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

May 13, 1968

B-161604

Dear Mr. Chairman:

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The accompanying report presents the results of our survey into the review and approval of contractor executive and professional compensation of \$25,000 or more a year by administrative contracting officers of the Department of Defense and certain other Federal agencies. This survey was made in response to your letter of May 17, 1967, expressing your interest in the efforts being made to control salaries of employees of contractors who derive a significant portion of their business from Government contracts.

We conducted this survey to obtain information on the agencies' management systems established for the review, evaluation, and approval of contractor employee compensation and to observe these management systems in operation. The \$25,000-or-more criterion has been set forth in several of the agencies' procurement instructions and/or directives as the salary level requiring special attention by administrative contracting officers.

In general, our survey indicated that administrative contracting officers, in discharging their responsibilities for the review and approval of contractor executive and professional compensation (hereinafter referred to as executive compensation), need: (1) more clearly defined standards or criteria for determining the reasonableness of contractor executive compensation, (2) definitive procedures for evaluating contractor executive compensation, and (3) in some instances, personnel knowledgeable in compensation matters who can assist the administrative contracting officers in performing their assigned tasks in this area of contract administration.

We did not make an in-depth and comprehensive review of this aspect of contract administration. However, the survey data that we obtained from the headquarters level of seven Government agencies and from 36 of their contract administration components indicated that, in general, the reviews performed by administrative contracting officers were superficial and not effective because these officers lacked a sound basis for determining the reasonableness of the executive compensation established by the contractors. Although there were

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various studies and statistics on executive compensation published by private and public organizations, there were also numerous intangibles in these studies which, according to administrative contracting officers, allowed contractors to justify and sustain whatever executive compensation they deemed reasonable.

Contractors who operate in the private competitive economy by virtue of having a significant amount of commercial business or having to compete for a substantial portion of their Government business have financial incentives to control costs, including compensation, to maintain a position in the market. We are concerned with what appear to be pro forma reviews by Government officials of executive compensation at those contractor plants or divisions where a significant portion of the business is obtained not from the open competitive market but from sole-source contracts with the Government.

The Department of Defense reported that, in fiscal year 1967, 52.5 percent of the military prime contract awards were noncompetitive and 43.7 percent of the contract awards contained pricing provisions other than firm fixed price.

We therefore believe that the lack of clear guidelines for administrative contracting officers is a matter warranting policy-level attention. We believe also that consideration might be given to determining whether or not it would be feasible to establish central review groups of compensation experts within the agencies to review and approve, where appropriate, contractor employee compensation and thus limit the number of personnel requiring specialized training and to ensure uniform and fair application of such guidelines. We have not obtained comments on our observations from the agencies included in our survey.

We are presenting this report for your information and use with the understanding that your Subcommittee intends to continue its studies of this subject and to pursue these matters with the agencies involved. We plan to make no further distribution of this report unless

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copies are specifically requested, and then we will distribute such copies only after your approval has been obtained or public announcement has been made by you concerning the contents of the report.

The matters included in this report have been discussed with members of your staff.

Sincerely yours,

FRANK H. WEITZEL

Acting

Comptroller General
of the United States

The Honorable David N. Henderson, Chairman
Subcommittee on Manpower and Civil Service
Committee on Post Office and Civil Service
House of Representatives

A. Rankin
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Ch. Bailey
4-26-68
Murman
5-8-68
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