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REPORT TO THE  
JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES

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U.S. Agencies Could Benefit  
By Better Management  
Of ADP Activities  
Of Government Contractors

B-115369

BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES

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MARCH 2, 1973



COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

B-115369

Dear Mr. Vice Chairman:

This is our report on how U.S. agencies could benefit by better management of automatic data processing activities of Government contractors.

We discussed our findings with responsible agency and contractor representatives. However, as requested by your office, we did not give the representatives an opportunity to review and comment on the report.

As agreed with your office, a copy of the report is being provided to the Director, Office of Management and Budget. We will not distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

A handwritten signature in cursive script that reads "James B. Stacks".

Comptroller General  
of the United States

The Honorable William Proxmire  
Vice Chairman, Joint Economic Committee  
Congress of the United States

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ABBREVIATIONS

ADP	automatic data processing
AEC	Atomic Energy Commission
DCAA	Defense Contract Audit Agency
DOD	Department of Defense
GAO	General Accounting Office
GSA	General Services Administration
NASA	National Aeronautics and Space Administration

COMPTROLLER GENERAL'S REPORT TO  
THE JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES

U.S. AGENCIES COULD BENEFIT BY  
BETTER MANAGEMENT OF ADP ACTIVITIES  
OF GOVERNMENT CONTRACTORS B-115369

D I G E S T

WHY THE REVIEW WAS MADE

The Chairman of the Joint Economic Committee asked the General Accounting Office (GAO) to review the Government's management of automatic data processing (ADP) equipment used by Government contractors.

The Committee specifically asked GAO to determine (1) the extent of commercial use of Government-furnished ADP equipment and (2) who possesses the title rights to ADP equipment procured under contractors' rental-purchase agreements.

FINDINGS AND CONCLUSIONS

The extent of commercial use of Government-furnished ADP equipment operated by contractors was very small. GAO contacted 61 organizations responsible for 648 Government-furnished ADP systems operated by contractors--about 50 percent of the Government-wide total.

Only eight of 648 systems were used commercially, and this use amounted to only 5 percent of operating time. When equipment was used for commercial purposes, procedures did exist for remunerating the Government for such use. (See p. 5.)

Leased ADP equipment operated by Government contractors is often used on a combination of Government

and commercial work and/or a variety of contract types. The Government generally does not participate in certain benefits earned even when it absorbs most of the leasing costs. Federal procurement regulations provide that the Government may participate in any purchase or other benefits earned through rental payments for ADP only when it absorbs 100 percent of the costs under cost-type contracts. (See p. 7.)

GAO reviewed 75 leased ADP systems at eight contractor plants. Government contract work represented 95 percent of the eight contractors' sales during 1971 and the Government absorbed 92 percent of their ADP operating costs for the year. However, only six of the 75 systems were used for cost-type contract work, with the Government absorbing 100 percent of the costs. (See p. 8.)

Although using accrued purchase credits is not always the most economical means of purchasing ADP equipment in many instances, it may result in savings. GAO found instances where the Government purchased equipment during the same general time frame that contractors terminated leases for the same kind of equipment and did not use purchase credits accumulated under their leases. Had the Government been in a position to take advantage of these unused purchase credits,

purchase prices would have been 12 to 27 percent lower. (See p. 10.)

If the Government's participation in purchase credits were to increase and a valid need existed for this equipment elsewhere in the Government, an undetermined amount of savings might result to the Government. However, the Government would first need to resolve certain political and/or philosophical arguments that have been advanced against extending the Government's position in this regard. (See p. 13.)

RECOMMENDATION

In view of the significant costs absorbed by the Government in

connection with Government contractors' ADP equipment leases, GAO believes that the Government should make further attempts to secure some of the benefits that arise from these costs. Moreover, despite the philosophical and political questions, some method of enabling the Government to use these benefits might be devised. In this respect, it is significant that some contractor representatives apparently would voluntarily allow the Government to use such benefits. Accordingly, GAO recommends that the Office of Management and Budget explore the ways available to the Government of improving its entitlement to benefits earned under these contractor leases.

## CHAPTER 1

### INTRODUCTION

In response to a request from the Joint Economic Committee, we reviewed selected aspects of the Government's management of automatic data processing (ADP) equipment used by Government contractors.<sup>1</sup> The Committee specifically requested that we determine

- the extent of commercial use of Government-provided ADP equipment used by contractors and
- who possesses the title rights to ADP equipment that is procured by contractors' rental-purchase agreements.

Because our prior reviews indicated that significant problems do not exist in the commercial use of Government-furnished ADP equipment, we limited our review in this area.

ADP equipment at Government contractor plants is either furnished by the Government or acquired by the contractor under purchase or lease agreements. While Government-furnished equipment is financed directly by the Government, applicable costs associated with contractor-acquired equipment--whether leased or purchased--are charged, either directly or indirectly, to Government contracts.

Our study included discussions with agency and contractor officials and a review of documents at the Department of Defense (DOD), the Atomic Energy Commission (AEC), the National Aeronautics and Space Administration (NASA), and the Defense Contract Audit Agency (DCAA). In addition, we visited eight contractor plants and contacted 61 organizations using Government-furnished ADP equipment.

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<sup>1</sup>The Committee also recommended that we review the utilization of the Government's ADP equipment and determine the total annual cost of the Government's ADP operations. Separate reports are being issued on each of these matters.

## CHAPTER 2

### COMMERCIAL USE OF GOVERNMENT-FURNISHED ADP EQUIPMENT OPERATED BY CONTRACTORS

At the contractors' locations we visited, commercial use of Government-furnished ADP equipment did not appear to be a significant problem. ADP equipment constituted only a relatively small percentage of Government-furnished equipment in the custody of contractors, and where it was installed, the contractors were either exclusively or almost exclusively engaged in Government work.

Two of our recent reviews showed no significant problems had been disclosed in this area, and with concurrence of the Committee staff, we limited our current work.

The General Services Administration (GSA) reported that, as of June 30, 1971, there were 1,380 Government-furnished ADP systems operated by contractors.<sup>1</sup> As can be seen from the following table, most systems were managed by AEC, DOD, and NASA.

<u>Agency</u>	<u>Number of ADP systems</u>
AEC	936
DOD	223
NASA	168
Other	<u>53</u>
Total	<u>1,380</u>

DOD, NASA, and AEC regulations generally do not differentiate ADP equipment from other Government-furnished property. The Armed Services Procurement Regulation requires approval by the contracting officer for non-Government use of Government-furnished equipment. AEC officials advised us that AEC's policy specifically prohibits commercial use of its Government-furnished equipment when it is not considered to be in AEC's interest.

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<sup>1</sup>Excluded from the GSA data are analog computers and ADP equipment that is an integral part of a tactical weapons system or space system and that is specially built or modified to meet the Government's needs.

During hearings before the Joint Economic Committee on July 1, 1970, the Chairman requested that we make a limited study to examine contractor acquisition and use of ADP equipment. We made a limited review and in a letter report dated November 24, 1971 (B-115369), to the Committee, we reported that most of the 1,079 ADP systems in contractors' plants at June 30, 1970, were being used by contractors that performed work almost exclusively for AEC, DOD, and NASA.

In another review completed during fiscal year 1972,<sup>1</sup> we made a followup study of controls over Government-owned plant equipment in the custody of DOD contractors. There were still many deficiencies in controls over such equipment, in general. However, ADP equipment constituted a relatively small portion (about 1.4 percent) of Government-furnished equipment in the custody of DOD contractors, and on the basis of a limited test, we concluded that there was no significant deficiency in the acquisition or use of this ADP equipment.

During this review, GAO contacted 61 organizations, responsible for 648 Government-furnished ADP systems operated by contractors--about 50 percent of the Government-wide total. The responses obtained from the questionnaires showed the following mix of Government and commercial work on 648 ADP systems as of September 30, 1971:

	Systems used for		Total
	<u>Government work</u>	<u>Government and commercial work</u>	
AEC	385	4	389
DOD	72	2	74
NASA	174	2	176
Other	<u>9</u>	<u>-</u>	<u>9</u>
Total	<u>640</u>	<u>8</u>	<u>648</u>

The eight ADP systems used for Government and commercial work were used about 5 percent of the time for commercial systems during the 12 months preceding September 30, 1971.

We subsequently visited eight contractors' locations where we reviewed documents and talked with Government

<sup>1</sup>Report to the Congress entitled "Further Improvements Needed in Controls over Government-owned Plant Equipment in the Custody of Contractors," August 29, 1972 (B-140839).

and/or contractor officials. There was no new information indicating that there was extensive commercial use of Government-furnished ADP equipment in the custody of contractors. In the few instances where commercial use was made of Government-furnished ADP equipment, procedures did exist to insure remuneration to the Government.

### CONCLUSION

Three of our reports over the past 2 years showed no evidence that Government-furnished ADP equipment operated by contractors was being used improperly or extensively on commercial work. And, in the few instances where Government-furnished ADP equipment was used commercially, procedures existed to insure remuneration to the Government.

## CHAPTER 3

### GOVERNMENT ENTITLEMENT TO

### BENEFITS EARNED UNDER CONTRACTORS' LEASES

Purchase credits which accrue under contractor leasing arrangements for ADP equipment used on Government contract work are generally not available to the Government, even after it absorbs most of the leasing costs. The Armed Services Procurement Regulation specifies that the Government can participate in such benefits only when it absorbs 100 percent of the leasing costs under cost-type contracts. Because ADP equipment leased by contractors is often used on a combination of Government and commercial work and/or cost and other type contracts, the Government generally does not have an opportunity to participate in these benefits.

Our examination of the plausibility of extending the Government's entitlement to purchase such credits showed that:

- Several philosophical and political arguments would need to be fully resolved if the Government's position were to be extended.
- Although savings to the Government would probably result from having purchase credits available in more instances, it was not feasible to determine how significant these savings might be.

In connection with the enactment of Public Law 89-306 in 1965 and revisions to the Armed Services Procurement Regulation in 1967, the Government's role with respect to ADP equipment used by contractors was debated extensively. Some of the major points raised at those times are summarized below.

- Government ownership and management of contractors' ADP equipment would be inconsistent with the basic philosophy that contractors maintain their own competitive capability for performing work and could negate the contractor's responsibility for success or failure of contract performance.
- ADP equipment should not be singled out for treatment different from that of other property used by contractors.

--A trend in DOD procurement policy places maximum responsibility on the contractor for performing under the contract, including the selection and acquisition of all necessary equipment and facilities.

The underlying difficulty was to find an acceptable way of insuring proper stewardship of public funds, without interfering with the contractors' prerogatives.

The Armed Services Procurement Regulation provides that, if the total cost of leasing ADP equipment is reimbursed under one or more cost-type contracts, the Government will have the option to use any purchase or other benefits earned. Only six of the 75 leased ADP systems that we reviewed were being used solely under Government cost-type contracts. Generally, ADP equipment was being used for commercial and Government work and under several types of contracts; therefore, the Government did not have an opportunity to participate in purchase credits earned through rental payments for most of the ADP systems.

We reviewed pertinent data for 75 ADP systems leased by eight contractors. The following table presents the mix of work at the eight contractor locations visited.

Sales, Operating Year 1971

<u>Contractor</u>	<u>Total</u>	<u>Government</u>	<u>Commercial</u>	<u>Government contracts</u>	
				<u>Cost type</u>	<u>Other</u>
(000,000 omitted)					
A	\$ 208	\$ 208	\$(a)	\$ 204	\$ 4
B	447	403	44	318	85
C	764	651	113	209	442
D	166	164	2	124	40
E	694	694	-	32	662
F	142	141	1	50	91
G	116	111	5	57	54
H	757	741	16	696	45
<b>Total</b>	<b>\$3,294</b>	<b>\$3,113</b>	<b>\$181</b>	<b>\$1,690</b>	<b>\$1,423</b>
Percent		95%	5%		

<sup>a</sup>Less than \$0.5 million.

The table below shows the extent to which ADP costs were allocated for the eight contractors during operating year 1971.<sup>1</sup>

<u>Contractor</u>	<u>Total cost incurred</u>	<u>Allocation of costs</u>	
		<u>Government</u>	<u>Commercial</u>
----- (000 omitted) -----			
A	\$ 9,893	\$ 9,515	\$ 378
B	19,245	15,250	3,995
C	17,428	16,050	1,378
D	5,926	5,920	6
E	7,141	7,141	-
F	2,692	2,685	7
G	1,255	1,221	34
H	<u>16,966</u>	<u>16,288</u>	<u>678</u>
Total	<u>\$80,546</u>	<u>\$74,070</u>	<u>\$6,476</u>
Percent		92%	8%

Under some leasing arrangements, the contractors accumulated purchase credits which would reduce the cost of equipment if it were to be purchased later. We estimated that about \$5.8 million in purchase credits had accumulated during 1971, as shown below:

<u>Contractor</u>	<u>Amount of purchase credits (000 omitted)</u>
A	\$1,000
B	1,400
C	400
D	200
E	300
F	100
G	200
H	<u>2,200</u>
Total	<u>\$5,800</u>

The amount shown above represents the total purchase credits accrued to the contractors during operating year 1971 and not necessarily total available purchase credits.

<sup>1</sup>These costs include personnel, equipment, contract services, and other cost categories.

Of the 75 ADP systems, 14 were returned to the lessor during 1971 without taking advantage of the available purchase credits. For example, one contractor returned three systems to the lessor, forgoing \$988,000 in purchase credits. If the Government had had a valid need for this equipment and the purchase credits could have been used, a savings to the Government may have resulted.

For selected components which had been released as part of the 14 systems, we

- attempted to identify purchases of similar items by Federal agencies on or near the date the contractors' equipment was released and
- compared purchase prices actually paid to purchase prices that would have been paid had the Government been in a position to take advantage of purchase credits accumulated on equipment released by the contractors.

One agency purchased equipment similar to that released by the contractor. The following table summarizes the results of our examination.

<u>Equipment</u>	<u>Purchase date</u>	<u>Date contractor released equipment</u>
Storage unit	May 1971	Aug. 1971
Channel selector	Nov. 1971	July 1971
Multiplexer	Sept. 1971	Nov. 1971
Tape control unit	June 1971	July 1971
Magnetic tape unit	May 1971	July 1971

Since the contractors' release dates were reasonably close to the Government's purchase dates, the Government's needs might have been met by acquiring the equipment released by contractors. Furthermore, the costs to the Government would have been reduced between 12 and 27 percent if the Government could have used the purchase credits, as shown in the following table.

<u>Equipment</u>	<u>Purchase price if purchase credits used (note a)</u>	<u>Actual purchase price (note a)</u>	<u>Difference if purchase credits used</u>	
			<u>Amount</u>	<u>Percent</u>
Storage unit	\$174,217	\$237,100	\$62,883	27
Channel selector	140,613	179,334	38,721	22
Multiplexer	89,013	106,894	17,881	17
Tape control unit	28,528	36,178	7,650	21
Magnetic tape unit	26,543	30,400	3,857	12

<sup>a</sup>Does not include ancillary costs, such as those for transportation and installation.

FACTORS THAT MAY OFFSET  
PURCHASE CREDIT BENEFITS

Although significant amounts of purchase credits are being accumulated under leasing arrangements for ADP equipment used primarily on Government contract work, the use of these purchase credits may not necessarily result in savings. Agency and contractor officials pointed out that:

- ADP equipment may sometimes be acquired more economically in other ways, either by purchasing or leasing, than by using purchase credits offered by lessors.
- Administrative costs associated with procedures for identifying leased equipment being released by contractors, and matching the equipment to a need within the Government, may offset savings achievable by using purchase credits.

Possibility that more economical  
acquisitions could be made

In some instances, contractors found that it was more economical to purchase equipment from other sources instead of exercising purchase options. For example, one contractor decided to purchase ADP equipment which was being leased. The lessor's price was about \$184,000--\$216,000 less \$32,000 in accumulated purchase credits. Quotes obtained from three suppliers of similar equipment showed that the items could be purchased for about \$125,000.

Contractors and Government agencies have many other alternatives, in addition to use of available purchase credits, available to them in obtaining ADP systems, such as:

- Renting them directly from the equipment manufacturer.
- Leasing them from a third-party vendor.
- Purchasing used equipment from third-party vendors.
- Purchasing equipment from nonequipment manufacturers.
- Acquiring excess equipment from a Government reutilization program.

In order to decide the most economical procurement route, all these alternatives need to be considered.

### Costs to administer a matching program

Some Government and contractor officials pointed out that the administrative costs to identify leased ADP equipment being released by contractors and matching that equipment to a current need within the Government might offset any possible savings. Several Government agencies, however, already have programs for identifying and reutilizing ADP equipment within the Government. These programs may offset any substantial increase in costs since a totally new mechanism may not be needed.

One existing program is the DOD ADP Reutilization Program. DOD reported that, during fiscal year 1971, ADP equipment having total original purchase prices of \$191 million was transferred from organizations which no longer needed the equipment to organizations that did need it. It is particularly noteworthy that Government-furnished ADP equipment used solely by contractors under cost-type contracts is subject to reutilization under this DOD program; therefore, the inclusion of other contractor-leased equipment being released by the contractor may not be extremely difficult.

### CONTRACTOR AND AGENCY COMMENTS

We discussed with contractor and agency officials the possibility of extending the Government's rights regarding purchase credits for ADP equipment used less than 100 percent of the time on Government cost-type contract work. Generally, we found agreement for the need to improve the Government's position in this regard but found no consensus on how to accomplish this.

Five contractors indicated that they would not object to the Government's benefiting from purchase credits on leased ADP equipment they were releasing which the Government had primarily financed. On the other hand, some contractor officials stated that, since the Government assumes no risk on leased equipment, it should not be entitled to any benefits accruing to the contractors. They said this is particularly true in the case of fixed-price contracts.

DOD and NASA officials expressed differing views regarding the propriety of extending the Government's rights to purchase credits. DOD officials believed that the Government should have greater rights in this area but could not agree as to how much further the Government's entitlements should be expanded.

NASA officials stated that the administrative procedures required to implement expanded Government rights to purchase credits would require considerable effort and expense. They believed that more aggressive contract negotiation on a case-by-case basis could result in the Government participating in purchase credits more frequently--without changing procurement regulations.

In this regard, DOD did purchase a contractor-leased ADP system being reimbursed only 95 percent under a DOD cost-type contract. The contractor notified the contracting officer, who in turn advised the DOD ADP Equipment Reutilization Office when the equipment was to be released. The Navy had reported a need for similar equipment. Although the system did not meet the Armed Services Procurement Regulation requirements of being reimbursed 100 percent under cost-type contracts, the contractor and lessor allowed DOD to exercise the purchase option--possibly indicating that the Government's position could be improved on a more widespread basis.

#### CONCLUSION

The Government has only limited opportunities to participate in purchase credits accruing under leasing arrangements for ADP equipment used on Government contract work--even where the Government primarily absorbs the leasing costs. If the Government had more opportunities to share in these purchase credits and valid needs for equipment existed within the Government at the time contractors released equipment, savings to the Government might result.

#### RECOMMENDATION

In view of the significant costs the Government absorbed in connection with Government contractors' ADP equipment leases, GAO believes that the Government should further attempt to secure some of the benefits that arise from these costs. Moreover, despite the philosophical and political questions which exist, GAO believes that some method of enabling the Government to use these benefits might be devised. In this respect, it is significant that some contractor representatives apparently would voluntarily allow the Government to use such benefits. Therefore, GAO recommends that the Office of Management and Budget explore the ways available to the Government of improving its entitlement to benefits earned under these contractor leases.