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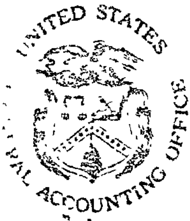

REPORT TO THE CONGRESS

Further Improvements Needed In Controls Over Government-Owned Plant Equipment In Custody Of Contractors B-140389

Department of Defense

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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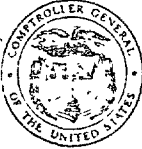

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-140389

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To the President of the Senate and the
Speaker of the House of Representatives

This is our report on the need for further improvements in Department of Defense controls over Government-owned plant equipment in the custody of contractors.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretary of Defense; the Secretaries of the Army, Navy, and Air Force; and the Director, Defense Supply Agency.

Elmer B. Staats

Comptroller General
of the United States

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ABBREVIATIONS

ASPR Armed Services Procurement Regulation

DOD Department of Defense

GAO General Accounting Office

IPE industrial plant equipment

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FURTHER IMPROVEMENTS NEEDED IN CONTROLS OVER GOVERNMENT-OWNED PLANT EQUIPMENT IN THE CUSTODY OF CONTRACTORS
Department of Defense B-140389

DIGEST

WHY THE REVIEW WAS MADE

On November 24, 1967, the General Accounting Office (GAO) reported to the Congress that there was a need for improved controls over Government-owned property in contractors' plants. Subsequent internal reviews by the Department of Defense (DOD) have shown the continued existence of this situation. GAO's current review was directed chiefly toward DOD management of a major part of such property--plant equipment--to examine into the underlying causes of the problems.

FINDINGS AND CONCLUSIONS

Some progress has been made toward the DOD goal of generally requiring contractors to furnish all equipment needed to perform Government contracts.

In December 1967 contractors had in their possession DOD-furnished plant equipment costing $4.6 billion. By June 1971 this amount had declined to $4.1 billion, of which $2.2 billion worth was industrial plant equipment, such as lathes, milling machines, and drills. The $1.9 billion balance was the value of other plant equipment, comprised of machines costing less than $1,000 and such items as furniture, vehicles, and computer equipment. (See p. 5.)

In March 1970 the military services and the Defense Supply Agency were directed to require contractors to submit plans to phase out their use of Government-owned facilities. The Deputy Secretary of Defense, however, has permitted deferment of these plans at contractors' plants where mobilization base requirements are being developed and where the phaseout would be contrary to the Government's interest or would create an economic hardship for the contractor. The Department expects to receive, by March 1973, plans from about 647 contractors. As of December 31, 1971, 187 plans had been approved. (See pp. 7, 8, 9, and 13.)

As a result of a prior GAO review, DOD stated in October 1970 that the Armed Services Procurement Regulation (ASPR) would be revised to stop the practice of furnishing general-purpose test equipment--i.e., plant equipment--as special test equipment to contractors. But on March 15, 1972, the Department informed GAO that it had decided not to implement the proposed revision. (See pp. 9 and 10.)

DOD is rebuilding existing equipment at contractors' plants without an evaluation as to the need. The Air Force has spent about $200,000 to refurbish equipment for which future use is questionable. Such expenditures

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would be curbed if DOD applied to the rebuilding program the criteria it uses for furnishing equipment--i.e., needed for use in a Government-owned plant, needed in support of mobilization production, or specifically determined by DOD to be necessary. (See p. 12.)

The reuse potential of Government-owned industrial plant equipment has not been fully realized because of weaknesses in the procedures for reporting unneeded equipment to the Defense Industrial Plant Equipment Center for screening and redistribution.

At 13 of the contractors' plants visited, GAO identified 327 items of equipment costing $11.4 million which had not been reported to the Center but were idle, had little use, or were used predominantly for commercial work. Of the 327 items, the Center identified 78 costing $1.7 million which, had they been reported, might have been used to fill equipment requirements at other locations. (See pp. 16 to 22.)

Some contractors use Government equipment for commercial work without obtaining the approval required in advance of the actual use. When obtained, this approval normally limits the commercial use to 25 percent of available machine time. When commercial use is expected to exceed the 25-percent limitation, approval must be obtained from the Secretary of the military department concerned, and, in the case of certain metalworking equipment, from the Office of Emergency Preparedness. GAO identified instances of unauthorized use within the framework of these criteria. (See pp. 23 to 25.)

Available machine time is not always an appropriate basis for measuring commercial use, because it is possible for machines to be used solely or predominantly for commercial work without exceeding the 25-percent limitation. Consequently, approval requirements for commercial use should be based on 25 percent of actual machine time rather than of available time. (See p. 25.)

DOD regulations permit considerable flexibility in computing rent for commercial use of equipment. The lack of a uniform method of computing the credit for Government use has resulted in inequities to the Government and to the contractors. (See pp. 30 to 36.)

Under the Air Force heavy-hammer program, five contractors have been permitted to use about $20 million worth of Government-owned plant equipment under nonstandard leases which permit unlimited commercial use at rental rates significantly lower than the rates provided in ASPR for the same classes of equipment. These terms were granted because it was thought there was only a small commercial market for the types of items produced with the equipment.

At one contractor's plant, however, GAO found that during 1 year over 80 percent of recorded sales of products produced using Government-owned equipment were not under Government contract. (See pp. 37 to 40.)

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RECOMMENDATIONS

The Secretary of Defense should:

--Reemphasize the DOD program for phasing out the use of Government-owned facilities by contractors. (See p. 15.)

--Revise the definition of special test equipment to exclude general-purpose equipment. (See p. 15.)

--Strictly apply to the rebuilding of existing equipment the criteria for furnishing equipment to contractors. (See p. 15.)

--Revise the regulations to require contractors to maintain utilization records for individual machines making up some minimum portion, for instance 75 percent, of the acquisition cost of Government-owned industrial plant equipment. GAO estimates that, by including only those items having the highest acquisition cost, this might require such records for only 25 percent of the machines. The records should show the amount of Government use and commercial use. (See p. 29.)

--Revise the regulations to require that the commercial-use factor be based on actual machine time rather than on available time. (See p. 29.)

--Remind contract administrators of the need to (1) monitor use of Government-owned plant equipment, (2) identify unauthorized use of equipment, and (3) incorporate regulation changes promptly into facilities contracts to insure contractual coverage of DOD policies concerning industrial plant equipment. (See p. 29.)

--Revise ASPR to provide clear criteria for identifying and reporting unneeded items of equipment. (See p. 29.)

--Revise the regulations to establish a uniform and equitable method of computing rent. To the extent practicable, this should be done on a machine-by-machine basis with the credit for rent-free (Government) use applied to each machine in its ratio of Government to total machine hours of use. (See pp. 41 and 42.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Assistant Secretary of Defense (Installations and Logistics) indicated that DOD had made significant progress both in phasing out the use of Government-owned equipment held by contractors and in managing the remaining such equipment. In his view, increased emphasis on enforcing existing policies rather than on issuing new or revised regulations will provide the necessary improvements.

Although DOD has made some progress toward its goal of generally requiring contractors to furnish all equipment needed to perform Government contracts, the significant amount of equipment remaining in the possession of

contractors necessitates a renewed emphasis on the Department's phase-out program if it is to achieve its stated objectives. (See pp. 13 and 14.)

The improvements necessary in DOD's management of industrial plant equipment in the possession of contractors cannot be achieved in all cases by only reemphasizing existing DOD policies and procedures. The Secretary of Defense should give further consideration to the recommendations stated above which call for revising certain DOD policies and criteria.

MATTERS FOR CONSIDERATION BY THE CONGRESS

This report provides information on the progress being made to reduce the amount of Government-owned plant equipment in the hands of defense contractors and on the problems associated with adequately managing this property. The information should be useful in considering proposed legislation relating to such property as well as in evaluating DOD's stewardship in this area.

Existing legislation does not permit the direct sale of equipment through negotiation with holding contractors unless certain conditions are met. DOD officials feel that enactment of House bill 13792, which permits the direct sale of equipment to holding contractors, would facilitate DOD's efforts to phase out the use of Government-owned equipment at contractors' plants. GAO has endorsed similar legislation, proposed in previous years, and agrees with the intent of House bill 13792 to permit direct sale of equipment to the using contractors. (See p. 8.)

CHAPTER 1

INTRODUCTION

Armed Services Procurement Regulation (ASPR) 13-101.1 establishes five separate categories of Government-owned property. These are facilities, special tooling, special test equipment, material, and military property such as weapons systems and related support equipment.

"Facilities" is defined in ASPR 13-101.8 as industrial property, including real property and rights therein, buildings, structures, improvements, and plant equipment.

Plant equipment includes such items as machine tools, test equipment, furniture, vehicles, and accessory and auxiliary items. Government-owned plant equipment in contractors' possession is furnished by the Government or is purchased by contractors for Government account, in accordance with the basic policies set forth in ASPR, under facilities contracts. As a rule, such equipment is furnished only if it is needed for the performance of a Government contract. However, commercial use of the Government-owned items is permitted when certain conditions, including the payment of a rental fee, are met.

The amount of Department of Defense (DOD)-owned plant equipment in contractors' custody has decreased by about $500 million since 1967. As of June 30, 1971, the acquisition cost of DOD-owned plant equipment in contractors' possession totaled about $4.1 billion. Of this equipment, about $1.4 billion worth was at locations where only Government projects were involved.

About $2.2 billion worth of the equipment was industrial plant equipment (IPE), which is defined in ASPR B-102.11 as:

> "*** that part of plant equipment with an acquisition cost of $1,000 or more; used for the purpose of cutting, abrading, grinding, shaping, forming, joining, testing, measuring, heating, treating, or otherwise altering the physical, electrical or chemical properties of materials, components or

end items, entailed in manufacturing, maintenance, supply, processing, assembly, or research and development operations; and IPE is further identified by noun name in Joint DOD Handbooks as listed in 13-312."

On November 24, 1967, GAO reported to the Congress (B-140389) that there was a need for improvements in controls over Government-owned property in contractors' plants. Since that time the Auditor General, Defense Supply Agency, has reviewed, at the various Defense Contract Administration Services Regions, the administration of industrial facilities under the control of defense contractors. The Auditor General's reports for 1968, 1969, and 1970 noted deficiencies similar to those reported in our 1967 report. In almost all cases the various regional commanders of the Defense Contract Administration Services concurred in the findings and commented that the appropriate sections of ASPR and the Defense Supply Agency's manuals would be followed and that seminars would be held to correct the deficiencies. However, because the same deficiencies have been recurring, we performed this work to examine the underlying causes of these problems and to make further recommendations. We directed our review chiefly to the management of plant equipment.

Because of congressional interest, our review included Government-owned automatic data processing equipment. DOD statistics show that such equipment, worth only about $63 million, is a minor portion of the total Government-owned equipment in the possession of contractors. One of the contractors included in our review had Government-owned automatic data processing equipment valued at $5.2 million. We did not find any significant deficiencies in the controls over its acquisition or utilization at this location.

CHAPTER 2

PROGRESS IN RELIANCE ON CONTRACTORS

TO FURNISH EQUIPMENT

Since our 1967 report the Department of Defense has sought to curtail the furnishing of new machines at contractor-owned plants. Funding for this purpose approximated $120 million in 1967 but decreased substantially in subsequent years. Also, in March 1970 DOD initiated a program to phase out Government-owned facilities at contractors' plants. Although these actions appear to be in consonance with DOD's existing policy of relying on contractors to finance the purchase of equipment, we believe that a general phaseout is unlikely to occur because:

1. The Deputy Secretary of Defense, on February 13, 1971, established broad criteria permitting deferment of phaseout plans.

2. DOD is reassessing its mobilization-production-planning program to determine its adequacy. Present regulations permit the furnishing of new equipment when the contractor has a mobilization plan approved by the Assistant Secretary of Defense. Hence, under the existing criteria, the DOD investment in equipment at contractor-owned plants may increase rather than decrease in future years.

3. On April 9, 1971, GAO reported to the Congress (B-140389) that significant quantities of general-purpose plant equipment had been furnished to contractors under a category termed "special test equipment." DOD estimated that its total inventory of special test equipment and special tooling was worth between $3 billion and $3.5 billion. To preclude the furnishing of general-purpose items in the future, we recommended that the definition of special test equipment in ASPR be revised. DOD concurred. However, on March 15, 1972, we were advised that DOD had concluded that it would not be in the best interests of the Government to implement the proposed revision.

FIVE-YEAR PHASEOUT PLANS

In March 1970 the Assistant Secretary of Defense (Installations and Logistics) issued a memorandum to the Assistant Secretaries (Installations and Logistics) of the Army, Navy, and Air Force and to the Director of the Defense Supply Agency concerning phaseout plans for Government-owned facilities in the possession of contractors.

This memorandum restated the basic DOD policy of relying on the use of privately owned facilities in performing Government contracts. Contractors were required to submit plans to phase out the use of in-place Government-owned facilities. Nonprofit and not-for-profit contractors and wholly Government-owned, contractor-operated plants which do not engage in competition with commercial firms were exempted.

The objective of the plans was to orderly phase out contractor use of Government-owned facilities over a period generally not to exceed 5 years. All exceptions were to be approved by the Secretary of Defense.

As of December 1971, 187 of 647 expected phaseout plans had been approved. We were told that some contractors did not submit plans because their production contracts with the Government would terminate shortly, requiring them to return the equipment to Government custody. Other contractors delayed submitting plans because they wanted to buy the Government-owned equipment in their possession. However, existing legislation does not permit the direct sale of equipment through negotiation with the holding contractor unless it is sold in a package with an entire Government facility or is nonseverable and is classified by the General Services Administration as real property. DOD officials indicated that enactment of House bill 13792, which permits the direct sale of equipment to holding contractors, would facilitate DOD's phaseout efforts without affecting the industrial production base needed for emergency defense requirements. We have endorsed similar legislation, proposed in previous years, and agree with the intent of House bill 13792 to permit the direct sale of equipment to the using contractors.

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On February 13, 1971, the Deputy Secretary of Defense issued a memorandum stating that DOD was evaluating the impact on the mobilization base of the 5-year phaseout plan, in connection with a reassessment of its mobilization-production-planning program. The memorandum delegated to the Secretaries of the Army, Navy, and Air Force the authority to approve the exemptions or exceptions to the basic policy of the phaseout plan, which were initially required to be approved by the Secretary of Defense. In addition, it provided for deferring phaseout plans where mobilization base requirements were in the process of being developed and where phaseout would be contrary to the interests of the Government or would work an economic hardship on an individual company. In our opinion, the deferment criteria pertaining to the interests of the Government and to the economic hardship on an individual company are so general as to permit many exceptions to the phaseout. We believe that this memorandum will delay much of the activity which may have been anticipated in connection with the 5-year phaseout plan.

IMPROPER ACQUISITION OF PLANT EQUIPMENT AS SPECIAL TEST EQUIPMENT

On April 9, 1971, we reported to the Congress that significant quantities of plant equipment--specifically, general-purpose test equipment--had been acquired as special test equipment and has been paid for by the Government. Had this equipment been classified properly as general-purpose test equipment, in all likelihood it would have been provided by private investment, because the acquisition would not have met the ASPR criteria for furnishing Government-owned equipment to contractors.

We reported that, at five contractors' plants, special test equipment on hand costing about $62 million had been purchased for the Government's account. Of this amount, an estimated $12 million represented the cost of plant equipment which should have been provided by private investment. At the time of the review, a DOD official estimated that the total active and idle Government-owned special tooling and special test equipment under DOD administration would be worth from $3 billion to $3.5 billion. These figures did not provide a breakdown of special test equipment, but we were told that it was considered to be a significant part of the total.

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The acquisition of plant equipment as special test equipment has been permitted by the ASPR definition of special test equipment, which specifically includes "all components of any assemblies of such equipment." This definition permits the acquisition of plant equipment as special test equipment when it is to be included in a group of test equipment items assembled for a specific use.

We expressed the belief that it is feasible to require contractors to provide their own general-purpose components of special test equipment and that such a requirement should result in significant cost savings on new weapons systems currently undergoing design, development, or initial production.

We recommended that the Secretary of Defense act to revise the definition of special test equipment in ASPR and other pertinent DOD regulations to exclude items that are really plant equipment.

On October 20, 1970, the Assistant Secretary of Defense (Installations and Logistics) stated that the recommendation to revise the definition of special test equipment to exclude general-purpose equipment was concurred in and that necessary action in this regard was being developed and would be made effective soon. On March 15, 1972, however, we were advised that DOD had concluded that it would not be in the best interests of the Government to implement our recommendation (see p. 7), and we were asked to comment on proposed revisions to ASPR. We reviewed the revisions and found that they offered no significant improvement because they continued to permit the acquisition of general-purpose items as special test equipment.

EQUIPMENT INVESTMENT POLICY AND TRENDS IN DOD

Since our November 1967 report, DOD has revised its criteria for furnishing Government-owned equipment to contractors. The present criteria, published in September 1968, are more restrictive. ASPR 13-301(a) states that, with certain limitations, it is DOD policy that contractors furnish all facilities required for the performance of Government contracts. Facilities are not to be provided to contractors except

--for use in a Government-owned, contractor-operated plant,

--for mobilization production in accordance with a mobilization plan package approved by the Assistant Secretary of Defense (Installations and Logistics), or

--when DOD determines that the furnishing of facilities is necessary or in the public interest. Such determinations must be supported by the contractor's written statement that it is unwilling or unable to acquire the necessary facilities with its own resources.

Since 1967 DOD's payments for new industrial plant equipment have been reduced, as shown below.

Fiscal year	New industrial plant equipment paid for by DOD and delivered to	
	Contractor-owned plants	Defense installations
	(millions)	
1967	$120.3	$25.5
1968	36.5	95.0
1969	34.2	78.6
1970	14.6	50.2

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REBUILDING OF EQUIPMENT APPROVED WITHOUT EVALUATION OF NEED

We found that large amounts of Government money had been spent or authorized for rebuilding equipment without an adequate review of the equipment's use to insure that rebuilding was justified. For example, at one location, during the period April 1969 to January 1971, the contractor had submitted five proposals totaling $993,350 for the rebuilding of 96 machines to a "like new" condition. At the time of our review, three of the proposals had been approved by the Air Force and the facilities contract had been modified accordingly. The other two proposals had been recommended for approval by the Defense Contract Administration Services. We reviewed the use of these machines and questioned whether 55 items--having an estimated rehabilitation cost of $551,675--had been used enough to justify rehabilitation. Repairs had been completed on 15 items at an estimated cost of $197,075, while repair work, estimated to cost $37,900, was in progress on five other items. Rebuilding of the remaining 35 items, at an estimated cost of $316,700, had not been started.

Representatives of the Defense Contract Administration Services had reviewed the machines to be rehabilitated and determined that they were in need of repair. However, no consideration had been given to the past or probable future use of the equipment. As a result of our findings, the contractor was notified that no more machines were to be repaired until a current need was established.

Air Force officials told us that projects such as those described above were approved as "capital type rehabilitation" projects and were authorized under the maintenance clause of facilities contracts. Capital-type rehabilitation projects are not subject to the ASPR 13-301 criteria governing the furnishing of new facilities. (See pp. 10 and 11.) The assumption is that the equipment is needed unless the administrative contracting officer determines otherwise.

CONCLUSIONS

Two DOD plans which would have resulted in a greater reliance on contractors to furnish equipment have not been fully implemented. These plans are the expected phaseout of

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contractor use of Government-owned equipment and the revision of the definition of special test equipment to exclude general-purpose items which are, in fact, plant equipment.

It appears that the more restrictive criteria for furnishing equipment to contractors, as presently set forth in ASPR, have been effective in limiting the acquisition of new items at contractor-owned plants. However, the rebuilding of existing equipment to like-new condition is the equivalent of furnishing new items and should be based on an evaluation of use and a determination of need, in accordance with the ASPR criteria.

AGENCY COMMENTS AND OUR EVALUATIONS

Phaseout plans

In our draft report we suggested that the Secretary of Defense act to determine whether the criteria for deferment of phaseout plans were too broad and would result in suspension of the program. In replying to our draft report in a letter dated May 16, 1972, DOD stated that current controls were adequate to monitor the number of cases in which deferments were requested and that the value of IPE in use by contractors had been reduced by nearly $700 million from the end of 1967 to the end of 1971. DOD stated that deferments had been authorized to 16 contractors for only 388 items having a value of $9.9 million as of January 1972.

DOD informed us that, in achieving the reduction of nearly $700 million worth of IPE in use by contractors, most of the equipment was returned without invoking a phaseout plan. As of December 31, 1971, 187 of 647 expected phaseout plans had been approved. The value of the equipment included under the approved phaseout plans represents only about $55 million of the $2.5 billion being reviewed for possible phaseout. According to the implementation instructions, all phaseout plans must be received by March 1973.

Also, we found that nearly $200 million of the cited reduction was due to a reclassification of equipment, which merely transferred certain classes of IPE to "other plant equipment." Thus, this portion of the decrease in IPE was accompanied by a corresponding increase in other plant

equipment. The remaining reduction of about $500 million does represent some progress toward the Department's goal of generally requiring contractors to furnish all equipment needed to perform Government contracts. However, a significant amount of equipment--about $4.1 billion worth as of June 30, 1971--still remains in contractors' possession. In view of the significant amount of equipment still in the possession of contractors, we feel that the phaseout program needs renewed emphasis to achieve its stated objectives.

Definition of special test equipment

Although DOD stated in its reply that it concurred with our recommendation to revise the definition of special test equipment, the proposed revision seems to offer only limited improvement, because it will continue to permit the acquisition of general-purpose items as special test equipment.

DOD's stated reason for continued acquisition of general-purpose items as special test equipment is that there is often a legitimate requirement to incorporate general-purpose items into special test equipment.

It is our opinion that Government ownership of general-purpose components of special test equipment is generally not justified. However, revising the definition of special test equipment to exclude general-purpose items, as we have recommended, would not prohibit the acquisition of such items for the Government's account if a bona fide requirement, meeting the ASPR 13-301 criteria, could be established. In this case, the general-purpose items would be furnished as facilities under a facilities contract, rather than as special test equipment under a supply contract. Consequently, the contractor would not be paid a fee for the acquisition of the equipment and its use and subsequent disposition would be subject to more stringent controls.

Criteria for rebuilding equipment

DOD states that there are adequate criteria for review of capital-type rehabilitation projects and that ASPR provides guidance concerning the removal of equipment for which retention is not justified.

The rehabilitation proposals we cited as examples of the need for more stringent criteria were recommended for approval without consideration of past or probable future use. Rehabilitation projects are not subject to the ASPR 13-301 criteria governing the furnishing of new facilities. The assumption is that the equipment is needed unless the administrative contracting officer determines otherwise. We have pointed out elsewhere in this report that there is no firm criteria for identifying items "for which retention is not justified" and have recommended that clearer criteria be established. (See p. 17.)

RECOMMENDATIONS

The Secretary of Defense should (1) reemphasize the DOD program for phasing out the use of Government-owned facilities, (2) revise the definition of special test equipment to exclude general-purpose equipment, and (3) apply the ASPR 13-301 criteria for furnishing equipment to the rebuilding of existing equipment.

CHAPTER 3

NEED FOR BETTER CONTROL OVER UTILIZATION

LACK OF CONTRACTUAL COVERAGE OF ASPR REQUIREMENTS

Appendix B of ASPR sets forth the basic requirements to be observed by contractors in establishing and maintaining control over Government property. The requirements contained therein may be clarified, extended, or modified, but they cannot be contradicted by the legal contract between the contractor and the Government.

Appendix B generally applies to all DOD contracts for supplies or services that obligate appropriated funds, and it is generally incorporated into contracts by reference as being in effect at the date of the contract. Therefore, subsequent changes to appendix B, which substantially repeal or affect existing contract rights, are applicable only when they are made a part of the contract through a modification accepted by both parties. During our review we found examples of the absence of contractual coverage of important provisions of appendix B.

ASPR B-603.1, by Revision 3, dated June 30, 1969, established requirements for recording authorized and actual use for IPE and provided for minimum utilization levels and the reporting of items not needed. At the time of our review, however, we identified deficiencies in the utilization record systems at five contractor locations where ASPR B-603.1 had not been incorporated into the facilities contract. Four of the five had inadequate or incomplete utilization records; none of the five had established minimum utilization levels. The facilities contracts were dated prior to June 30, 1969, and had not been modified to reflect the utilization requirements established on that date in ASPR B-603.1. One of the contractors had repeatedly refused to accept such a modification. We found no evidence of attempts on the part of the Government to modify the other contracts.

LACK OF RECORDS PREVENTS EVALUATION OF UTILIZATION

At 16 of the 27 locations we visited after the effective date of ASPR B-603.1, we found that the contractors' utilization records were not adequate for a proper evaluation of the use of IPE. Such utilization records are necessary to identify equipment no longer needed by the contractor, to insure that equipment is used only for authorized purposes, and to insure that an equitable method is used for determining rental charges.

NEED TO CLARIFY CONTRACTUAL REQUIREMENTS FOR REPORTING OF UNNEEDED ITEMS

ASPR B-603.1(iv) provides that contractors have procedures for immediately reporting to the contracting officer all IPE items for which retention is not justified. ASPR 7-702.23, Notice of Use of the Facilities, which generally is included in facilities contracts, provides that the contractor shall notify the contracting officer whenever any item "is no longer needed or usable for purposes of performing existing Government contracts or subcontracts for which use has been authorized." Similar language is contained in ASPR B-101(d).

Although the intent of all of these provisions is clearly to require the reporting of unneeded items, there are no firm criteria for identifying such items. Terms like "items for which retention is not justified" and "no longer needed or usable" are subject to interpretation. Consequently contractors are relatively free to develop their own criteria for identifying unneeded items.

At eight of the 27 locations we visited, we found that the contractors had not established minimum levels of usage for Government-furnished IPE. If used in conjunction with utilization records, the established minimum levels would provide the contractors with a means for identifying equipment not being utilized to the extent necessary to justify retention. At three of these locations the minimum use levels requirements were included in the facilities contract. At the other five locations they were not.

At another location the contractor-established minimum use criteria provided for the reporting of items idle for 10 or more consecutive days and for the justification of their retention. Thus, if an item were used every 10th day, retention would be justified, regardless of the total amount of use.

Minimum utilization levels established at one location were meaningless, because the contractor did not maintain machine utilization records.

Unless DOD prescribes a more uniform use criteria on a contractual basis, the retention of unneeded items is likely to continue indefinitely. Government personnel stated that authorizations under supply contracts for rent-free use of facilities further complicate the problem of removing equipment from contractors' plants. Generally authorization is granted on the assumption that such use will result in lower Government procurement costs on current contracts. Once rent-free use authorization is granted, the Government cannot legally remove the equipment under the terms of the facility contract without an equitable adjustment in the price or delivery schedules, or both, of any uncompleted supply contracts. Consequently the authorization of rent-free use of existing facilities could result in indefinite retention of equipment for which the original purpose had been completed.

RETENTION OF UNNEEDED ITEMS PREVENTS USE ELSEWHERE

ASPR B-603.1 provides that contractors' utilization procedures require periodic analysis of needs for IPE and have firm provisions for immediately reporting to the contracting officer all IPE items for which retention is not justified. Items no longer needed are to be promptly reported to the Defense Industrial Plant Equipment Center, Memphis, Tenn., in order to be made available for reutilization. Idle IPE within DOD is centrally managed by the Center whose primary function is to facilitate reutilization by directing transfer of equipment to other locations and thereby to avoid unnecessary procurement of new equipment.

At 13 of the 27 contractor locations we visited, we identified 327 items of IPE having acquisition costs totaling about $11.4 million which had not been reported to the Center. In our opinion, these items were not justified for retention because they (1) were idle, (2) had little use, or (3) were used predominantly for commercial work.

In identifying such items, we generally used machine utilization records maintained by the contractors. However, many contractors did not maintain adequate utilization records (see p. 17), and we were unable to fully evaluate machine usage at those locations.

Idle equipment

We found that 51 items having acquisition costs totaling about $2.3 million had been idle for periods of 6 months or more but had not been reported to the contracting officer or the Center.

For example, at one contractor location we found 28 items costing about $1.1 million which had been idle for periods ranging from 6 to 10 months. The contractor stated that a dramatic decline in defense business was responsible for the idle equipment and that unneeded items would be reported and removed as fast as possible.

At another location 14 items costing about $833,000 had been idle for periods ranging from 6 to 22 months. The contractor stated that the equipment was needed for mobilization production and that the retention of these items would be justified to the Administrative Contracting Officer. During the periods covered by our review, however, ASPR made no provision for retention of idle equipment except that which was part of a mobilization plan package; no such mobilization package had been established at this location.

Low-use equipment

We identified 182 items costing about $5.6 million which had been used less than what we considered to be a reasonable minimum. In making the determination, we used the contractor-established minimum use levels when minimums

had been established. When they had not, we used the 35-percent, or 14 hours per week, criteria previously used by DOD as the level of use below which justification for retention would be required.

At one location we found that 95 items costing about $2.9 million had been used an average of less than 14 hours per week during a 10-month period. The contractor stated that unneeded items would be reported and removed as soon as possible.

At another location 22 items having a total cost of about $1.3 million were used less than the contractor-established minimums during the last 6 months of 1970. Contractor officials stated that they were reluctant to report as excess all low-use equipment, because a substantial amount would be required in the event of mobilization. During the period covered by our review, however, there was no justification for holding currently unneeded equipment for mobilization use, unless it was idle and was part of an approved mobilization plan package; no such package had been approved for this location. Subsequently, on July 12, 1971, DOD issued Defense Procurement Circular No. 89 which permitted temporary retention of idle IPE by contractors while mobilization planning was being accomplished.

Commercial use

In addition to idle and low-use items, we found 94 items costing about $3.5 million which had been used predominantly for commercial work. We considered commercial use of 75 percent or more of total actual use as being predominantly commercial.

For example, at one location 23 items having a total acquisition cost of about $1.5 million had been used predominantly for commercial work during the first 10 months of 1970. Twenty-one of the items having an acquisition cost of $1.4 million had been used only for commercial work for 8 to 10 months. In addition, 19 of the 23 items were scheduled entirely for commercial work for the 5 months ended June 30, 1971. Projected Government use of the other four items for the same period was extremely low.

In 1969 the contractor and the Government entered into negotiations for the sale of the Government equipment to this contractor. However, they have been unable to agree upon a price. Officials of the Defense Contract Administration Services were directed by the Air Force early in 1969 not to report as excess any of the production equipment which the contractor had proposed to purchase, pending completion or termination of price negotiations. The contractor stated that efforts to effect the purchase had been renewed in March 1971.

At another location 11 items having a total acquisition cost of about $529,000 were used predominantly for commercial work during the period from July 1970 through January 1971. The contractor stated that the utilization of Government-owned machines fluctuates because of the short duration of most Government contracts and that, consequently, some machines have been used for commercial work.

A third contractor used 18 items costing about $322,000 for which commercial work ranged from 75 to 100 percent of total use during the 6 months ended January 31, 1971. The contractor stated that these items were scheduled to be reported as excess.

Lost opportunities for reutilization

Our review showed that, had they been reported to the Defense Industrial Plant Equipment Center as excess, many of the items which we identified as unneeded at contractors' plants could have been used to fill approved needs at other locations. These determinations were made by the Center's technical personnel at our request. They compared the unneeded items with approved requisitions which they had been unable to fill during the same period of time for which we had questioned retention of the unneeded items by the contractor. As a result, they identified 78 items having a total acquisition cost of about $1.7 million which, had they been available to the Center, would have been offered to satisfy requirements which the Center had been unable to fill for lack of suitable items in its idle inventory.

Although the offer of an item does not necessarily mean that it will be accepted, a Center official stated that they

have experienced an acceptance rate of 75 to 80 percent for items offered. Because of the number of installations involved, we did not attempt to determine how many of the unfilled requisitions resulted in the purchase of new equipment. However, the estimated purchase price of the 78 requisitioned items totaled about $2.3 million. The difference between this and the $1.7 million acquisition cost of the unneeded items represents primarily price increases since the latter were acquired.

UNAUTHORIZED USE

ASPR provides that the use of Government-owned equipment for work other than that specifically authorized for use without charge must be authorized in advance by the contracting officer. For each item used without authorization, the contractor is liable for the full monthly rental. ASPR also provides, in paragraph 13-405, that non-Government use of IPE in excess of 25 percent of available time requires approval in advance by the Secretary of the department concerned and, in the case of certain metalworking equipment, by the Office of Emergency Preparedness.

The Office of Emergency Preparedness established the procedure for prior approval primarily to preclude contractors from obtaining a favored competitive position through using Government-owned production equipment. As discussed below, we found instances in which the appropriate approval had not been obtained.

Authorization by the Administrative Contracting Officer not obtained

At four locations we found that the contractors, without obtaining authorization from the contracting officer,had used equipment for work not authorized as rent-free.

At one of the locations we found that 22 machines had been used on jobs for which the contractor had not obtained rent-free authorizations. A contractor official stated that the company had not paid rent for the use of the Government-owned equipment since the early 1950's. On the basis of utilization records maintained by the contractor, we estimated that rent of about $22,860 was due for 1970 and the first quarter of 1971. Utilization records were not available for earlier periods. We discussed our findings with the contracting officer, who subsequently obtained payment from the contractor.

At another location the contractor had not obtained advance authorization for 16 machines which it used during 1 month on commercial work. We discussed the matter with the contracting officer. Subsequently the contractor paid $21,838 in additional rent and revised its procedures to prevent unauthorized use of Government-owned equipment.

BEST DOCUMENT AVAILABLE

At the other two locations, although the equipment was used without proper authorization, the contractors paid the full rent for the period of unauthorized use.

Approval of the Office of Emergency Preparedness not obtained

At seven contractor locations, Government-owned machines had been used more than 25 percent of available time for commercial work without approval of the Office of Emergency Preparedness.

The approval requirement applies individually to machines costing $25,000 or more. The use of machines costing less can be averaged. At one location we reviewed the commerical use of machines, costing over $25,000 each, during nine 1-month rent periods. On the average, 70 machines had been used without authorization each month for commercial work for more than 25 percent of available time. Although the contracting officer had advised the contractor in July 1968 that commercial use in excess of the 25-percent limitation would constitute unauthorized use, both the contractor and the contracting officer stated that the contractor was not required to comply with ASPR 13-405, because it was not included in the facilities contract. We believe that, in addition to being required to obtain permission from the contracting officer to use Government equipment on non-Government work, the contractor is obligated to obtain prior approval of the Secretary of the department concerned and of the Office of Emergency Preparedness, as appropriate, when the non-Government use is expected to exceed 25 percent of available time even though neither is stipulated in the contract, because the provisions of ASPR 13-405 must be given full force and effect unless specifically modified by the terms of the contract.

At another location 32 machines having an acquisition cost of more than $25,000 each had been used without approval for commercial work more than 25 percent of available time during a 6-month period. The contractor's procedures provided for payment of the full rent for such machines. Contractor officials stated that 20 of the 32 machines were scheduled to be declared excess and that all Government-owned items retained beyond 1971 would be used predominantly for Government work.

We found instances of unauthorized use for commercial work in excess of 25 percent of available time at five other locations. At one of the five locations the contractor had paid additional rent for the unauthorized use. At the other four locations the contracting officer initiated or promised corrective action as a result of our review.

Available machine time is not an appropriate basis for measuring commercial use

The time a machine is available for use is not always an appropriate basis for measuring the degree of commercial use of Government-owned equipment. Available time is based on the contractor's normal work schedule, as represented by scheduled production-shift hours. Therefore, available time increases proportionately with the number of scheduled shifts. If a contractor operates on a multiple-shift basis, machines can be used for a significant number of hours on commercial work without exceeding the 25 percent of available time limitation.

For example, at one location we identified six machines costing more than $25,000 each for which commercial work ranged from 77 to 100 percent of actual use during a 6-month period. However, commercial use stated as a percentage of available time ranged from 6.5 percent to 16.5 percent. Actual hours of commercial use ranged from 184 to 463.

At another location a similar comparison made by Navy auditors for six machines showed a wide disparity between percentages of non-Government use based on available hours and those based on actual usage. The commercial use based on available hours ranged from 9 to 23 percent, while commercial use based on total actual use ranged from 37 to 68 percent. The Navy auditors recommended that the Chief of Naval Material consider initiating action to change ASPR 13-405 to require that the 25-percent ceiling on non-Government use be based on actual production time rather than on available time.

CONCLUSIONS

The examples cited in this chapter show that items of Government-owned plant equipment have been retained in contractors' plants without appropriate justification and have been used for non-Government work without authorization. They also show that proper evaluation of the need for and use of Government-owned equipment generally cannot be made in those instances where adequate utilization records are not maintained. In our opinion, the deficiencies discussed above have resulted from:

--A lack of contractual coverage and ambiguous contract terms that inhibit the enforcement of DOD policies concerning IPE.

--A lack of a specific requirement in ASPR for machine-by-machine utilization records.

--Measuring commercial use on the basis of available time rather than actual machine time.

It seems reasonable that contractors should be required to account to the Government for the use of its equipment. However, we believe that the current requirement in ASPR B-603.1(ii) is too general to be effective in establishing adequate utilization records if the contractor is reluctant to do so. As is demonstrated by the examples on pages 17 and 18, the lack of adequate records prevents evaluation of machine use. Such evaluations are essential to effective property management, in order to facilitate the identification and reporting of unneeded items and to control improper or unauthorized use.

Utilization records should show machine hours of use for individual machines and should differentiate between Government and commercial work. The feasibility of maintaining machine-by-machine utilization records has been demonstrated by many contractors who are currently keeping such records. Information obtained from 11 of the 27 contractors included in our review shows that the estimated costs of installing their machine utilization records systems ranged from $600 to $165,000.

The estimated annual costs of operating these systems ranged from about $1,200 to about $48,000, and the number of Government-owned items included ranged from six to about 14,000. Complete information on installation costs and operating costs was not available at all locations. Because the costs cited above are based on contractor estimates and because of differences in the systems, we did not attempt to evaluate these costs in the light of the results produced. However, we observed that generally a high proportion of the cost of Government-owned machines on hand was made up of a relatively small number of machines.

On the basis of the above facts and the fact that many contractors have successfully established machine utilization records, it would seem reasonable to require contractors to maintain utilization records for individual machines representing some minimum portion, for instance 75 percent, of the total acquisition cost of Government facilities on hand and for such other items as practicable. At several locations included in our review, 75 percent of the acquisition cost of Government-owned equipment on hand was made up by 25 percent or less of the items.

It is also our conclusion that available time is not an appropriate basis for measuring commercial use, because equipment can be used extensively for commercial work without exceeding 25 percent of available time.

AGENCY COMMENTS AND OUR EVALUATIONS

Utilization records

DOD does not agree that utilization records should be required for individual machines. It states that the cost of such a system is unnecessary and prohibitive and proposes an audit review of the contractor's method of measuring use prior to agreement with the contractor to insure that the method adequately reflects the use.

During our review we found that maintaining utilization records for individual machines was generally the only method that could be relied on to accurately measure machine use. The DOD conclusion that the cost of individual machine records is "unnecessary and prohibitive" is based on a 1968

study which, at that time, DOD considered to be inconclusive. Our current review shows that many contractors do have machine-by-machine utilization records systems and that some very good systems have relatively low installation and operating costs. Furthermore, our recommendation would not require records for <u>all</u> machines. We observed that, at several locations, 75 percent of the acquisition cost of Government-owned equipment on hand was made up by 25 percent or less of the items. We also found that, in the absence of machine utilization records, there is no reliable way to determine whether other measurement methods will adequately reflect machine use. (See pp. 31 to 35.)

Limitations on commercial use

Although DOD concurred with our position that the 25-percent commercial use factor be based on actual production time, the concurrence is largely negated by its stated qualifications. DOD's position is that forecasted actual use may be based on "other than actual machine hours" and that the use of groups of equipment may be approved in lieu of approval on a machine-by-machine basis.

Our review has shown that machine hours are generally the only reliable measure of machine use. We do not object to approval on a group basis for machines costing less than $25,000, as is currently permitted by ASPR 13-405. However, we feel that machines costing $25,000 or more each should continue to be approved on an individual basis. Group approval which included both high-cost and low-cost machines could result in 100 percent commercial use of high-cost machines, if the group included sufficient low-cost machines for averaging purposes.

Criteria for identifying unneeded items

DOD does not agree that the ASPR provisions for the reporting of unneeded items are ambiguous or that clearer criteria are required.

As we stated on page 17, there are currently no firm criteria for identifying unneeded items. The ASPR terminology is subject to interpretation. Consequently contractors are relatively free to develop their own criteria for

identifying unneeded items. Our position is supported by the numerous examples (see pp. 18 to 21) of items not justified for retention which had not been reported.

RECOMMENDATIONS

To improve the utilization of Government-owned plant equipment, we recommend that the Secretary of Defense:

--Revise ASPR B-603.1 to require contractors to maintain utilization records for individual machines making up some minimum portion, for instance 75 percent, of the acquisition cost of Government-owned industrial plant equipment on hand. The equipment to be included in the 75 percent should be those items having the highest costs. Such records should be based on machine hours of use and should differentiate between Government and commercial use.

--Revise ASPR 13-405 to require that the 25-percent commercial use factor be based on actual machine time rather than on available time.

We further recommend that contract administrators be reminded of the need to (1) monitor utilization of Government-owned plant equipment to facilitate the reporting of unneeded items, (2) identify instances of unauthorized use and take appropriate action, and (3) initiate timely action to incorporate changes to appendix B of ASPR into individual facilities contracts.

Finally we recommend that the Secretary have ASPR reviewed to identify and eliminate all ambiguous terms in the sections of ASPR which pertain to the reporting of unneeded items and that clearer criteria be established for identifying IPE items for which retention is not justified.

CHAPTER 4

NEED FOR UNIFORMITY IN RENT AGREEMENTS

METHOD OF COMPUTING RENT

The DOD criteria governing the payment of rent by contractors for the use of Government-owned plant equipment are contained in ASPR 7-702.12, the "Use and Charges" clause which is required to be included in all facilities contracts. The requirements of the Use and Charges clause are generally implemented by a written rent agreement which supplements the facilities contract. Items to be rented must be authorized in advance. The length of time covered by each rent payment is subject to agreement between the contractor and the Government, but it cannot be less than 1 month or more than 6 months. Rental rates--expressed in percentages--are based on the age and/or type of the equipment and are uniform for all facilities contracts. These rates have been increased since our 1967 review. However, because DOD does not maintain centralized records of rent collections, we were unable to determine the total amount of rent collected. We were told that obtaining such data would be extremely difficult and expensive.

The Use and Charges clause provides that the full rent due for the rent period is to be computed by applying the specified rental rates to the acquisition costs of the items authorized to be rented. The full rent is to be reduced by a credit for use of equipment which has been specifically authorized in advance as rent-free. Generally, rent-free use is that part of the use applicable to work on Government contracts and subcontracts. The credit is to be computed by multiplying the full charge for the period by a fraction whose numerator is the amount of rent-free use during the period and whose denominator is the total amount of use during the period.

LACK OF UNIFORM RENT CREDIT PERMITS INEQUITIES

For the purpose of computing the credit for rent-free use, the Use and Charges clause provides that the measurement unit for determining the amount of use shall be:

"*** direct labor hours, sales, hours of use, or any other measurement unit which will result in an equitable apportionment of the rental charge, as may be mutually agreed to."

Contrary to the requirement for an equitable apportionment of the rental charge, this all-inclusive definition has resulted in inequitable rent computations, because it permits the use of measurement units which do not reflect machine usage.

In our 1967 report we cited examples of inequitable rent credits and concluded that the full rent for the rent period and the rent credit should be computed individually for each machine above an established dollar value and that the rent credit should be based on machine hours of use. During our current review we found that the same type of inequities reported in 1967 still exists.

Rent credit based on value or quantity of contractor-owned equipment

At two locations the rent credit was based, in part, on the value or quantity of contractor-owned equipment. At one of these locations the full rent was reduced by two credits. The first of these credits was based on the ratio of contractor-owned items to the total acquisition cost of plant equipment in productive work centers. The adjusted rent was further reduced, on the basis of the ratio of rent-free cost of sales to total cost of sales. Prior to 1970 only the credit based on cost of sales was applied to the full rent. A rent agreement negotiated in March 1970 for the period January 1, 1970, through June 30, 1971, added the credit based on the ratio of contractor-owned equipment. The use of the new method resulted in a rent payment of $81,729 for the period January 1 through June 30, 1970. Under the previous method, using only a single credit for rent-free work based on cost of sales, the rent for the same period would have been $178,682, or $96,953 more than was actually paid.

We discussed the rent computation with the contracting officer, who was of the opinion that the method used was

equitable and that it provided the contractor with an incentive to phase out Government-owned equipment, because an increase in contractor-owned equipment would result in a larger rent credit.

At the other location the contractor's rent credit for periods prior to June 1970 had been based on the relationship of direct labor hours spent on Government work to total direct labor hours, on a departmental basis. For the 6-month period ended November 1970, the contractor increased the rent credit by allocating to the Government hours in each department a portion of total departmental direct labor hours, based on the percentage of the total number of contractor-owned machines in that department. As a result, Government hours (rent-free) are counted twice. The intent of the allocation was to give the contractor credit for Government work done on contractor-owned equipment.

The illogical nature of the rent-free credit computation is best demonstrated by the fact that computed rent-free hours for two departments exceeded total hours worked by 42 percent and 70 percent, respectively. Consequently no rent was due for these departments, even though both had commercial work. The commercial work in one department was 6,237 hours, or 33 percent of the total direct labor hours for the 6-month period.

The revised rent credit procedure resulted in a proposed rent payment of $8,971 for the 6-month period ended November 30, 1970. The previous method, with a single rent credit based on direct labor hours, would have resulted in a payment of $20,054, or $11,083 more. At the completion of our work at this location, the proposal had not been approved by the Government.

In both of the instances cited above, the lack of machine utilization records prevented us from determining what the rent payment should be if it were based on the machine-by-machine rent computation recommended in our 1967 report.

In our opinion, rent credit based on the value or quantity of contractor-owned machines is inequitable because contractor-owned items are not included in the rental base and because the Government generally pays for the use of

contractor-owned equipment through allocation of depreciation to overhead accounts. In the latter example, Government hours were counted twice, which increased the rent credit.

Rent credit based on number of parts produced

One contractor's rent agreement provided for a rent credit based on the ratio of the number of parts produced on a rent-free basis to the total number of parts produced. Although the contractor did not maintain machine utilization records, we found--by examining machine time standards and quantities produced--that this method did not equitably reflect machine usage, because the commercial parts being produced generally required more machine processing time than rent-free parts.

For example, for one machining operation, 73 percent of the parts produced during 1 month were items authorized for rent-free use. However, only 56 percent of the standard machine processing time for that month was used to process these parts. Conversely, 44 percent of the standard machining time was used to process the 27 percent of the parts which were commercial. Other machining operations showed similar results. In all, we reviewed operations on machines accounting for over 80 percent of the value of Government-owned equipment.

We estimate that the rent paid for 1970 would have been about $76,800 higher, had the method of computing the rent credit recognized the differences in processing times between commercial and rent-free parts.

We discussed our findings with officials of the Defense Contract Administration Services. As a result, the contractor was asked to submit a proposal for a revised method of computing the rent.

"Mobilization" credit

One contractor used still another type of additional rent credit. The total rent for the period was initially allocated between Government and commercial work on the

basis of machine hours of use by groups of machines. The amount thus allocated to commercial work was further reduced by a "mobilization" credit based on the relationship of the acquisition cost of machines used on Government work less than an average of 14 hours per week to the total acquisition cost of all equipment on which time records were kept. Under the terms of a modified equipment mobilization package approved for this location, the contractor was allowed to use the equipment for current production, including commercial work. The contractor stated that the purpose of the additional credit was to recognize that rent was charged for many machines which were being retained for mobilization but which were not needed for current operations and that the contractor was required to maintain and repair those machines at its expense.

In our opinion, the mobilization credit is inequitable. We do not agree that the contractor is entitled to consideration in the rent computation for maintenance of Government-owned equipment. The requirement for the contractor to maintain the machines is a normal one under facilities contracts. The costs of such maintenance are generally charged to overhead or burden accounts and are reflected in the prices of the items produced.

Furthermore, the machines represented in the numerator of the fraction which determines the percentage reduction in the rent payment are selected only on the basis of low Government usage. As a result, the commercial use of these same machines is ignored. Our review showed that there was commercial use of many such machines and that some were used solely for commercial work during one of the two 6-month rent periods included in the 12 months ended June 30, 1970. The application of the mobilization credit for these two periods reduced the rent payment for the 12 months by $107,704, or about 25 percent. Since the credit was applied only to that part of the rent allocated to commercial work, it resulted in rent-free use of Government-owned equipment for about 25 percent of the contractor's commercial work.

Sales dollars not representative
of machine usage

At three contractor locations the rent credit was based on the relationship of Government sales dollars to total sales dollars, even though machine utilization records, which would have provided a more equitable basis for the rent credit, were maintained. We found at these locations that sales dollars did not accurately reflect machine usage.

Prior to May 1970 one contractor had computed rent by applying the rent credit to each machine in its ratio of Government to total machine hours of use. In August 1970 the contractor requested, and was authorized, to compute the rent credit on the basis of the ratio of Government sales dollars to total sales dollars. We compared the rent liability for the period May 4 to December 31, 1970, under the two methods. The method previously used, based on machine hours of use, would have resulted in rent of $99,868; the new method, based on sales dollars, resulted in rent of only $45,708, a decrease of $54,160, or 54 percent.

At the second location we recomputed the rent for a 12-month period, applying the rent credit to each machine in its ratio of Government to total machine hours of use. The resulting amount was $46,000 more than was paid by the contractor which used a rent credit based on sales dollars.

At the third location the summary utilization records did not differentiate between Government and commercial work. However, the end-use could be determined from detailed records. On the basis of a test, which was limited by time considerations to the rent for 1 month on machines costing $25,000 or more, we concluded that the rent credit based on sales dollars did not reflect actual machine usage. The rent applicable to the machines included in our test, as computed by the contractor's method, was $1,306. Our computations, based on applying the rent credit individually to each machine in its ratio of Government to total machine hours of use, showed that the rent for the selected machines should have been $1,656, or about 27 percent higher than was actually paid. Because of the limited test made, we did not try to project the difference over more items or over a longer period.

Average rent credit not always equitable to contractor

The preceding examples have illustrated rent credits which, in our opinion, resulted in underpayments of rent. We also found four contractor locations where the rent paid was higher than would have resulted from our recommended method of computing rent individually for each machine.

At these locations the rent credit was based on the average percentage of direct labor hours or machine hours applicable to Government work. Although it is our opinion that either direct labor hours or machine hours would produce an equitable rent credit if applied separately to individual machines, we found that average use based on the same factors does not always do so.

At one location an average rent credit was computed for each of four groupings of equipment on the basis of the relationship of applicable rent-free direct labor hours to total direct labor hours. We recomputed the rent for each of 61 selected machines, representing 57 percent of the total rent value of all Government-owned equipment, for a 1-month period. For the selected machines, the rent computed by our machine-by-machine method was $4,720 less than by the contractor's method. Projecting the results of our test to the total rent for that month shows that the machine-by-machine method would have resulted in a reduction of $7,054, or 15.6 percent, in the amount actually paid under the contractor's average-use method. Similar comparisons at the three other locations showed that the rent would have been reduced by amounts ranging from $3,272 for a 2-month period to $1,400 for a 6-month period, had the contractor used a machine-by-machine basis instead of a credit based on average use.

LACK OF UTILIZATION RECORDS PREVENTS
EVALUATION OF AMOUNTS PAID

The above examples demonstrate the inequitable rent computations which resulted from various methods of computing the credit for rent-free use. We were unable to evaluate the rent payments made at two other locations because of the lack of machine utilization records. One of these contractors computed the rent credit on the basis of direct labor dollars. The other used sales dollars. Because machine utilization records were not available, we could not determine whether these bases reflected actual machine usage.

NONSTANDARD LEASES

In addition to providing plant equipment under standard facilities contracts, the Air Force has provided certain contractors with equipment under nonstandard leases, with different requirements concerning utilization and rent. Specifically, these contractors are those included in the Air Force heavy-press and heavy-hammer programs. As of January 1971 the heavy-press program included seven contractors that had Government-owned facilities costing about $212 million. Four of the seven contractors operated Government-owned plants. The $212 million included the land and buildings at these four locations. The heavy-hammer program, as of the same date, included five contractors who had Government-owned plant equipment costing about $20 million.

The original purpose of furnishing equipment to the heavy-press and heavy-hammer operators was to provide a capability which did not exist elsewhere. Nonstandard leases were used to recognize the specialized nature of the equipment and the fact that it was not expected to operate at capacity, due to the lack of a commercial market for its products. Rent had been charged the contractors for all use of the equipment, both Government and commercial. Air Force officials stated that heavy-press and heavy-hammer operators were generally second- or third-tier subcontractors and that rent-free use for Government work had not been authorized because of the difficulty in tracing the consideration for such use through all the higher tier contractors using the heavy-press and heavy-hammer products in their end items.

Status of heavy-press program

In our 1967 report we concluded that the heavy-press rent payments did not provide an acceptable rate of return on the Government's investment. We also concluded that the policy of charging rent for Government work could result in significant increases in end-item prices through the application of indirect expense and profit factors to the rent cost included in the prices of forgings and extrusions. Consequently we recommended that DOD take action to increase the rent return for commercial use of the heavy presses and reexamine its policy of not authorizing rent-free use for Government work.

Since our last review the heavy-press rental rates for commercial work have been increased from 4 percent to 7 percent of net sales. We have not reviewed the rent payments to determine whether they now represent an acceptable rate of return on the Government's investment. Rent is still charged at 4 percent of net sales for Government work. An Air Force official said that rent-free use had been discussed but had not been authorized for the same reasons previously stated.

In addition, heavy-press facilities costing about $22 million have been sold to one contractor. These consisted of eight pieces of equipment at five locations. We were told that negotiations were being conducted with three other contractors for the sale of heavy presses in their possession and that no new acquisitions of heavy-press facilities were contemplated.

Need to reevaluate the terms of heavy-hammer leases

Our findings at the one heavy-hammer contractor included in our review lead to the conclusion that the terms of the heavy-hammer leases may need to be reevaluated.

No limitations on commercial use

The heavy-hammer leases permit unlimited commercial use of the equipment. There is no requirement to obtain advance authorization for commercial use, as is provided by ASPR for standard facilities contracts.

The contractor did not maintain adequate machine utilization records. By examining daily labor tickets for a 1-month period, however, we identified 30 machines that had been used more than 75 percent for commercial work. Of the 30, 14 had been used only for commercial work.

Low rental rates

The heavy-hammer leases provide for rental rates significantly lower than those established in ASPR for the same classes of equipment. The leases set the annual rental rate for commercial use of the forging hammers and all supporting equipment at 9 percent of acquisition cost. This is equal to the minimum rate that would be charged under ASPR 7-702.12 for items more than 10 years old. The ASPR annual rate for new items is 36 percent. Thus, any heavy hammer less than 10 years old is rented at a rate more favorable than that provided under standard facilities contracts. We estimated that the rent paid by the contractor for 1970 would have been about $96,000 more if the ASPR rates had been used.

Rent reduced for idle time

Under the Use and Charges clause for standard facilities contracts (ASPR 7-702.12), the entire rent computed for the rent period by applying the specified rates to the acquisition cost of the equipment is allocated between Government and commercial use. In contrast, the heavy-hammer leases provide that rent for items used less than 13 days a month will be charged one twenty-first of a month's rent for each day of use. This method of rent computation was established to avoid charging the contractor for idle capacity of machines installed for Government use. We estimated that rent paid by the contractor for 1970 would have been about $208,000 more if the ASPR method of allocating the full month's rent between Government and commercial work had been used.

CONCLUSIONS

The examples cited above demonstrate that the absence of a requirement for uniformity has resulted in a variety of rent credits which do not accurately reflect the use of

the equipment being rented. Consequently the amounts paid for rent have often been either too low or too high to satisfy the requirement for an equitable apportionment of the rental charge, as stated in the Use and Charges clause. Because the degree of equity of any of the above methods would depend on the circumstances at the particular location concerned, they cannot be categorized as inequitable per se. However, the lack of assurance as to their reliability as a measure of actual machine usage makes them generally undesirable.

In our opinion, the only method which can be consistently relied on to produce an equitable allocation of the rental charge is one in which the rent credit is computed individually for each machine, on the basis of the ratio of its rent-free hours of use to its total hours of use. We realize that there is some equipment for which it may not be feasible to keep utilization records. As we have noted, however, the major part of the cost of Government-owned items generally comprises a relatively small portion of the number of items. Hence, it would seem reasonable to require a machine-by-machine rent computation for items representing some minimum portion, for instance 75 percent, of the total acquisition cost of Government facilities on hand and for such other items as practicable.

The rental charge on items for which utilization records are not practicable could be allocated in the same overall proportion that results from the machine-by-machine computation for the selected items.

The terms of the heavy-hammer leases were based on the premise that the equipment would be used primarily for Government work and that there would be idle capacity due to the lack of a commercial market. Although this assumption may have been valid at the time the program was established, our review showed that it was no longer true for the heavy-hammer operator included in our review. Over 80 percent of calendar year 1969 recorded sales of products produced using Government-owned equipment were not under Government contracts.

In view of the high degree of commercial work, the favorable terms regarding commercial use and the computation of rent may no longer be justified.

AGENCY COMMENTS AND OUR EVALUATIONS

Uniform rent computation

The DOD does not agree that a uniform rent computation method is warranted or that it should be applied to individual machines. It proposes a method whereby the Defense Contract Audit Agency would evaluate the method selected for measuring and allocating use, prior to finalizing the agreement with the contractor.

Our report identifies many examples of inequitable rent computations which have been permitted under the current regulations. We feel that these examples adequately demonstrate the need for a uniform method which would be equitable to both the Government and the contractor. We agree that there may be instances, particularly at the subcontractor level, where it may be difficult to specifically identify machine hours as commercial or Government. In such cases, it may be necessary to allocate machine use on the basis of other information. However, the existence of possible exceptions should not prohibit the application of a method which has been demonstrated as generally feasible.

Our review has shown that other methods of measuring and allocating use cannot be relied on to reflect actual machine usage. We found that, in the absence of machine utilization records, there is no reliable way to evaluate other measurement methods.

Nonstandard Leases

The DOD has agreed to evaluate the terms of the heavy-hammer leases. It stated that the Air Force Systems Command was requested in November 1971 to reexamine leasing methods for the entire heavy-press and heavy-hammer programs.

RECOMMENDATIONS

We recommend to the Secretary of Defense that ASPR be revised to require that the credit for rent-free use be applied, to the extent practicable, to each machine in its ratio of Government to total machine hours of use. Because it is not practicable to keep utilization records on all

machines we recommend that, when the impracticability is agreed to by an appropriate Government representative, the machine-by-machine rent credit be applied to items representing some minimum portion, for instance 75 percent, of the total acquisition cost of Government facilities on hand and that the rental charge for other items be allocated in the same overall proportion that results from the machine-by-machine computation for the selected items.

CHAPTER 5

SCOPE OF REVIEW

Our review examined the management controls over the acquisition, utilization, and rent of Government-owned plant equipment furnished to contractors. The review was made at 27 contractors' plants, five military commands, and the Defense Industrial Plant Equipment Center, Memphis, Tenn. Our review did not include plant equipment in contractors' possession at locations involved only in Government operations.

We examined pertinent DOD regulations and contractors' documents and records and interviewed responsible officials at the locations visited.

The results of our review were discussed with contractor and DOD officials.

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

16 MAY 1972

INSTALLATIONS AND LOGISTICS

Mr. R. G. Rothwell
Associate Director, Logistics
and Communications Division
U. S. General Accounting Office
Washington, D. C. 20548

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Dear Mr. Rothwell:

Reference is made to the draft Report, "Further Improvements Needed in Controls over Government-Owned Plant Equipment in the Custody of Contractors." The draft has been reviewed and our specific comments are attached. Also attached are general comments with respect to statements made on page 19 of the report. (OSD Case #3415)

We disagree with the statement on page 4 that "as of June 30, 1970, the acquisition cost of DoD-owned plant equipment in contractors plants totaled about $4.6 billion." This figure represents plant equipment in the custody of contractors regardless of where located and includes, for example:

(a) $668.4 million of IPE at Distant Early Warning Sites (DEWLINE) in the sub-Arctic.

(b) $572.0 million in wholly Government-owned, contractor-operated ammunition, missile and tank plants where no commercial products are produced.

(c) $155.2 million in South Vietnam.

(d) $50.0 million on loan to the Nationalist Chinese Air Force.

(e) IPE on loan to the Smithsonian Institution, American Museum of Natural History, Franklin Institute and the American Red Cross.

(f) A substantial amount of equipment which is retained in contractors' plants, in inactive "packaged" status to provide industrial readiness for emergency production.

(g) $96.0 million of IPE, which is idle and is in the process of disposal.

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In our opinion the amount of IPE in use by contractors is a much more valid indicator of progress in phasing out contractor use of DoD-owned equipment. The amount of such equipment at the end of 1967 was 213,657 units with an acquisition cost of $2,655,387,000. At the end of 1971 it was 144,978 units with an acquisition cost of $1,978,075,000. This represents a reduction of 32% in numbers of items and 26% in acquisition value. It should be noted that most of the equipment returned to the Government was shipped without invoking a phase-out plan.

We also disagree that the deferment of phase-out plans authorized by the Deputy Secretary of Defense to permit completion of industrial preparedness planning or prevent economic hardship is "tantamount to suspension of the phase-out program" or that the deferment criteria are "so broad as to permit almost any contractor to suspend phase-out plans." On 12 July 1971 the Deputy Secretary of Defense policy was implemented by a letter to DoD Agencies which was published in Defense Procurement Circular #89. This requires approval of both the Armed Services Procurement Planning Officer and the Procuring Contracting Officer for each phase-out deferment and also requires that each item approved for deferment from phase-out be reported to the Defense Industrial Plant Equipment Center (DIPEC) at Memphis, Tennessee, using a special status code 4F. The DPC also states that the number of cases where deferment is authorized should be very limited, completely justified and closely monitored. By the end of January 1972 only 16 contractors had been granted such exemptions covering a total of 388 items with a value of $9.9 million.

The report points out that several contractors indicated a desire to purchase Government equipment in their plants but cannot do so because of lack of authority of the DoD to make such sales. The enactment of legislation currently pending (H.R. 13792) would greatly facilitate the phase-out effort without detriment to maintenance of an industrial production base capable of fulfillment of emergency defense requirements.

In summary we believe that significant progress has been made both in the phase-out of use of Government-owned equipment by contractors and in other aspects of management of DoD-owned industrial plant equipment. It is noted that management improvements were under way just before and during the period of the GAO review, and additional actions have recently been instituted as a result of internal review of equipment management. We believe that increased emphasis on enforcing existing policies rather than the issuance of new regulations will provide the necessary improvements. Action is underway to reemphasize to our field activities the need for assuring that existing policies are fully implemented and monitored.

Sincerely,

Attachments

Glenn V. Gibson
Deputy Assistant Secretary of Defense

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APPENDIX I

DEPARTMENT OF DEFENSE
COMMENTS ON GAO DRAFT (CODE 87/21)

"Further Improvements Needed in Controls Over Government-Owned Plants in the Custody of Contractors"

1. Deferment of Phase-out Plans

RECOMMENDATION:

The Secretary of Defense should act to determine if the recently issued criteria permitting contractors to defer their phase-cut plans are too broad and will result in suspension of the phase-out program.

COMMENT:

Criteria covering granting of exemptions to the phase-out program were published in DPC #39 of 12 July 1971. This DPC also provides for reports to permit determination if such deferments appear to be too numerous. Reports received to date indicate close adherence to limitation of deferments since they had only been authorized for 388 items on 31 January 1972. We consider current controls to be adequate.

2. Revise Definition of Special Test Equipment

RECOMMENDATION:

The Secretary of Defense should act to revise the definition of special test equipment to exclude general purpose equipment.

COMMENT:

Concur. An ASPR revision has been prepared which redefines special test equipment. ASPR is also being revised to provide new review and approval procedures for contractor acquired special test equipment prior to its acquisition to assure that it is properly classified as special and to assure that general purpose component requirements are screened with DIPEC to determine their availability prior to purchase authorization. This revision does not exclude providing general purpose test equipment to contractors since general purpose test equipment is often legitimately required to be incorporated into special test equipment. The revised regulations are being transmitted to industry (and GAO) for expedited coordination with a view toward their publication in a DPC in approximately 60 days.

3. Utilization Records

RECOMMENDATION:

The Secretary of Defense should act to revise the regulations to require contractors to maintain utilization records for individual machines making up some minimum portion, for instance 75 percent, of the acquisition cost of Government-owned plant equipment on hand. The records should reflect the amount of Government use and commercial use. Contract administrators should be reminded of the need (1) to incorporate regulation changes into facilities contracts to insure contractual coverage of DoD policies concerning industrial plant equipment, (2) to monitor use of Government-owned plant equipment and (3) to identify unauthorized use of equipment.

COMMENT:

Non-concur. We agree with the GAO that improvements in controls over utilization of IPE are in order. We strongly disagree that utilization records are required for individual machines except in unusual situations. The cost of such a system is unnecessary and prohibitive. What is needed is an audit review of the method of measuring use prior to agreement with the contractor in order to assure that the method adequately reflects the use. We agree that normally commercial use factors should be based on actual production and a prospective change in the regulation to this end is being studied.

As you know a feasibility test of maintenance of machine by machine utilization records was performed by 19 contractors in 1968. The conclusions resulting from the test indicated that (1) cost of installation and maintenance of such records far out-weighed their value, (2) data resulting from such records had little, if any, value for accurately projecting future equipment needs.

We have a study currently underway by the Logistics Management Institute (LMI) to evaluate the merits of a rent-across-the-board concept. Under this concept the contractor would pay full rent for both Government and commercial use from the time the equipment is received until it is returned to the Government.

GAO made a recommendation to purge ASPR 7-702.23, B-101(d) and B-603.1 of "ambiguous" terms and to establish clearer criteria for identifying unneeded items. We do not agree that the cited provisions are ambiguous or require clearer criteria. We believe that the decision of the continuing need for a piece of equipment can only be made in the light of the situation at the point of use. The decision can only be made by personnel capable of assessing the need for the equipment in the light of the contractor's

projected (Government) requirements and also with consideration to alternative means of obtaining the required production. We believe that the inclusion of detailed criteria in the Regulation would be counter productive and accordingly intended to accomplish remedial action through increased training and management attention.

4. Basis for Charges for Commercial Use

RECOMMENDATION:

The Secretary of Defense should act to revise the regulations to require that the commercial use factor be based upon actual production time, rather than available time, and that the limitations be made contractually binding.

COMMENT:

Concur. This concurrence is with the stipulation that forecasted actual use may be based upon other than actual machine hours and that, where appropriate, the use of groups of equipment may be approved in lieu of the approval on a machine-by-machine basis. As stated above, we believe a requirement that records be kept of actual machine use on a machine-by-machine basis in unnecessary to achieve a proper level of control. In forecasting expected use for the purpose of obtaining the required approvals, the contractors' practices should generally follow the same pattern as is used for forecasting expected use of direct labor and allocation of overhead. The unit of measure of use should ordinarily be the same as that used in computing the rent under the Use and Charges clause.

5. Development of Uniform Rental Computation Methods

RECOMMENDATION:

The Secretary of Defense should act to revise the regulations to establish a uniform and equitable method to compute rent. To the extent practicable this should be done on a machine-by-machine basis with credit for rent free (Government) use applied to each machine in its ratio of Government to total machine hours of use.

COMMENT:

Non-concur. GAO, in supporting this recommendation, calls to our attention several cases where contracting officers have agreed to improper rental arrangements. We concur with GAO's view of these situations but not with the conclusion that they warrant prescribing a single method of making the computation. Experience has shown that there are sufficient cases where a single method would be too restrictive. We are currently considering a method whereby the contracting officer would obtain the opinion of the cognizant DCAA

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auditor as to the adequacy of the method selected for measuring and allocating use prior to finalizing the agreement with the contractor. In this recommendation GAO repeats the recommendation for machine-by-machine computations and we non-concur for the reasons given under recommendation number 3.

6. Application for Criteria for Furnishing Equipment to Rebuilding or Retrofitting

RECOMMENDATION:

The Secretary of Defense should act to strictly apply the regulation critiera for furnishing equipment to contractors to the rebuilding or retrofitting of existing equipment.

COMMENT:

Non-concur. The reference to the retrofitting of the 10 turret lathes was the subject of a GAO Review of Air Force Industrial Plant Equipment Modernization Projects (B-140389) issued in February 1969. We advised GAO in April 1969 that this was a Modernization Project rather than a Capital Type Rehabilitation Project and that the project had in fact been evaluated against the ASPR criteria for furnishing equipment to contractors as set forth in ASPR 13-301. The other case mentioned by GAO, a Capital Type Rehabilitation Project, has been stopped pending reevaluation. Our reply to the previous review in April 1969 stated that Modernization Projects of all Military Departments would be evaluated against the ASPR 13-301 criteria. It should be noted that the case of the 10 turret lathes was reevaluated after the 1969 GAO Report and was determined to be necessary to provide a quicker reaction capability to support Southeast Asia type contingencies. The present utilization of the equipment is being investigated.

The Department of Defense is currently considering modifications to ASPR 13-301 to cover the provision of industrial plant equipment when such action has been determined to be necessary for maintenance of a modern, responsive industrial production preparedness base.

We non-concur with the GAO recommendations to establish an ASPR revision concerning Capital Type Rehabilitation since we consider that adequate detailed policy and procedure criteria already exist for review of such requirements. Further, the ASPR already provides policy guidance requiring the removal of equipment for which retention is not justified. If this criteria is not met Capital Type Rehabili tation is not justified. We believe that increased emphasis of existing policies can correct problems that may exist in this area.

7. Heavy Press Lease Term Reevaluation

RECOMMENDATION:

The Secretary of Defense should act to evaluate the terms of the heavy hammer leases in the light of the current and probable future mix of Government and commercial use.

COMMENT:

Concur. The Air Force heavy press and hammer facilities are leased to the contractors under the provisions of Section 2667, Title 10, U.S. Code, which permits deviation from the standard ASPR rental rates. Our rental arrangements for these leases have been previously reviewed by GAO, OASD (I&L), CEP, and Congressional sources. The rental rates are continuously under review to assure that they are equitable, and that competitive advantage does not accrue to users of this equipment. The rental rates for commercial work performed on the press and hammer facilities were increased in 1969.

The ultimate Air Force objective in the management of these facilities is to achieve private ownership while assuring the retention of their capabilities to meet current and emergency defense needs. In this connection, the Assistant Secretary of the Air Force (I&L) has directed a special effort to consider either sale or lease of such facilities on the basis of their real value as a going business operation. As a result of this effort, Wyman-Gordon has indicated an interest in negotiating with the General Services Administration for the purchase of AFP #63. GSA has engaged an appraisal firm which will evaluate the property as an operating entity, in terms of the overall production capability of the plant, a reasonable projection of the market for its products, and the financial return that can be anticipated from the sale of these products. The going business or earnings value as a true reflection of the fair market value of the property would be used by the Air Force as a basis for a rental determination (as opposed to the present percent of sales rate), in the event a sale is not consummated.

On February 1, 1972, the Aluminum Company of America advised the Assistant Secretary of the Air Force (I&L) that it desired to enter into negotiations for the purpose of acquiring Air Force Plant #47, located at Cleveland, Ohio on the same basis as that being explored with Wyman-Gordon. The Aeronautical Systems Division is presently obtaining a complete and verified description of all of the property associated with this plant for use of the Corps of Engineers in filing the preliminary report of excess. Again, we feel that the GSA appraisal leading to sale or leasing arrangements on this type of equipment must be based on the true value of the property involved as a going business.

Concurrent with the foregoing action, the Air Force Systems Command was requested on November 17, 1971, to reexamine our methods of leasing for the entire heavy press and hammer programs including consultations with commercial leasing firms, as well as with such Government agencies as the Army Corps of Engineers and the General Services Administration. It is intended that these findings will be used as a basis in renegotiating equitable leasing arrangements to minimize or eliminate competitive advantage, and to provide an acceptable rate of return on the Government's investment in these facilities.

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DEPARTMENT OF DEFENSE
COMMENTS ON GAO REPORT (CODE 87721)

"Further Improvements Needed in Controls Over Government-Owned Plants In the Custody of Contractors"

General

Page 19 - GAO states "Government personnel stated that authorizations under supply contracts for rent-free use of facilities further complicate the problem of removing equipment from contractors' plants. We were told that since supply contracts provide for rent-free use, the Government could not legally remove equipment without contractor permission until the completion of all contracts authorizing such use. Consequently, the routine authorization of rent-free use of existing facilities could result in indefinite retention of equipment for which the original purpose had been completed."

Comment - We do not agree with the statement the Government cannot legally remove equipment without contractor permission until completion of all contracts authorizing use. We do not know of any contracts that do not reserve the right of the Government to remove or direct the removal of an item of facilities. Contracts providing for furnishing or use of facilities generally provide for an equitable adjustment in price or delivery or both if the contractor is deprived of use, but there is no question concerning the Government's right to remove an item.

It is also considered that the use of the adjective "routine" in the last sentence is misleading. Contracting Officers do give full consideration to the advantages to the Government, the contractors' needs and alternatives available prior to requesting use of or furnishing facilities. Further, that the extent of Government-owned facilities made available to a contractor is considered in the negotiation of profit as provided in ASPR 3-805.5(e)(1), which requires less favorable profit consideration to discourage contractors from relying on Government facilities.