could be corrected by my associates, that that provision that you are talking to has to do with catalog prices. We have a definition in the regulation on established catalog or market prices, we define the term "established catalog price." We define the term "a commercial item." We define "sold in substantial quantities." We define "to the general public." These definitions appear in the regulation in some detail.

We have additional coverage in our working handbook, our pricing manual, which goes into these matters in more detail. We have adequate coverage on the exemption, and that is what we have to bear in mind I think, that the catalog item under 87-653 is an exemption from the requirement of the statute for the submission of certified cost or pricing data.

I think it is rather fully covered in our regulations. As I indicated previously, I do not have any basic quarrel with the General Accounting Office suggestion here. I don't believe they have any basic differences with the Department of Defense on this item.

Mr. HARDY. I would like this information I read from the ASPR a little better if it were stated in the affirmative rather than the negative.

Mr. MALLOY. We will take a hard look at it, Mr. Chairman.

Mr. HARDY. I don't care whether you take a hard look at it on that particular score, but I think it is rather inconsistent with the point you were making a while ago. I still think it is, in spite of the fact you say you have a lot of other sections that deal with catalog and pricing.

This tells you when you cannot request cost or pricing data. At least that is the way I read it.

If it is in conflict with some other regulations in your ASPR's then certainly somebody ought to take a look at it and clear it up.

Do you have anything, Mr. Pirnie?

Mr. PIRNIE. Yes, Mr. Chairman.

Just to pursue that question addressed to you a little earlier, trying to draw the distinction between disciplinary action, which in itself is a rather severe term, and corrective action.

Mr. MALLOY. Certainly.

Mr. PIRNIE. If you start having the ball go through shortstop rather regularly, you shift the lineup because you are looking for team effort.

What has disturbed me is that no response was made to that question as to whether or not you might change the assignment of a person who didn't seem to have that judgment that would tell him that 20 times or 50 times is an excessive price. You don't have to rely just on the contractor to have a judgment to guide you in the procurement of certain items, isn't that true?

Mr. MALLOY. Surely, and I agree with the general point you are making.

Mr. PIRNIE. I think you could give us a great deal of encouragement if there were some indication that when these things come to your attention you make it very clear to the individual involved, regardless of whether he did it through any improper motive or not, that it is a serious omission, and without attempting to see whether it is punishable by the Department of Justice, you could take appropriate action so that that type of judgment would not be employed in the next procurement. Isn't that true?

Mr. MALLOY. I agree, sir.

Mr. HARDY. Thank you, Mr. Pirnie.

Mr. Lennon?

Mr. LENNON. Mr. Secretary, let's discuss briefly the illustrations used on page 28 of the GAO statement, where you are involved in over \$100,000.

Beginning on line 4, of page 28:

For one of these awards, the contracting officer's memorandum of the negotiation indicated that he considered the price fair and reasonable because it was included in a published commercial price list, and because the contractor stated the price was based on established catalog prices of commercial items sold in substantial quantities to the general public.

It was subsequently developed or disclosed that the contract items had not been sold previously to either commercial sources or the general public.

The contractor, when contacted, denied he had informed the Government contracting officials that item had been sold commercially to the general public.

Do we have any procedural method to cover this? There is no record made, no statement taken down by the contractor, no application, no questions he signs? He makes a categorical representation to the contracting officer that these are not published in commercial price lists. And that they are sold in substantial quantities. Does he just make that representation in an oral colloquy and discourse, and subsequently when you go back and pin him down, he says, "I didn't say that to the contracting officer. He has lied about it." Subsequently, it appears you are faced with the situation of whom you are going to believe.

Apparently, when they went back to the contracting officer and asked him about this, he brushed it off and said: "Well, under current regulations, I'm not required to obtain this information, because I have been assured that this was a commercial item, sold in substantial quantities to the general public, by the contractor."

Then who are you going to believe, if you don't have the procedural method by which the contractor is required to put in writing, under the penalty and pains of perjury, necessary when he makes a categorical statement as he made in this case, and then subsequently denied it. Everybody went free in that case, didn't they, except the American taxpayer? He got hooked, apparently. Are you familiar with this case?

Mr. MALLOY. Not with the specific case they are talking about.

Mr. LENNON. I think it is referred to specifically on page 4, in an appendix.

The thing that concerns me, and it is found in a communication directed to Col. G. C. Houser by the regional manager of the U.S. General Accounting Office in Cincinnati, they had a job system where you can't really tell who is telling the truth about this, the contracting officer or the contractor.

The contracting officer, in his first contract, on his memorandum, states or indicates that the contractor told him the price was based on established prices of commercial items sold in substantial quantities, and was published in commercial price lists.

When they went back and reviewed it, they found out that the contracted items had not been sold previously commercially or to the general public. Then they go to the contractor. He says, "I never told the purchasing officer that, or the contracting officer." Then you go back to the contractor, and he says, well, he doesn't say that the man did tell him then, he just said, "Well, I have obtained in my judgment adequate support for my determinations, and under present regulations I'm not required to go any further."

Who can be held accountable in a case like that, assuming what I stated is true, and I'm just paraphrasing it from this statement here. Who could be held accountable in a situation like that?

Mr. MALLOY. I'm not sure that the contractor, for example, under this circumstance, could be held accountable for any violation of Public Law 87-653.

It seems to me that here was a situation in which our contracting officer was required to make a judgment. Was the item a catalog item or not? If it was a catalog item, the provisions of the law would not apply. In order to make that judgment, he has to get information from the contractor. You asked, Congressman Lennon, whether there was any set, formalized, affidavit-type representation made by the contractor in these instances. To the best of my knowledge we do not have that. We do not have that type of affidavit in most of our dealings with the industry people.

But there is a requirement on our own contracting officers to have—to render a judgment, and they obviously, in my judgment, need to do more than just to accept a contractor's statement. That should have been verified in this case, and apparently was not, I take it from your statement.

Mr. LENNON. Obviously it was not, in this correspondence that had taken place.

But who would ultimately be held accountable for the loss to the American taxpayer for this? The contractor? You can't touch him. He has not committed perjury. He just told the man in a social gathering, perhaps, or in a little meeting like we have today, that this is included in a commercial price list. The contracting officer doesn't take the time or have the interest or the dedication to see if that is so.

The contractor makes another representation verbally, that these items are sold in substantial quantities to the general public. Obviously, the contracting officer said, "Well, I will buy that. You are a good friend of mine." And then when the chips are down, and they go back and make a review, they found out they had not been sold previously to commercial sources or to the general public. Then they approach the contractor and he says, "Well, I never told that fellow that. He is all wet."

We must realize that this committee and all of us are interested in the same thing. How can we improve the image of the procurement practice with the American public? The news media that carried the stories concerning Mr. Pike's involvement in this have done irrevocable damage to the image of DOD and to the Federal Government, and will continue to do so. It does not seem unreasonable to me that when a contractor makes a statement which is accepted, as it apparently was by the contracting officer, the contracting officer should be required to sign it. Then somebody could be held accountable.

Now, this contractor, in my judgment, perhaps lied about it, although he says not. We have no way to prove it. But if he lied about it, he should never be permitted to get a Federal Government contract. At least that is my philosophy.

I'm a little bit concerned about your philosophy. I think you are interested in your duty, but you do not, in my judgment, perhaps have the zeal to be sure that everybody in the procurement side of the Federal Government—I'm not talking about DOD but in every level—should be concerned with primarily how we get a dollar of value for every dollar spent of the taxpayers' money. We have a \$30 billion deficit facing us in fiscal 1968, and the American people are being called on now for \$47½ billion in surtaxes, and then stuff like this gets in the newspaper. No wonder there is a resentment, a credibility gap, and it is there. Something is going to have to be done about it, or there is going to be a turnover, and a turmoil.

Mr. HARDY. Thank you, Mr. Lennon.

I was about to make an observation that if this item had been procured on a cost-plus-fixed-fee basis, previously, it would at least have been entitled to a 10-percent credit on the cost-reduction program.

Mr. LENNON. That could have been a stimulus in itself.

Mr. HARDY. Mr. Secretary, can you tell the committee how many employees are engaged in procurement—or let's put it another way—purchasing officers or contracting officers for the Department of Defense?

Mr. MALLOY. I can estimate that figure.

Mr. HARDY. Give us a round figure.

Mr. MALLOY. I think it would be, in the contracting officer side, approximately 5,000 contracting officers. In the contract administration side, which is the postcontract area, we have close to 35,000 people involved in that, bearing in mind that between 40 and 45 percent of that latter figure are engaged in quality control, or inspection services. The balance are production expeditors, administrative contracting officers, people involved in paying contracting invoices and things of that kind. There are many others that are supporting these contracting people.

Mr. HARDY. What percent falls in the other group, quality control, and so forth?

Mr. MALLOY. Quality control makes up about 40 to 45 percent of the total of that group, and your production people—and I haven't seen these figures for some time—the production people might make up 10 percent, and the invoice people paying invoices would be another 5 percent.

I can supply that detail for the record, if you care to have that.

Mr. HARDY. All right. Without objection, it will be made a part of the record.

(The Department of Defense subsequently submitted the following statement:)

In the current calendar year, in rounded figures, approximately 37,000 persons are engaged in field performance of contract administration services. Approximately 4% are military personnel and approximately 96% are civilian employees. The breakdown by major functional area is Quality Assurance—45%; Contract Administration—20%; Production—13%; Data and Financial Management—10%; Other (Executive offices, administrative offices, plans and management)—12%.

Mr. HARDY. You added it up to 55 percent. Suppose you had 60 percent. That would leave you 40 percent of 35,000. That is 14,000, plus 5,000; that is 19,000; if my arithmetic is anywhere near correct.

You are talking now only about civilian?

Mr. MALLOY. These would be total.

Mr. HARDY. Total. Could we separate out what percentage of them would be civilian?

Mr. MALLOY. Mr. Chairman, I just don't know.

Mr. HARDY. All right. I will get to the question I was leading up to: Can you tell the committee how many of this great army of procurement people have been found to be incompetent, in the past year, for misperformance, or poor performance, or what-have-you?

Mr. MALLOY. I will attempt to get that for you, Mr. Chairman.

Mr. HARDY. I think it would be helpful if we could get some figures on this. I think it might give an idea, at least, of how this procurement

operation is going, and it might indicate why there are some questionable situations arising.

Actually, I recognize the problem that is involved in a lot of these complex procurements. But, honestly, I think sometimes that we have ruined our society by doing away with the woodshed. Nobody ever gets taken to the woodshed anymore. Instead of that, if they do something that is just a little off the "reservation," take them up to the parlor, and they get more opportunities presented than they had before.

(The Department of Defense subsequently advised the subcommittee that it could not supply the information because procurement personnel records are not broken down by functional categories.)

Mr. HARDY. Are there any further questions?

Mr. Gubser, do you have any?

Mr. GUBSER. No.

Mr. HARDY. Thank you, Mr. Secretary, very much.

Admiral Fahy, would you come on up here, please, sir? Do you want to bring some of your cohorts with you?

TESTIMONY OF REAR ADM. E. J. FAHY, COMMANDER, NAVAL SHIPS SYSTEM COMMAND; C. W. BROCKMAN, DIRECTOR, SHIP-BUILDING AND REPAIR, PURCHASE DIVISION, OFFICE OF CONTRACTS; AND HAROLD GOLD, GENERAL COUNSEL, NAVAL FACILITIES ENGINEERING COMMAND, DEPARTMENT OF THE NAVY

Admiral FAHY. I don't have many cohorts with me.

Mr. HARDY. Members of the committee, we are pleased to have Adm. E. J. Fahy with us.

I like to call him chief of Bureau of Ships, but he disclaims that now. I have to look at my sheet here to see what his present title is.

He is Commander, Naval Ships Systems Command.

Admiral, we appreciate your presence. We are sorry you had such a long wait.

Mr. Reddan, you had some questions.

Mr. REDDAN. Admiral, you have had a copy of the GAO statement, have you not, sir?

Admiral FAHY. Yes, I followed it this morning as we went through it.

Mr. REDDAN. In that statement at page 26 they make reference to a firm-fixed-price contract for the overhaul, refueling, and missile retrofit of a nuclear submarine.

I believe that was the subject of a letter addressed to you by the General Accounting Office, on July 18, 1966.

Do you have a copy of that letter there, sir?

Admiral FAHY. Yes, I have it somewhere here. I am well aware of it.

Mr. REDDAN. I believe at that time the GAO raised a question as to the adequacy of the competition in that particular contract, and the committee would appreciate hearing your comments, or your evaluation of that finding or criticism.

Admiral FAHY. All right, sir.

We had two people bidding on that situation: One of them was General Dynamics Electric Boat Division. The other one was Newport News Shipbuilding.

During the time of, you might say, preliminaries to the submission of the bids by the people, we gave Newport News every advantage we could by giving them all types of information that they would need to satisfactorily bid in this particular area, and Newport News was very vigorous in their pursuit of trying to get the contract. They kept a representative at Electric Boat. The large numbers of questions that were presented by the Newport News people at the bidders' conference indicated that they were certainly knowledgeable of difficulties and what they had to go into.

So, we felt at that time, since they already had had refueling experience in the CVAN and were getting ready to work on additional refuelings, and since they had built something in the order of about 14 of these nuclear submarines, and had done the post-shakedown availabilities, which included many of the alterations that were included in the proposed overhaul contract for the two submarines in question, we felt certainly that should have given them a "feel," and have given them an opportunity to have come in with a good figure in this case and that the bids would, in fact, be competitive.

It was not a case of an outfit not having had any experience in this field at all. They had considerable experience.

Mr. REDDAN. The GAO reached the conclusion there was evidence that the higher offeror in this case could not submit a realistic estimate for the work required, and there appeared to be no assurance that the low offer was reasonable.

What is your reaction to that, sir?

Admiral FAHY. Well, I have mixed feelings on that particular statement.

First, the high offeror was high because he estimated he would require a considerably larger number of man-hours to do the job—direct labor hours. And this, I think, to a great extent, accounted for the large increase or the difference in his price.

Mr. REDDAN. Would that have been due to his lack of experience in this field, in your opinion?

Admiral FAHY. It might have been due to—well, his supercautiousness, you might say, so as not to get burned, and take a contract and find he was stuck with it.

The other statement, to the effect it was felt there was no gage to measure this particular low bid against, is not quite correct, because we brought a third party into the act, Mare Island Naval Shipyard, and got their estimate on doing the job for the 601—an identical job—and the costs were comparable to the Electric Boat figures—about \$24 million, which is comparable for a single ship.

Mr. REDDAN. Within what time frame was this third one?

Admiral FAHY. While these requests for bids were going out.

Mr. REDDAN. At the same time?

Admiral FAHY. Yes. The plan was to put the 601, which is the one that Mare Island bid on, into Mare Island for a similar job. They were also asked to estimate. They were given no idea of what anybody else was doing, or had proposed, or given any other information than that, and made a complete study of the job and came up with an end price.

Mr. REDDAN. Had any other shipbuilder, or had any other companies had any experience in this particular work, other than Electric Boat?

Admiral FAHY. No. I would say only Newport News and Electric Boat.

The others had fueled but had not refueled.

Mr. HARDY. It is a little difficult to call this kind of a situation any real competition, Admiral. I don't know where you would get competition under this set of circumstances, because you only had two.

Admiral FAHY. We only had two, so it would be a horserace between the two.

Mr. HARDY. It wouldn't be much of a horserace, when you came up with two figures as far apart as those.

Admiral FAHY. That is true.

Mr. HARDY. One got left at the post.

Admiral FAHY. That is right; he undoubtedly did, I would say, presumably due to a supercaution on his part.

Mr. HARDY. Maybe he had a lot of other work to do, and wasn't particularly interested in it.

Admiral FAHY. This happens, as you well know.

Mr. HARDY. Of course it happens. It happens all the time.

Admiral FAHY. It happens all the time. In a case like that, he could put in a "no quote" bid, or could return it with no bid. So, when you open it, it indicates no bid.

Mr. HARDY. They did not do that in this case.

Admiral FAHY. In this case, no; because they were interested in getting into the business, and it evidenced a large amount of interest.

Mr. HARDY. It goes to show you should have had the Norfolk Naval Shipyard qualified to do this long before this. I have been arguing about this for a long time. You all just put it off.

Admiral FAHY. I wish the answer were as simple as "we just put it off." It is a matter of having another facility that we could put ships like the *Forrestal*, and what not, in—

Mr. HARDY. You are putting them in there now.

Admiral FAHY. Well, the same thing has been happening all over the last several years, sir. I mean, every time we have a carrier problem, that Norfolk is our east coast carrier yard. We don't have a New York yard any longer, so it all has to go to Norfolk.

Mr. PIRNIE. May I ask a question, Mr. Chairman?

Doesn't that seem to indicate it might have been a good thing to have that New York yard?

Admiral FAHY. Sir, I would not want to tread on those hot coals at this time.

Mr. PIRNIE. That may be unfair to you.

Admiral FAHY. I think so.

Mr. PIRNIE. I won't press you for an answer.

Mr. HARDY. I will join you in it, Mr. Pirnie.

Mr. PIRNIE. That we had these capabilities on the east coast, that we can be penny wise and pound foolish to disintegrate them and destroy them.

Admiral FAHY. I don't feel a gun in my back, but I know it is only 6 inches away.

Mr. PIRNIE. I have not forced you to answer on it, but I just expressed an opinion.

Mr. HARDY. I can appreciate your problem, Admiral.

Admiral FAHY. I can give you an example of something else that has come up here quite recently, that almost looks like this particular case, and yet wherein I think there was still competition.

We went out for modernization and repair of guided-missile frigates and the bids came in quite disparately. The low bidder was about \$38½ million. The next low bidder was 26 percent higher than that, \$48 million. The third was \$56 million, and the fourth was \$67 million, almost twice as high. And these are experienced people. The fourth bidder was General Dynamics, of Quincy; the low bidder was Bath Iron Works, of Maine.

Mr. HARDY. That gets you right back to the same question I raised a while ago, whether or not they were all really interested in the work, or whether they had enough work and really didn't want that, some of them. At least that would be one approach to the reason for such a high differential between the high and the low.

Certainly, the yardstick for these yards, in computing costs, ought to be good.

Admiral FAHY. Well, this particular contract of the DLG's would utilize a lot of the skills the people had in electronics and fire control, that they had left over, say, from the instrumentation ships that were built and converted up at Quincy, so that they would really have a motive for trying to get the contract for the DLG's.

Mr. REDDAN. Did you make an analysis, Admiral, to determine the reason for that broad spread?

Admiral FAHY. We analyzed all the prices, and the labor dollars was one of the big ones. The Bath hourly wage rate is low, as we know; it is one of the lowest in the country, just like Portsmouth. That is where a big part of the difference was.

The other was in overhead dollars, which was much higher in the case of the noncompetitive bids as opposed to the other areas.

Mr. HARDY. Go ahead.

Mr. PIKE. Admiral, quite frankly I can't get too excited about your taking the low bid here. I am interested in some of the other ramifications of what happened.

How has the contract negotiated with General Dynamics been as far as performance is concerned? Have they performed within the price frame, within the time frames on this contract?

Admiral FAHY. I think they have done so reasonably, sir.

Mr. PIKE. You don't sound enthusiastic in your response.

Admiral FAHY. Well, these are never just a simple case of letting a contract at a fixed price, and then having the job finished.

Because of the experience that we are continually deriving from the Polaris patrols, we have a constant updating in what we call our ship-alt programs, or SP program alterations, to try to update the ships every time we get them into an overhaul condition. So there have, in effect, been changes to the contract, negotiated changes, so that you just can't look at the end cost and say they came within that because of these negotiated changes that went into and on top of the basic contract.

To be perfectly honest, I might say when their price came in initially we thought it was too low.

Mr. PIKE. So the letter here indicates.

Admiral FAHY. We were concerned about it, because we did not feel they honestly could do this, or if they did so honestly, they would

probably be deluding themselves. Sometimes you know people buy in contracts to try to keep a competitor out.

So we looked at this to see if this was feasible, and it came within what the navy yard said it could do—it was pretty close, so we felt that was a pretty fair guidance.

Mr. PIKE. How did it compare with what General Dynamics had done on the first two?

Admiral FAHY. They were not completed, you see, so we did not have them as a yardstick to say they did or did not perform.

Mr. PIKE. How did it compare with the price General Dynamics had given?

Admiral FAHY. It was less.

Mr. PIKE. It was less?

Admiral FAHY. Less.

Mr. PIKE. The fact this was negotiated after what the Navy felt to be competition—and frankly I don't take great issue with that, because I don't see what else the Navy could have done; there is the question of alternatives. But did the fact that it was negotiated with one company after this bid prevent you from going back to them now for their cost data and renegotiating this contract? Isn't that the essential problem that we are dealing with here? The fact that by labeling it a competitive contract you are wiping yourself out from finding out whether it is really costing them this much? You were not concerned with that, because you felt their price was too low; is that the fact of the matter?

Admiral FAHY. We thought their price was low enough to be reasonable; yes, sir.

Mr. PIKE. That is all I have.

Mr. HARDY. I am trying to understand exactly how this wound up. As I understand it you had two proposals; one was for \$46.8 million, the other was for \$62.7 million?

Admiral FAHY. Yes, sir. That was for two submarines in this case.

Mr. HARDY. That was for two submarines. What did you finally wind up with? You negotiated a contract with the high bidder, at what figure?

Mr. PIKE. Oh, no, the low bidder.

Mr. HARDY. You negotiated with the low bidder, and you negotiated his price out. How much above his original proposal?

Admiral FAHY. We didn't do that.

Mr. HARDY. All right, did you come up with the same price?

Admiral FAHY. Yes. We accepted his price, his contract price, what Congressman Pike indicated was, that by doing this, as a result of competitive bidding, we had in effect excluded ourselves from going in behind the scenes and digging out all the additional information.

Mr. LENNON. Will the gentleman yield at that point?

Mr. HARDY. Yes.

Mr. LENNON. I believe in connection with this, Newport News Shipbuilding & Dry Dock came forward with the proposition it ought to be done on a fixed-cost-plus contract for about \$55 million, as I recall the testimony earlier. Did that develop? I see the gentleman nodding his head.

Mr. BROCKMAN. As an alternate proposal, yes.

Mr. LENNON. A cost plus of \$55 million by Newport News.

Did any members of the Bureau ever indicate they believed Electric Boat's real low bid was—I believe you gentleman used the word—“hyperstimulated” by future competition from Newport News? Do you recall ever having made that statement?

Admiral FAHY. I am sure that we had that feeling, because this was lower than their bids for the other SSVN's 598 and 599, and I am sure that with the tapering off of the new construction program they were anxious to establish themselves as a going concern in these conversions and overhauls.

Mr. LENNON. You wouldn't call that buying in as we used it in other places?

Admiral FAHY. That is the common term; yes, sir.

Mr. LENNON. Thank you, sir.

Admiral FAHY. But if they buy in and perform, you make out, but watch out for the next contract.

Mr. GUBSER. Admiral, did you say you asked Mare Island for quotation on one of these submarines?

Admiral FAHY. Yes, sir.

Mr. GUBSER. They were in the ball park, as far as the figures were concerned?

Admiral FAHY. Yes, sir. The E. B. price was \$46.8 million for two boats. Dividing that by two, which is not quite comparable, because you make out better if you work two than if you work one, you come out with \$23.4 million for one ship overhaul.

Mare Island's estimate was \$24 million for this ship.

Mr. GUBSER. They got the 601?

Admiral FAHY. They got the 601; yes, sir.

Mr. HARDY. Thank you, Admiral.

Is there anything further, Mr. Reddan?

Mr. REDDAN. We have another matter here, Admiral, which involves the award of a contract which involved 13 test firings. Are you familiar with that, sir?

Admiral FAHY. No, sir; I am not.

Mr. REDDAN. I see. I think that will be all, Mr. Chairman.

Mr. HARDY. I am interested in this contract here from this standpoint: The original proposal was for a fixed-price procurement. You wound up with a fixed-price procurement?

Admiral FAHY. Yes, sir; after competitive bidding.

Mr. HARDY. Well, you started out with an advertised competitive bidding, presumably. Isn't that right?

Mr. BROCKMAN. No; it was competitively negotiated. Not formally advertised in that sense of the word.

Mr. HARDY. Do you call that competition? It wasn't really competitive negotiation.

What do you do, start out by asking for a proposal on this as a basis for competitive negotiations; is that what you started out with?

Mr. BROCKMAN. Yes.

Mr. HARDY. And then you negotiated with the low bidder, and came up with a contract which was identical with his proposal, is that right?

Mr. BROCKMAN. There was no negotiation, sir.

Mr. HARDY. There was no negotiation?

Mr. BROCKMAN. No, sir. We accepted his offer as being reasonable, which is permitted by the regulations in accordance with the request for proposals.

Mr. HARDY. So you didn't change the form of procurement except in accepting his offer, which was supposed to be a basis for negotiation?

Mr. BROCKMAN. We did not change it; no, sir. The terms and conditions were as he proposed or as he quoted, and as we invited him to quote.

Mr. HARDY. Well, normally don't you take a figure that has been proposed and expect to negotiate it down a little bit? Or do you?

Mr. BROCKMAN. No, sir, not if it is considered reasonable, and on the basis of what we consider competitive.

Mr. HARDY. Suppose you had had one that was \$46.8 million and another one that was \$52 million, would you have negotiated with both or just one?

Mr. BROCKMAN. I missed your first figure, sir.

Mr. HARDY. I just used the one you had, \$46.8 million, the other \$52 million, trying to get a spread in there to see what you would do, how you would decide which one you would negotiate with.

Mr. BROCKMAN. The range would have been small, and where we considered that negotiations were in order, then we would have negotiated with both of them.

Mr. HARDY. Well, of course, that can lead you to a long, drawn-out determination as to how you arrive at it. Both of them should be negotiated with.

Mr. BROCKMAN. That is right.

Mr. HARDY. Observing this type of procurement, there is an awful lot of judgment sometimes that goes into these things without being able to reach any determination as to why there wasn't more than one of them negotiated with. When you have a spread as wide as this one, I can understand some basis for it.

Is there anything else?

Mr. Pirnie.

Mr. PIRNIE. I don't mean to interrupt.

Mr. HARDY. Go ahead.

Mr. PIRNIE. Admiral, you heard our discussion earlier about supervising contracting officers.

Admiral FAHY. Yes, sir.

Mr. PIRNIE. Both military and civilians.

Perhaps you may have gained the impression as to where I am specifically interested, not so much to try and pinpoint punishment in the literal sense of the word, but to try and promote efficiency and to make it very clear that if a person is going to handle responsibilities in such a status that performance is expected or else a change in personnel handling the contracts.

Do you agree we ought to be very sensitive to these situations as they are uncovered, and appropriate personnel actions should be undertaken?

Admiral FAHY. I can give you a "Yes" answer, but I would like to elaborate a little on it.

Mr. PIRNIE. I don't want to confine you to a "Yes" or "No" answer. I want to get the thinking on this.

Admiral FAHY. Yes, sir. I agree if we can find any dereliction of performance, or any connivance with contractors—

Mr. PIRNIE. Just a minute. I don't want you to talk about just dereliction and connivance.

Admiral FAHY. No, sir.

Mr. PIRNIE. With a criminal or selfish intent.

I am talking about the whole gamut of inappropriate contracting action as far as it is reflecting on the standard of protection of the interests of this Government. I am talking about competence on the job as it is reflected in the handling of billions of dollars of the taxpayers' money.

Admiral FAHY. Yes, sir. I think something should be said about that particular facet of the picture.

I don't think it is any secret to anyone to state that there is direct competition for competence in this particular area. The Government is competing against private industry for these types of individuals who are most competent to handle contracts.

As a result of that, we have a great deal of work to be handled, and we have a certain number of people to do these jobs.

We have a pretty high turnover for a variety of reasons, and you get people to fill the job if you can. And I might say we have a lot of vacancies, even though our ceiling is not considered adequate. So you have a constant problem of education, and a problem of trying to increase the competence among the people who are actually awarding and administering the contracts.

It is not an easy job. And our people are working considerable overtime hours. And I am only saying this to show you there are extenuating circumstances to this matter of competence, increasing skills, and so on.

We have encouraged people to take additional courses, but when people are working overtime they just can't get off for the courses.

We have encouraged people also to study on their own. We have tried to hire. We have tried to have lectures, and things of this nature, all of them tending toward increasing the competence of the people.

When you get right down to it, the Indians are down there working pretty doggoned long, hard, hours, and I think that this may be Mr. Malloy's reasoning in saying that they haven't gone after somebody. I will admit this has been a great fault, if someone has a catalog and doesn't look up a particular item, but we have to look at the way some of these people are working to see what the extenuating circumstances are.

Mr. PIRNIE. Admiral, you aren't telling us that this is due to the fact the decision is being made at 2 o'clock in the morning?

Admiral FAHY. Oh, no, sir; no.

Mr. PIRNIE. We are held responsible for our vote, whether we cast it at 4 a.m., or 4 p.m.

Admiral FAHY. Yes, sir. I am not saying that. I am merely saying—

Mr. PIRNIE. Let's get right to the point I am interested in. I am sympathetic with any personnel difficulties you may have. I know you are not achieving perfection, no matter how much you try. And so I am perfectly willing to be tolerant and considerate of your efforts.

I am only asking what you do when you discover that such a situation of incompetence exists so that there is a neglect of protecting the interest of our country, and I have not been able to get an answer on that subject from anyone. I am going to pursue it until I do.

Admiral FAHY. I would say if we found such an example we would probably remove the person.

Mr. PIRNIE. You would try to see they handled something of lesser responsibility until you are convinced that the capability exists to make the judgment, isn't that right?

Admiral FAHY. If we did not feel they were capable of carrying out the responsibilities of that job, we would either move them out or get rid of them if it was too flagrant.

Mr. HARDY. They are awfully hard to get rid of, Admiral; you know it and I know it.

Admiral FAHY. Sir, I got rid of a number of people in my period of time.

Mr. HARDY. I have one of your former masters in the Norfolk Shipyard. One reason he retired was because he was required to employ people without an interview. He said "You know what that did to me, don't you? It means we got them aboard, and then we had to go through a lot of stuff to try to get rid of them and you couldn't get rid of them." You and I know it is a whole lot easier not to employ them than to fire them after you get them aboard.

Admiral FAHY. Yes, sir, that is our problem.

Mr. PIRNIE. It is doubtless difficult to take a complete action, but I am referring to reassignment and stricter supervision. When you detect a weak link in the chain, I have been expecting somebody to say, "Yes, we are seriously concerned about it, and that would put us on notice so we would be more careful in that area." That seems to me a simple and direct answer. Is that the way you would view it, Admiral?

Admiral FAHY. Yes, sir.

Mr. BROCKMAN. That is the way I do it.

Admiral FAHY. That is the way it is being done.

Mr. PIRNIE. Instead of defending these actions, that is what I am getting at. I think we ought to say we regret them just as much as anyone else.

Admiral FAHY. Yes, sir.

Mr. PIRNIE. And we are trying to do our very best so they won't reoccur, because I think what has been said here is to try and stimulate imagination so that you would know where to go for the information.

Mr. Malloy, when he was responding there, was attempting to indicate what his state of mind would be with respect to a proper scope of action in order to discharge his responsibility.

But what I am seeking is that there be standards of mental activity commensurate with the responsibility in this area of awarding contracts, because we could certainly save a good many tax dollars, and improve our image with our electorate, with people of this country, if we indicate that is our goal. Don't you feel so?

Admiral FAHY. I agree with you 100 percent, sir. The only reason I said these words in extenuation of the condition of the way in which our people operate is because I don't think too many people appreciate it; and I felt it was a good opportunity to get it out. I rescind entirely any attempt to try and beg off. I feel that if something were remiss we should certainly do something about it, and do something about it immediately, and we have been doing that.

Mr. PIRNIE. We were speaking about the obvious, Admiral, because we did have some examples here where you've got a simple item, about which I, with my lack of manufacturing know-how, would have some concept of price. And if I were quoted a price that seemed to be ex-

tremely out of line, I think I would dig a little deeper. That is what we were trying to get at here.

I am sorry to take so much time, but I think it very important that this attitude prevail.

Mr. HARDY. I have just one more point I wanted to clear up.

Back to this submarine contract.

This was a matter of judgment to accept the proposal without negotiation, and based pretty largely on the figures submitted by Mare Island; is that right?

Admiral FAHY. That, and the prior figures we had for the 599, in particular, from Electric Boat.

Mr. HARDY. We will say, certainly, these gave you some basis for a judgment, but how do you determine, under this set of circumstances, how do you check against your judgment? If you got some cost data on the performance of that contract, you would have a better idea as to whether or not you really were exercising good judgment, wouldn't you?

Mr. BROCKMAN. You mean cost after performance?

Mr. HARDY. That is right.

Mr. BROCKMAN. We have it, sir.

Mr. HARDY. How are you coming out?

Mr. BROCKMAN. The way we figure it, again our best estimate now that the work is substantially completed and the ships are gone. Comparing it with the basic price and the basic work, trying to back out the changes Admiral Fahy noted because of developments that occurred since we made the initial award, we have concluded that the contractor will be very fortunate to make a 4 percent profit on the basic work.

Mr. HARDY. Well, I am interested in this because whenever we see an award made on somebody's judgment without having some pretty good backing for it, it brings into question how you know, or how you establish whether that is a good procedure or not. We have another one going on now. I don't know if you are familiar with it. The Navy switched from an advertised procurement to a CPFF, a cost-plus procurement. When we get a little more time, we are going to try to establish just what caused that. The best we can determine now is that the Navy reached this decision strictly on a basis of judgment. We want to run a test on that and see how it comes out.

Admiral, is there anything further you would like to comment on concerning this matter we are pursuing?

Admiral FAHY. No, sir. I don't think so. I have been through these GAO audits. I find that it is just like having the firemen come around and inspect your house, it is a real handy thing to have.

Mr. HARDY. Mr. Lennon, do you have a question?

Mr. LENNON. Yes. I would like to question Mr. Harold Gold, the General Counsel for the Naval Facilities Engineering Command. Would you mind coming up a minute, please, sir, since you are one of the witnesses here?

Mr. Gold, Public Law 87-653 became effective on December 1, 1962. Were you called on by DOD to make the determination as to whether or not this particular act was applicable to construction contracts under the Naval Facilities Engineering Command?

Mr. GOLD. I wasn't called on by DOD, but we had the determination to make when the act was enacted, and we concluded that it was applicable to construction.

Mr. LENNON. That it was?

Mr. GOLD. It was, yes, sir.

Mr. LENNON. When was that determination made?

Mr. GOLD. Well, way back in the end of 1962, I believe. We put out, I believe, an instruction in the Bureau of Yards and Docks in January of 1963 which implemented the ASPR provisions on the subject of the new legislation.

I don't happen to have a copy here of that instruction, but in a draft of the GAO report concerning construction contracts in the Navy, which was transmitted on January 6, 1967, there was a reference to that instruction, and I refer here to page 2 of this letter of January 6, 1967, as addressed by the General Accounting Office to the Secretary of Defense, and it said the NFEC, that is the Naval Facilities Engineering Command, has interpreted ASPR as not requiring cost or pricing data when the contractor's proposal is determined to be reasonable. In this connection, division officials referred to Bureau of Yards and Docks Notice 4330, dated January 17, 1963, which supplemented ASPR, and which permitted a price analysis without resort to cost analysis in determining the reasonableness of the proposal whenever the price analysis performed in the prescribed manner provided a reasonable basis for the award.

I believe, Mr. Lennon, that the point was not that our people didn't understand the statute to be applicable, but, rather, they had some misconception of the difference between the requirements of section 18 of ASPR, specifically relating to construction contracts, and section 3.

Mr. LENNON. Thank you. Then I assume you read the statement made by the spokesman for the General Accounting Office, which is in the last paragraph at page 5, and a continuation on page 6, where he—were you here when that was read?

Mr. GOLD. I was, sir.

Mr. LENNON. That is what I was addressing myself to. The implication there is that neither the Naval Facilities Engineering Command, nor the U.S. Corps of Engineers considered the law was not applicable to construction contracts. Then, they go on and say, instead the construction agencies placed primary reliance for comparison with the contractor's proposal with their own cost estimates. We were informed—and GAO was informed in January, 1967, according to that date you read from the DOD memo—that the agencies now recognize that the law does apply to construction contracts and concern the necessity of obtaining cost pricing data.

I was trying to reconcile your statement with their statement. So you see it was in January 1967 the DOD acknowledged to General Accounting Office that the agencies, to wit, the Corps of Engineers and the Naval Facilities Engineering Command recognize that the law was applicable. Do you see what is going through anybody's mind when he reads this? I want to know who is right.

Mr. GOLD. If I may attempt to clarify it. I think what we said in January 1967 was, notwithstanding the ideas that our people had in the past, based upon section 18 of ASPR, and the use of an independent Government appraisal as the basis for negotiation, that from thenceforth on we would comply with the strict requirements of section 3 of

ASPR, implementing Public Law 87-653, to get cost and pricing data beyond that which would otherwise be required by section 18 of ASPR.

Mr. LENNON. The point was—why the recognition after a period of approximately 4 years and 7 months that you did come under this section of ASPR as related to Public Law 87-653?

Mr. GOLD. Well, it was not the recognition that we were covered by it. We had known all along we were covered by the law. And I think the GAO report indicates that we did get certificates of pricing. I know for a fact that we did have the standard clause in our contracts with respect to defective pricing, and that we did get data.

Now, the question really that was called to our attention by the GAO report was whether or not that date was adequate within the requirements of section 3 of ASPR, which implements the statute.

Mr. LENNON. All right. Thank you. I just wanted to clear my own mind on the subject.

Mr. GOLD. Very good, sir.

Mr. HARDY. Thank you. Thank you very much, gentlemen. I think we can finish up in a few minutes.

Mr. Cox of the Army. Have a seat, Mr. Cox. We will try not to take very long.

TESTIMONY OF EDWARD C. COX, CHIEF OF PROCUREMENT POLICY DIVISION, DIRECTORATE OF PROCUREMENT POLICY AND REVIEW, OFFICE OF THE ASSISTANT SECRETARY (INSTALLATIONS AND LOGISTICS), DEPARTMENT OF THE ARMY

Mr. Cox. All right, sir.

Mr. HARDY. Go ahead.

Mr. REDDAN. Mr. Cox, were you in the room during the GAO presentation this morning?

Mr. Cox. Yes, I was.

Mr. REDDAN. You have had available a copy of the GAO statement?

Mr. Cox. Yes, I have.

Mr. REDDAN. There were two matters in there which they referred to that embrace Army procurements. Are you prepared to address yourself to those particular procurements?

Mr. Cox. Yes.

Mr. REDDAN. On page 13, the observation was made by GAO that supervisory reviews are seldom made of technical evaluations. And the case that they refer to there is discussed in a letter addressed to Col. B. B. Drummond, Commanding Officer, Southwest Procurement Agency, Army Materiel Command, Pasadena, Calif., under date of May 2, 1966.

Would you care to comment on the GAO's observations in that case, sir?

Mr. Cox. I think they are commenting on the extent to which an engineer justifies for the record the basis upon which he evaluated material and labor in this specification. I think they had reference to, how did he determine that 63,800-some hours were correct, and how did he determine the weights of three particular materials that were going into a particular explosive? And indicated in there that there was no justification in the file.

Mr. REDDAN. The labor and material estimates accounted for about 95 percent of the total contract price in this case; is that correct?

Mr. Cox. That is correct.

Mr. REDDAN. All right; go ahead, sir.

Mr. Cox. We have seen fit since to write instructions to our people to be more specific in this particular area.

I might say that we are somewhat concerned, as the chairman indicated earlier this morning, that we not burden the file with too much paperwork, but we do believe that the instructions that we have put out will be sufficient to give some better tracking of the reasoning behind these judgments.

Mr. REDDAN. What form did those instructions take, Mr. Cox?

Mr. Cox. There was a letter from the Army Materiel Command. I do not have a copy with me. I will be glad to furnish it for the record if you wish.

Mr. REDDAN. Will the instructions be incorporated in the ASPR provisions at a later date?

Mr. Cox. They will not, sir. We are working over the entire field in this area. We felt best they put this out, and we get some experience under it, and we will, if we feel that it is appropriate, and that it is beneficial, that it is not burdensome, then we will bring this to the attention of the ASPR Committee.

Mr. REDDAN. Fine. Would you supply the committee with a copy of the letter of instructions?

Mr. Cox. I will.

(The letter, dated December 23, 1966, signed by Col. Walter I. Woolwine, Deputy Director of Procurement and Production, Headquarters, U.S. Army Materiel Command, was furnished by the Department of the Army, and follows:)

DEPARTMENT OF THE ARMY,
HEADQUARTERS UNITED STATES ARMY MATERIEL COMMAND,
Washington, D.C., December 23, 1966.

Subject: Documentation of Technical Aspects of Contract Pricing Decisions.
To: See Distribution.

1. References

a. ASPR 3-811.

b. Chapter 14, ASPM No. 1—ASPR Manual for Contract Pricing, 29 October 1965.

2. From time to time, this command has received criticisms by audit and inspection personnel relative to the lack of documentation supporting opinions of technical personnel, in the evaluation of proposals for noncompetitive procurements. These opinions usually deal with the need for quantities and types of materials, labor, and other efforts in the performance of the proposed contract, which have often been accepted at face value by contract pricing and negotiation specialists.

3. Since these opinions support contract pricing decisions they are subject to the same degree of documentation as other records that support such decisions, and should be "in sufficient detail to reflect the most significant considerations controlling the establishment of the initial or revised price." (ASPR 3-811(a)).

4. For acceptability as documentation of the pricing process, such technical opinions should be presented in a form that the contract pricing or negotiation specialist can understand and appreciate. In this respect the following quotation from Chapter XIV of the ASPR Manual for Contract Pricing is particularly pertinent:

"For this reason, you will not ask the contract auditor, the ACO (and through him, any of the field specialists) or any other persons outside the procurement activity to give you a recommendation as to the fairness and reasonableness of the contract as a whole or as to total costs, proposed prices or profit weights and rates. In asking for a recommendation, you are asking someone else to make your decision for you, something he may be in no position to do.

"You go to these people for facts on which to base your decision and not for the decision itself. Generally, you will know more about the overall situation and be in a better position to make these decisions. You are looking for facts and informed opinions based on facts, and you are asking these specialists for information on matters within their areas of special competence. You should not be asking them to give you a negotiation objective which is, in effect, what a price recommendation at this point would amount to."

5. It is requested that this interpretation be brought to the attention of all contract pricing and negotiation personnel as well as technical personnel whose input represents a part of the contract negotiation process.

WALTER I. WOOLWINE,

Colonel, GS, Deputy Director of Procurement and Production.

Mr. REDDAN. There was one other case that the General Accounting Office referred to this morning. That involved a contract, I believe, with General Electric Co. It was referred to in a letter dated May 11, 1967, to the Secretary of the Army from the General Accounting Office. Are you familiar with that case, sir?

Mr. COX. That one I don't recall on that basis. Is it stated here?

Mr. REDDAN. Yes, sir; on page 24 of the GAO's statement, under "Failure to recognize the need for and to request postaudit awards."

Mr. COX. That one, I believe, hits into the general subject that Mr. Malloy stated was a question that was undecided before the Department of Defense at the present time.

Mr. REDDAN. What is the position of the Department of the Army on that recommendation, Mr. Cox?

Mr. COX. Well, we feel that there are a lot of points at stake, primarily the integrity of the fixed-price system. We believe that if contractors are forced to permit the Government to review performance, and make a recovery after performance, that this will reduce fixed-price contracting to cost-plus-fixed-fee-type contracting, or some other kind of less desirable type than a fixed price. It would disrupt, or at least it would have a tendency to disrupt the fixed-price system which we feel, and I believe formal advertising is based upon, is the best kind of contracting.

Mr. REDDAN. Are you saying, then, that you feel that the postaward audits, as suggested by the General Accounting Office, should not be made?

Mr. COX. I think here we should clearly understand that postaward audit can mean two things. You can post award, as of the date of the certificate of current cost and pricing data, which we are firmly in agreement with. But you can also do an audit of performance after the fact. That is, of what actually took place after you finished your negotiations. And these are two different things. That distinction I believe is not clearly made in the report.

Mr. REDDAN. Well, now, do you have any further comments or observations that you want to make on the presentation of the General Accounting Office?

Mr. COX. No; only to say that we appreciate the work of the GAO when they point out places where we can be more specific, or clearer in our instructions, and do a better job, and we accept them with that spirit, and we try to do a better job as a result of any constructive comment that they have.

Mr. HARDY. Talking in terms of the two different types of postaward audits that you mentioned, if the one that would determine performance had to do with deficiencies in the data submitted as a

basis for negotiation, it would seem to me that it would be a highly important thing. You are not looking to determine what the costs were, except insofar as they related to inadequacies in the cost data. Isn't that correct?

Mr. Cox. Yes, sir, Mr. Chairman; but you are going to put a contractor to a great deal more expense to go into audits of great detail. Certainly a cost that he normally would not anticipate in a normal today's fixed-price contract. He enters into a contract. The contract is signed. It is executed. And those are the terms of the contract.

Mr. HARDY. Well——

Mr. Cox. There is no administration, you see.

Mr. HARDY. There is one GAO referred to here, it says the contracting officers accepted these refunds without determining whether the refunds were adequate. Now, this grew out of a failure, I believe, to be completely responsive, or accurately responsive, during the period of negotiations; isn't that right?

Mr. Cox. This could be, sir. I do not have the exact facts on this.

Mr. HARDY. It says here, "In some instances a lengthy period had elapsed between the time of preaward audit and the time of contract negotiation."

Mr. Cox. Right.

Mr. HARDY. Now, in that period—of course this gets into the problem of long, drawnout negotiations—but in that period you had things happen that affected or should have affected your negotiations.

Mr. Cox. That is right.

Mr. HARDY. But it didn't. You had had a preaward audit made. But then you had extended negotiations. So what happened in between might have had a sharp bearing on the negotiated price if it had been known.

Mr. Cox. That is right, it could have.

Mr. HARDY. That being the case, how can a contracting officer merely accept the contractor's statement that this is the refund you are entitled to without making some check to see the effect of the information which occurred between the award and the preaward audit?

Mr. Cox. In that case, if that is data that should be certified as current, correct, and accurate, as of the time of executing the contract, and the refund is made on the basis of that kind of inaccuracy, I would agree there should have been an audit.

Mr. HARDY. This is the way I read what they say here.

Is there anything further?

Mr. REDDAN. No.

Mr. HARDY. Mr. Lennon.

Mr. LENNON. Mr. Cox, returning briefly to pages 13 and 14, with respect to the so-called Harvey Aluminum, Inc., contract, the statement indicates that the technical evaluation was made by a so-called agency industrial specialist. He simply listed, according to the available reports and documents, that consisted of listing labor and material quantities, and his, the industrial specialist's conclusion, that the proposed labor and material estimates were reasonable, and a recommendation that the contract be awarded the contractor. There was no indication of any supervisory degree of the technical adviser's work. Is that a fact?

Mr. COX. I would assume so, if the General Accounting Office recorded this is what their findings were.

Mr. LENNON. The contract was over a million dollars, as I recall it.

Mr. COX. Yes, sir.

Mr. LENNON. They have recommended in the future that supervisory personnel should at least make a cursory or perfunctory review at least of these recommendations where your person says "I find this, in my judgment, to be reasonable, and I recommend the contract be awarded."

Do you agree that the GAO's recommendations should be followed, and that supervisory personnel should review the work performed, and at least assure themselves that the reports resulting from these evaluations are prepared?

Mr. COX. Sir, it would seem to me that our normal process of contract approval gives that kind of supervisory review.

Mr. LENNON. Apparently it did not in this case; at least the record doesn't reflect it.

Mr. COX. Well, I think it is the latter, sir, because before we can approve a contract for that kind of money it would go before a contract clearance board, or board of awards, who are specialists. They have legal, accounting, and engineering, technical backgrounds, all of whom would have had this kind of information before them to sift over and question the contracting officer much as I am here before you today.

Mr. LENNON. Yes. And that would be a supervisory review of the technical evaluator's work in this job such as you indicated?

Mr. COX. I am sure; yes, sir.

Mr. LENNON. You think that did happen. The record doesn't reflect it, but it did happen?

Mr. COX. Yes, sir.

Mr. HARDY. Do you have any further comments you would like to make, Mr. COX?

Mr. COX. Except to just state also the Corps of Engineers did know that this law did apply to construction. I think the record indicates that the Corps of Engineers did not know, and it is based on an examination made at whatever areas—I believe one of them was Fort Worth, and one of them might have been Mobile; I am not sure. But the Corps of Engineers General Counsel was well aware of the application of Public Law 87-653 to construction contracting, and this is evidenced by the fact that we did have the clauses, we did get what we thought was cost and pricing data, and we did get the certificate.

It was, as I can repeat, as Mr. Gold said, that it was just that we did a price analysis, placing a great deal of reliance on the Engineers' estimate, their own inhouse estimate, of knowing what a given construction job should cost. And it was this reliance on our own estimates that proved to us that the price was fair and reasonable.

Mr. HARDY. So you decided on that basis you didn't need to follow the law?

Mr. COX. No, sir. We felt this was a pricing. There is a different interpretation of the cost and pricing data. We hope we have cleared that point up. And our people fully understand they must get cost data in these cases, and they must do a cost analysis, and not merely a price analysis, from here on out.

Mr. HARDY. If your price analysis were completely reliable, there wouldn't be very much point in getting competitive bids on the produc-

tion, would there? Because you wouldn't need to. You would know all about it and all you would need would be one. You could check him by your expertise, and you would know whether that was right or not.

Mr. COX. Most of ours is by advertised bids.

Mr. HARDY. I know. But some of them don't come in that category. If your pricing is as good as the Corps of Engineers thinks it is, it seems pretty hard to me to see how you could justify such a wide variation of prices which you get sometimes on your advertised production procurements, because certainly the corps doesn't have all the competence, and some of these contractors are pretty smart, too. Sometimes they vary widely. How the Corps of Engineers or the Bureau of Yards and Docks can set themselves as having sufficient expertise to pass on the reasonableness of negotiated contracts simply based on their price analysis—don't you think that sounds a little bit egotistical?

Mr. COX. We have convinced them of that, sir. It wouldn't happen again.

Mr. LENNON. Mr. Cox, you have insisted there was a supervisory review, and you claim that individuals, in substance, made the review of the technical evaluator's work in the Harvey Aluminum case. Would you furnish for this committee's information the response to a letter directed to Col. B. B. Drummond, commanding officer of the Southwest Procurement Agency, Army Materiel Command, Pasadena, Calif., signed by the Acting Regional Manager, the General Accounting Regional Office, in which they state:

We are also informed no supervisory review was performed of the technical evaluator's work.

Then they finally say—

We believe the work performed by your technical evaluators should be reviewed.

I would like to see whether or not Colonel Drummond says the same thing you said here today.

Mr. HARDY. Mr. Lennon, maybe we could expedite this just a little bit. Maybe Mr. Hammond can shed a little light on that as to whether or not he has a reply. Maybe we can get it right now.

Mr. LENNON. Well, it is interesting to me whether or not Colonel Drummond specifically and categorically stated there was a supervisory review. You say there was, but the records don't reflect it. I wondered how this letter was answered.

Mr. HARDY. It occurred to me it might be available.

Mr. COX. Congressman Lennon, I was making my statement on the basis of the normal procedure, which is for contracts of this magnitude to go before a contract board of awards.

Mr. HARDY. I get so fed up with people coming up here and sitting in the witness chair and answering specific questions on the basis of what a normal procedure ought to be.

Mr. COX. I will find out, sir.

Mr. HARDY. There isn't anything in the world to indicate whether that occurred. People do this all the time, so you don't need to feel too concerned about being singled out, because it has been done from the Secretaries right on down. But it is a silly thing to do before a Congressional committee that is asking you specific questions. I'm surprised to find that out. I thought you were answering in a specific

vein. The question was asked as to a specific situation. Of course, there is an awful lot of difference sometimes between what the regulations say and what gets done. I think you must have learned that.

Mr. COX. What was the date of that letter, May 2?

Mr. HARDY. He has it.

Mr. LENNON. May 2, 1966, and here is what appears to be a response from the Department of the Army, dated June 2, 1966, signed by a Lt. Col. O. S. Cox, to the Los Angeles Regional Manager of the General Accounting Office. There has to be a little thought given to it as to whether or not they answered that. All he does say is that our reply to this statement at the exit conference was that the industrial specialist is subject to concurrence of the Section and Branch Chiefs, and upon presentation of the request for award to the board of awards. The technical member of the board examined the result of the specialist's evaluation.

Mr. HARDY. He doesn't answer it any better than Mr. Cox does.

Mr. LENNON. He said it was subject to it, he didn't say it was done.

Mr. COX. I will furnish you the specific information. I was not in this case.

Mr. LENNON. I hope it was done.

(The following statement was subsequently submitted to the subcommittee by Edward C. Cox, Chief of Procurement Policy Division, Directorate of Procurement Policy and Review, Office of the Assistant Secretary, Installations and Logistics, Department of the Army:)

On 3 October 1967, I reviewed the Contractor Selection Board minutes for the subject case (Selection Board Register No. 8774). The "Negotiator's Check List" which is a part of the minutes indicates that the "Technical Analysis" of the proposed evaluation was considered. In addition, on 5 October 1967, I spoke to Mr. Richard Alonzo, the Technical Member of the Selection Board which approved the contract in question, and obtained his confirmation of the fact that the technical analysis in question had been reviewed by him and found acceptable for the purpose of recommending approval of the award to Harvey Aluminum.

Mr. HARDY. Thank you, Mr. Cox.

Mr. COX. Yes, indeed.

Mr. HARDY. Let the committee stand adjourned subject to the call of the Chair.

(Whereupon, at 4:47 p.m., the subcommittee adjourned subject to the call of the Chair.)



