

28 August 1965

**MEMORANDUM FOR:** Deputy Director for Plans  
Deputy Director for Intelligence  
Deputy Director for Science & Technology  
Deputy Director for Support  
Inspector General  
General Counsel  
Director, BPAM  
D/DCI/NIPE

**SUBJECT** : A Review of the Report and Hearings by a  
Subcommittee of the House Armed Services  
Committee on the Aerospace Corporation

I am forwarding herewith a copy of a review which has been prepared by the Office of Legislative Counsel. His office will be glad to provide a copy of the full report if you need it. It seems to me that the principal observation we might make from this report is that the Subcommittee considered Aerospace a creature of the Air Force and therefore held the Air Force responsible for its deficiencies. This same principle would of course apply to the many proprietary organizations in which the Agency has an interest.

/s/ L. K. White

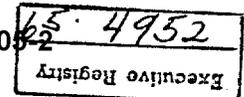
L. K. White  
Executive Director - Comptroller

**Attachment**

LKW:blp

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26 AUG 1965

## MEMORANDUM FOR THE RECORD

SUBJECT: A Review of the Report and Hearings by a Subcommittee of the House Armed Services Committee on the Aerospace Corporation

1. Aerospace Corporation, a nonprofit corporation created by the United States Air Force as a key technical adviser for advanced missile and space programs, was incorporated under the laws of the State of California on 3 June 1960. It now has 4,306 employees, of which 1,752 are technical staff members, and 2,554 are administrative and support personnel. It is the 45th largest defense contractor.

2. The Aerospace Corporation has undergone a study of fiscal and management policy and control by the Subcommittee on Special Investigations of the House Committee on Armed Services, chaired by Representative Porter Hardy, Jr. The inquiry was limited to the management policies and fiscal controls both as exercised by Aerospace Corporation itself and by the Air Force in regard to Aerospace. It did not attempt to assess the technical competence of Aerospace personnel nor the achievements of the corporation. The Subcommittee has had a continuing interest both in the operations of Aerospace Corporation and the related policy decisions of the Air Force. The Subcommittee made a review in 1964 of the cost of morale and recreation benefits for defense contractor employees and found slipshod control of certain expenditures in Aerospace and, therefore, decided that a further examination of management and fiscal control was needed. The Subcommittee also felt an investigation was necessary because of the attitude of Aerospace management, that although the corporation is a wholly Government supported nonprofit corporation created by a Government Agency, neither the Air Force nor the Congress's auditing agency, the General Accounting Office, had a right to audit all of its expenditures.

3. Initial working capital of the corporation was provided under an "advance payment pool agreement" between the Air Force and Aerospace. Aerospace has received over \$309 million in Air Force contracts and \$16 million in fees. The corporation operates under a cost-plus-fixed-fee contract, which is negotiated annually. One of the main difficulties the Subcommittee found was a conflict in the philosophies of Aerospace Corporation and the Air Force on the payment and use of fees. The corporation believes its fees

should be based on "worth of task" as provided by the Armed Services Procurement Regulations for commercial firms. Under this method, the contractor and the contracting officer establish the relative importance of various tasks to be performed by the firm and adjudicate a fee accordingly. The Air Force, on the other hand, has stated that the fee should be based on "need." This is official Air Force policy for its nonprofit corporations. The theory is that a nonprofit corporation has none of the risk and profit requirements of a private company. A private company requires fee for taxes, payment of dividends, capital improvements, continuing operating capital, etc. Air Force policy recognizes that a nonprofit organization might be said to need fee for independent research, working capital, and acquisition of facilities. Although the Subcommittee does not take a final position with regard to the method for setting fees, it is clear from its report that the Subcommittee feels that all of the needs of a nonprofit corporation could be met through a combination of reimbursement and an advance pool arrangement.

4. The Subcommittee took issue with Aerospace Corporation over its purchase of land and facilities financed by fees and borrowed capital, especially since existing Government owned land and facilities were available, and needed only minor modification and refurbishing. The Subcommittee felt that the articles of incorporation did not adequately protect the Government in obtaining title to the land and facilities.

5. In its investigation of Aerospace, the Subcommittee found that Aerospace's management wanted the benefits and prerogatives of private industry without any of the risks plus the protection and security of Government services without any of the restrictions. The investigation also found that Aerospace used its fees in many questionable ways: for paying unusually high salaries, many questionable fringe benefits, overly liberal education costs, too elaborate and frequent entertaining, the use of a public relations firm at a very high retainer rate to advise an overstuffed public information component of the corporation, and the use of a consulting psychologist for services of dubious value. Whenever such items were disallowed by the Air Force contracting officer from reimbursable funds, they were paid through the use of monies from fees by the corporation. Throughout the investigation and the negotiations with Aerospace, the Subcommittee found that neither the contracting officer nor representatives from the General Accounting Office and even investigators of the Subcommittee could obtain any information from Aerospace concerning the expenditures made by the corporation from

fee. This lack of cooperation by Aerospace was based apparently upon the decision of its Board that this information was privileged and that the corporation need not reveal the details of fee expenditures.

6. The Subcommittee found also that Aerospace had a number of personnel problems with potential security implications and that Aerospace handled these matters with an extraordinary measure of forbearance for the employees involved and did not always conform to security procedures and regulations, even to the point of not informing the Air Force about the cases. It complained about the hiring of a private detective firm to conduct certain investigations into the conduct of employees.

7. The Subcommittee also found that the Air Force must share in the responsibility for inadequate fiscal controls. The Subcommittee pointed out that there were sufficient laws, regulations, and policy directives available which could have prevented many of the reprehensible practices that occurred. The Subcommittee was told by the Air Force that "the technical contributions of the Aerospace Corporation have far outweighed the dollars we have invested," but the Subcommittee did not consider this responsive and stated: "No amount of technical perfection on one side of the ledger can balance waste and inefficiency on the other side."

8. The Subcommittee concludes that if Aerospace is going to function within the terms of its charter and within the scope of Air Force policy, some changes will be in order. First, title to facilities should be vested in the Government of the United States, rather than the corporation. Second, there is no real necessity for fee but if the fee system per se is not abolished, at the very minimum, Aerospace should be required to make complete and detailed disclosures to the Air Force of its fee expenditures. Third, the Secretary of the Air Force should take such steps as are required to insure the prudent control of public funds expended through Aerospace Corporation. Fourth, the Office of the Secretary of Defense should revise the procedure for contractor employee security clearance to discontinue the present practice of transferring employees' "secret" clearances from one contracting firm to another. Fifth, the Air Force should review the adequacy of security procedures at Aerospace. Sixth, the Air Force should require a complete review of salary and personnel practices at Aerospace to prevent recurrences of past abuses. Sixth, the Air Force should support its contracting and auditing personnel in such steps as are necessary to enforce reasonable management controls.

9. The Subcommittee investigation gave rise to some questions which may have a bearing on Agency operations. Is the concept of having a third organization do a single-manager job on technical matters a necessity at present, especially in systems technology? The Subcommittee suggested that it may be worthwhile for the Air Force to compare the management methods used by other Government agencies with extensive research and development programs. It said that the Navy had managed its nuclear-age research and development programs with outstanding successes such as the nuclear submarine and the Polaris missile. The Subcommittee also raises the question of the role of the nonprofit corporation in the conduct of the Government's business, and makes itself clear that if such are established by any Government agency, this does not excuse such agency from moral responsibility for prudent control of public funds spent through the nonprofit corporation.

10. Also, the Subcommittee feels that more thought should be given to the impact of nonprofits on Government service, because as more and more difficult tasks are thrown to nonprofit groups this may well run counter to the Government's efforts to improve the quality and morale of its own career service--civilian and military.

11. The Subcommittee also voices what it calls a widely accepted fact of life, and that is the practice of setting up nonprofit organizations to get around Government salary restrictions, and asks if this doesn't set up a ludicrous cycle in Federal pay comparisons since President Johnson recently said that in making a study of Federal pay in comparison to private enterprise, the salary rates of the nonprofit institutions, inter alia, would give added assurance that Federal salary rates are kept in appropriate relationship with salary rates throughout our economy.



Office of Legislative Counsel

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