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19 AUG 1975

MEMORANDUM FOR: Chief, Review Staff

SUBJECT : Discussion with HSC Representatives
Charles Mattox and Sandra Zeune Re
Proprietaries (10:15 Monday 18 August 1975)

1. The HSC representatives initially asked for a background briefing on the Audit Staff. I discussed the initial effort within the Office of Security in the late 40's and the expanded effort in the 50's due to the increase in proprietary activity and the lack of auditors trained in commercial auditing. I mentioned that nine members of the Audit Staff had been recruited from GAO to fill this experience gap. I indicated that proprietaries have been controlled very tightly over the years through the regulatory process. In addition they have been audited almost entirely on an annual basis. These audits determined compliance with administrative plans and project approvals and emphasized, among other things, maintaining a maximum of three months working capital on hand at any time.

2. At this point Mr. Mattox asked a number of questions the first of which was in regard to our relationship with the Internal Revenue Service. He was told that we filed all the appropriate federal and state returns required and that to the best of our knowledge there had never been any real problem resulting from returns being reviewed by the Internal Revenue Service. However, we indicated that there was a point of contact between OGC and the Internal Revenue Service in order to stop any investigation that might have involved surfacing any intelligence sources and methods. We were not aware of any specific case in which this contact had been used. The investigators were advised that an attempt was made to have each proprietary show a minimum profit in order that they would not attract undue attention.

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3. It was stressed that the major purpose of proprietaries was to perform a necessary Agency operation and not to compete in the commercial market. In response to a query regarding the number of proprietaries it was indicated that the greatest number of proprietaries was in the mid 60's and that after a formal committee study and report at about that time the number has been rapidly declining. We also stressed that there are strict rules regarding the operation of a proprietary and that these rules are contained in [] and elaborated upon in []

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4. Mr. Mattox then indicated that they would probably want a list of all active proprietaries in 1970 with the additions and deletions from that date to the present. He then asked how many proprietaries there are currently and I indicated that there are probably about [] projects and maybe as many as [] corporate entities, most of which are quite small and/or dormant. Mr. Mattox then asked what is done with regard to the disposition of corporate assets in dissolution. It appeared that he had the mistaken notion that we had a warehouse full of excess proprietary property [] We quickly corrected this erroneous assumption and indicated that except in the cases with which he was already familiar any assets remaining in dissolution would have been of very minimal value and would of necessity have been disposed of in a normal commercial manner in order to prevent showing that the corporation was Government connected.

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5. We then discussed the fact that we had over the years called on several of the "big 8" public accounting firms to do audits for us. Mr. Mattox wanted to know if this meant that we could currently call any one of the big eight and ask them to conduct an audit for us. I indicated that except for a recent use of [] it has been a number of years since we had occasion to make any use of these big public accounting firms. Miss Zeune at that point inquired as to whether we had a CPA firm of our own. I indicated that we did and it had responsibility for doing any commercial audits which we needed. Miss Zeune asked who audited the CPA firm and I indicated that this is done by the Audit Staff. Mr. Mattox then inquired as to whether companies had ever used their audited balance sheet as a basis for obtaining a bank loan. To the best of our knowledge the only occasion in which this happened was in the case of [] and he was thoroughly familiar with that case.

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7. Mr. Mattox inquired as to whether our contingency reserve could be called a revolving fund and we said it was not. We told him that the contingency reserve is closely monitored and at no time does it have a fixed amount nor is it reimbursed for the express purpose of bringing it up to a fixed balance. The interview ended with an indication that there would be numerous interviews with other Agency personnel and that they would be formally requesting numerous documents in connection with proprietaries.

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Chief, Audit Staff
Office of Inspector General

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