



REPORT TO THE CONGRESS



Pricing Of Noncompetitive
Contracts Subject To The
Requirements Of The
Truth-In-Negotiations Act--
A Summary Of Reports
Issued In Fiscal Year 1971

B-39995

Department of Defense

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BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

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OCT. 14, 1971



COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

B-39995

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

This is our report on the pricing of noncompetitive contracts under the Truth-in-Negotiations Act--a summary of reports issued in fiscal year 1971 to the Department of Defense.

This review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), the Accounting and Auditing Act of 1950 (31 U.S.C. 67), and the authority of the Comptroller General to examine contractors' records as set forth in contract clauses prescribed by the United States Code (10 U.S.C. 2313(b)).

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; the Director, Defense Supply Agency; and the Director, Defense Contract Audit Agency.

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

Comptroller General
of the United States

D I G E S T

WHY THE REVIEW WAS MADE

The Truth-in-Negotiations Act of 1962, Public Law 87-653, provides the Government with safeguards against payment of higher prices because of overstatements of costs used in negotiations for noncompetitive procurements. Noncompetitive contract awards by the Department of Defense (DOD) averaged about \$23 billion annually for fiscal years 1968, 1969, and 1970.

Since enactment of the law, the General Accounting Office (GAO) has continuously examined its administration by DOD, particularly the reasonableness of the costs proposed by contractors and accepted by the Government. The objective of these examinations is to identify the causes of any overstated estimates and to suggest corrective action.

This report summarizes 23 reports that GAO issued to agency officials and contractors during fiscal year 1971 on the pricing of selected noncompetitive contracts.

GAO reviewed selected cost elements included in the prices of contracts totaling about \$217 million, negotiated with 19 contractors. The contracts were awarded by 13 procurement activities, most of them in calendar year 1968 or 1969. GAO selected them for examination on the basis of indications that some pricing or contracting deficiencies were present. Since it was not practical to review a selection based on a scientific random sample due to the number of procurements involved, our findings must not be construed to apply to all noncompetitive contracts.

FINDINGS AND CONCLUSIONS

The negotiated prices for 28 contracts were about \$8.7 million higher than indicated by cost or pricing data available to the contractors at the time of negotiations. No overestimated costs were found for five other contracts examined. (See p. 5.)

Factors contributing to the overpricing included

--the failure of contractors to submit to the Government significant cost data which became available after they had submitted their proposals,

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- the failure of contracting officers to obtain all significant data or to have these data reviewed by Government auditors, and
- inadequacies in the Government's audits and technical evaluations of contractor proposals. (See ch. 3.)

In view of the relatively small number and value of contracts examined and their selection on the basis of potential findings, general conclusions cannot be drawn on the overall effectiveness of DOD's management of its responsibility to negotiate reasonable prices. GAO's findings indicate, however, that there is a need for continued attention by DOD to the performance of its personnel involved in this function.

RECOMMENDATIONS OR SUGGESTIONS

GAO reported its findings to agency procurement officials and individual contractors. It recommended to agency officials that they determine the extent to which the Government is legally entitled to price adjustments under the terms of the contracts. (See p. 12.)

GAO recognizes that its finding of overestimated costs may not represent amounts for which the Government is legally entitled to price adjustments. To obtain an adjustment, the contracting officer must determine that the price was increased because inaccurate, incomplete, or noncurrent data were submitted and were relied upon in price negotiation. He must also determine the effect of such reliance on the negotiated price. Any price adjustment so determined may be reduced by underestimated costs.

AGENCY ACTIONS AND UNRESOLVED ISSUES

GAO has received comments on 10 of the reports involving overpricing. In all instances DOD officials have initiated action to determine the extent of the Government's legal entitlement to a price adjustment. (See p. 12.)

Because of the significant amount of negotiated noncompetitive procurements, GAO plans to continue to review the pricing of individual contracts.

MATTERS FOR CONSIDERATION BY THE CONGRESS

GAO is bringing these matters to the attention of the Congress because of its expressed interest in negotiation of noncompetitive contract prices.

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ABBREVIATIONS

ASPR	Armed Services Procurement Regulation
DCAA	Defense Contract Audit Agency
DCAS	Defense Contract Administration Services
DOD	Department of Defense
GAO	General Accounting Office

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Factors contributing to the overpricing included

- the failure of contractors to submit to the Government significant cost data which became available after they had submitted their proposals,

- the failure of contracting officers to obtain all significant data or to have these data reviewed by Government auditors, and
- inadequacies in the Government's audits and technical evaluations of contractor proposals. (See ch. 3.)

In view of the relatively small number and value of contracts examined and their selection on the basis of potential findings, general conclusions cannot be drawn on the overall effectiveness of DOD's management of its responsibility to negotiate reasonable prices. GAO's findings indicate, however, that there is a need for continued attention by DOD to the performance of its personnel involved in this function.

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AGENCY ACTIONS AND UNRESOLVED ISSUES

GAO has received comments on 10 of the reports involving overpricing. In all instances DOD officials have initiated action to determine the extent of the Government's legal entitlement to a price adjustment. (See p. 12.)

Because of the significant amount of negotiated noncompetitive procurements, GAO plans to continue to review the pricing of individual contracts.

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CHAPTER 1

INTRODUCTION

Since the enactment in 1962 of Public Law 87-653, the Truth-in-Negotiations Act, the General Accounting Office has continuously reviewed and reported on the manner in which the law has been administered and the reasonableness of selected negotiated prices. In our latest report to the Congress on this subject (B-39995, Dec. 29, 1970), we commented on the effectiveness of revised Department of Defense (DOD) procedures in achieving fair and reasonable prices for 35 contracts negotiated primarily in calendar year 1968. We also commented on problems experienced by contractor and agency officials in implementing these procedures.

The objectives of our review of the pricing of an individual contract are to determine whether the negotiated price is reasonable in relation to available cost information, to identify the causes of any indicated overpricing, and to suggest corrective action. During fiscal year 1971, we issued to agency officials and the contractors involved 23 individual reports on our audits of the pricing of 33 selected contracts. This report summarizes for the Congress the results of these audits. Most of the contracts were awarded in calendar year 1968 or 1969. A listing of the procurements reviewed and related information is shown in the appendix.

In negotiating the price of a noncompetitive procurement expected to exceed \$100,000, the contracting officer must require the contractor to submit cost or pricing data in support of proposed prices and to certify that these data are accurate, complete, and current. The contracting officer is required to include a clause in the contract which gives the Government a right to a price adjustment where it is determined that the price was increased because the data submitted were not in accord with the certification.

The Armed Services Procurement Regulation (ASPR) provides that a cost analysis of a contractor's proposal be performed whenever cost or pricing data are required to be submitted. Cost analysis is the review and evaluation of a contractor's cost or pricing data and of the judgment factors applied in arriving at the estimated costs. Its purpose

is to provide the Government with information concerning the degree to which the contractor's proposed costs represent the amount that performance of the contract can be expected to cost, assuming reasonable economy and efficiency.

The contracting officer is responsible for negotiating a fair and reasonable price. He is assisted in the review, evaluation, and analysis of price proposals by personnel at the purchasing office, such as the price analyst, negotiator, buyer, and project engineer. He is assisted also by contract auditors of the Defense Contract Audit Agency (DCAA) and other technical specialists of the Defense Contract Administration Services (DCAS).

The results of our reviews of the contracts summarized in this report must not be construed to apply to all DOD-negotiated noncompetitive contracts since it was not practical for us to review a selection based on a scientific random sample due to the number of procurements involved. To obtain the most productive use of our limited manpower, we selected each contract for review after a preliminary examination indicated potential overpricing or deficiencies in price evaluations or in other contract-pricing procedures. The scope of our review and the selection of contracts included in this report are described in chapter 6.

CHAPTER 2

ESTIMATED COSTS IN NEGOTIATED PRICES

HIGHER THAN INDICATED BY AVAILABLE COST DATA

The 33 contracts we reviewed totaled approximately \$217 million and were awarded by 13 procurement activities to 19 contractors. The costs we examined were found to be about \$8.7 million higher than indicated by cost or pricing data available to the contractors and subcontractors at the time of each negotiation.

No overestimated costs were found for five of the 33 procurements examined. For 28 procurements the overpricing ranged from \$1,200 to \$1,448,800.

Our findings of overestimated costs by cost element, including related costs and profit, are shown below.

<u>Cost element</u>	<u>Overestimated costs</u>
Material	\$1,977,600
Labor	2,250,900
Overhead and general and administrative expenses	1,131,500
Other costs	784,600
Related costs and profit	<u>2,579,900</u>
Total	<u>\$8,724,500</u>

BASES FOR OVERESTIMATED COSTS

The bases for our findings of overestimated costs by cost elements are described below.

Material

Material cost estimates included in prices of 13 of the 33 procurements we reviewed were \$1,977,600 higher than indicated by various cost information available at the time of negotiations. This amount is net of estimated costs of

material, which were understated by \$47,000 because of errors made by the contractor in computing costs.

Examples of the overestimates follow.

- Estimates of \$24,164,600 were \$1,169,800 higher than shown by firm purchase orders and vendor quotations received by contractors after their proposals had been submitted but prior to completion of negotiations.
- Estimates of \$3,201,300 were supported by noncompetitive price quotations that were \$470,800 higher than prices previously paid to other suppliers who had not been requested to submit quotations.
- Material prices of \$92,100 were increased by \$85,400 for the costs of parts which were duplicated in the contractor's proposal.
- A cost estimate of \$83,200 for anticipated price increases was included in a contract price, although firm-priced orders had been issued at the time of negotiations.

Labor

The labor cost estimates included in prices of 14 of 33 procurements were \$2,250,900 higher than indicated by various cost information available at the time of negotiation. Examples of the overestimates follow.

- Labor cost estimates of \$1.3 million were \$119,200 higher than indicated by revised labor cost standards and by production data which became available after the price proposals were submitted but before negotiations.
- Labor costs of \$2.1 million included in a revised proposal submitted during negotiations were overestimated by \$303,600, because the costs were based on inaccurately computed unit costs of a prior contract. Costs of the previous contract were overstated by including a duplication of tooling costs and by

premature application of a wage increase. The number of units produced under the prior contract was underestimated and thus overstated unit costs.

--Estimated costs of \$14.4 million for hourly employees were based on the number of employees needed during the prior year when the scope of the work was greater than that under the proposed contract, which resulted in an overestimate of \$676,400.

--Estimated costs of \$6.8 million for salaried employees were increased by \$449,900 because contractors used average salary rates which were not representative of prior cost experience.

Overhead and general and administrative expenses

Overhead and general and administrative expenses included in the prices of four of the 33 procurements were increased by \$1,131,500 because (1) specific cost elements were higher than indicated by cost information available at the time of negotiations and (2) costs were for services of questionable need or benefit to the Government. Examples follow.

--General and administrative expenses were overestimated by \$163,500 because allocation practices were not consistently followed by the contractor and a current period was not used to estimate costs.

--Indirect labor costs were \$161,000 higher than indicated by (1) actual cost already incurred for part of the contract period and (2) the need for indirect labor during final stages of the contract.

--Costs for depreciation of buildings were overestimated by \$53,300 because the rates used for two Government contracts were not consistent. A depreciation rate of 33-1/3 percent was used for pricing two modifications to the contract reviewed, although a rate of 5 percent, based on a recommendation by DCAA, had been previously used for the same buildings on another contract.

Other costs

Estimates for other costs included in the prices of six of the 33 procurements were \$784,600 higher than indicated by various cost data available at the time of negotiations. Examples of the more significant overestimates follow.

- Estimated costs for packaging labor and materials were overestimated by \$194,800. The contractor's proposal was based on subcontracting, although information available before negotiations indicated that the contractor planned to perform the packaging in-house at lower costs.
- Freight and overtime labor costs were overestimated by \$161,000 because these costs were estimated on the basis of costs incurred for a prior contract which had required delivery of parts by air freight and extensive overtime to make up lost time due to a delay in the contract award.
- Preproduction costs included \$199,500 for parts which were also included in the costs of producing the end-item.

CHAPTER 3

INDICATED CAUSES OF OVERPRICING

We identified various actions by contractor and DOD officials that contributed to the overpricing we reported. These matters are discussed in the following sections.

CONTRACTORS

Under Public Law 87-653 contractors are responsible for submitting accurate and complete cost or pricing data that are reasonably available as of the date of price negotiations. ASPR provides guidelines as to when data are considered reasonably available. Unless specific cutoff dates are agreed to, data concerning matters of significance to the contractor and the Government are considered, under defense regulations, to be current and reasonably available as of the date of price agreement.

The most significant cause for the overestimated costs we reported was attributed to the failure of contractors to submit significant cost data which became available after their proposals were submitted and before price negotiations were completed.

CONTRACTING OFFICERS

For noncompetitive procurements, the contracting officer is responsible for negotiating a price that is reasonable in relation to the contractor's expected cost of performing the contract with reasonable economy and efficiency.

The price proposal which the contractor is required to submit should be supported by all facts existing up to the time of price agreement that could reasonably be expected to have a significant effect on price negotiations. The contracting officer must review the proposal and obtain audit and technical evaluations to the extent necessary to determine whether the data submitted provide for a realistic basis for price negotiation. Contracting officers did not always follow prescribed procedures for establishing a

reasonable price. In some instances contracting officers' actions were influenced by desires to award contracts for requirements that were designated as urgent and to meet deadlines to definitize letter contracts.

Instances of actions by contracting officers which we believe contributed to the negotiation of higher prices are summarized below.

- Contractors were not required by contracting officers to submit complete proposals and to properly identify supporting cost or pricing data.
- Contracting officer did not require or allow sufficient time for the contractor to obtain competitive price quotations for required contract items.
- Preaward audits were not requested by contracting officers, although available information in support of the price proposed was not adequate.
- Contracting officers did not allow contract auditors sufficient time to make an adequate preaward audit.
- Contracting officers did not request an audit of significantly revised proposals submitted by contractors.
- Contracting officer did not request the auditors to review cost data that had become available after the award of the initial letter contract, although significant time had elapsed since the audit of the initial proposal.
- Information in advisory reports by contract auditors and technical personnel was not adequately considered by contracting officers in negotiating contract prices.

CONTRACT AUDITORS

Preaward audit reports by contract auditors of DCAA did not provide adequate information to contracting officers in some instances. Examples of audit weaknesses follow.

- The auditors relied on data submitted by contractors in support of price proposals; more current available data were not reviewed.
- The scope of the audit was not broad enough to examine significant cost elements.
- Contracting officer was not advised that the contractor had deviated from established practices for distributing administrative expenses.
- Audit report did not show that contractor's proposed costs included material to be furnished by the Government.
- Auditors did not detect and report errors in estimating proposed costs.

TECHNICAL SPECIALISTS

The technical evaluations of contractor proposals by procurement office and DCAS personnel did not appear adequate in some instances to identify questionable costs. Examples are shown below.

- A change in test procedures that reduced labor requirements was overlooked.
- Procedures used to verify material requirements did not show that estimated quantities of material were overstated because the contractor was buying and using material of a lighter weight than was proposed.
- Evaluation of the proposal was not performed in sufficient depth to show that more recent data showing improved labor efficiency were available at the time of review.
- Discrepancies in the contractor's labor-hour calculation were not shown by technical specialists' review.

CHAPTER 4

AGENCY ACTIONS

In the reports we issued involving overpricing, we recommended that agency officials consider our findings and determine the extent to which the Government is legally entitled to price adjustments under the terms of the contracts.

We recognize that our findings of overestimated costs, although based on factual information available at the time of contract negotiation, may not represent defective pricing for which the Government is legally entitled to a price adjustment. This determination is made by the contracting officer on the basis of whether inaccurate, incomplete, or noncurrent data were submitted to him or his representatives prior to the negotiation and his reliance on such data and the effect of such reliance on the price. Price adjustments for defective pricing may be eliminated by offsets for underestimated costs.

We have received comments on 10 of the reports involving overpricing. In all instances DOD officials stated that action had been initiated as we proposed to determine the extent to which the Government is legally entitled to a price adjustment. Final determinations of price adjustments totaling \$533,900 have been made on four contracts on which we reported overpricing of \$2,295,900. For another contract the agency advised that there was no basis for a legal recovery of all or part of the overpricing we reported but that negotiations with the contractor were continuing.

CHAPTER 5

CONCLUSIONS

Our review of 33 procurements indicated overpricing of \$8.7 million, or about 4 percent of the contract prices. Percentages of overpricing ranged from .05 to 11.8 percent of the contract prices. No overpricing was found in five of the 33 procurements.

DOD's annual noncompetitive procurements averaged about \$23 billion for fiscal years 1968, 1969, and 1970. In view of the relatively small number and value of contracts we examined and their selection on the basis of potential findings, general conclusions cannot be drawn on the overall effectiveness of DOD's management of its responsibility to negotiate reasonable prices. Our reviews indicated that procurement officials were aware of DOD's procurement policies and, for the most part, had adequately implemented them.

The Procurement Management Review Group of DOD and the internal audit staffs of the military services are responsible for reviewing the activities of procurement and contract administration officials to ensure that DOD procurement policies are being followed. We believe that there is a need for continued attention by DOD to the performance of its personnel involved in this important function.

We plan to continue our reviews on the pricing of individual contracts negotiated on the basis of cost data. We are also considering performing reviews of matters affecting contract pricing generally where the need for improvement is indicated.

CHAPTER 6

SCOPE OF REVIEWS

We examined contractors' price proposals, cost or pricing data submitted in support of estimated costs, and the latest information available to contractors at the time of negotiations. We reviewed the adequacy of the verification of data and the evaluation of cost estimates performed by agency audit and technical personnel, and the acceptance and use of their findings by negotiators and contracting officers. Also we attempted to identify the causes or management weaknesses that contributed to overpricing noted in our reviews.

We used several methods to select the contracts included in this report. Eleven contracts were selected from a DOD list of contractors. Fifteen contracts were selected after visiting a number of large procurement and contract administration offices and contractors' plants. These contracts were selected after considering factors, such as the relationship of negotiated costs to actual costs, size of the contract, agency preaward audit or absence of audit, delays between preaward audit and negotiation, the DCAA postaward audit, and prior GAO reviews at the contractors' plant.

Five contracts were selected on the basis of information found during other types of reviews at procurement activities. Two of the contracts were reviewed because of a recommendation made by a congressional subcommittee.

APPENDIX

APPENDIX I

SCHEDULE OF REPORTS
ISSUED DURING FISCAL YEAR 1971

Report date	Procurement offices	Contract			Overpricing reported by GAO
		Month of award	Commodity	Amount	
7-2-70	Aeronautical Systems Division, Air Force Systems Command	Feb. 1969	External fuel tanks	\$ 712,500	\$ 2,000
3-12-71	do.	Mar. 1969	A-37B aircraft and related parts	7,986,900	4,400
		Mar. 1969	do.	7,653,700	7,000
		May 1969	do.	9,887,400	21,000
10-26-70	Frankford Arsenal, Army Munitions Command	June 1969	20 mm cartridge links	1,305,300	81,000
11-18-70	Army Weapons Command	Dec. 1969	M-16 rifles	40,870,000	700,900
11-18-70	do.	Dec. 1968	M-16 rifles	33,702,000	836,000
11-25-70	Naval Supply Center, Hawaii	Apr. 1968	Overhaul and repair of valves	158,000	8,900
11-25-70	Air Force Eastern Test Range	May 1969	Transponders	119,700	1,200
12-11-70	Sacramento Air Materiel Area, Air Force Logistics Command	Nov. 1968	Inspection, modification, and repair of electronic tubes	257,000	20,200
2-8-71	Army Ammunition Procurement and Supply Agency	Apr. 1968	Fuzes	10,414,700	707,400
3-19-71	do.	Jan. 1968	Rocket motors	1,192,000	-
		Dec. 1968	do.	4,631,000	31,400
4-20-71	do.	June 1968	Boosters	5,167,600	482,600
		Dec. 1968	Fuzes	16,190,800	1,275,900
3-9-71	Navy Ships Parts Control Center	Feb. 1968	Bomb fin assemblies	7,300,000	840,700
3-19-71	do.	Feb. 1969	Rocket motors	2,447,400	91,400
4-16-71	do.	June 1968	Fuze monitors	1,003,000	46,500
6-30-71	do.	Apr. 1967	MK 52 projectiles	4,751,800	164,100
6-30-71	do.	Nov. 1969	Converters-navigation system	139,500	7,000
4-16-71	Navy Ships Systems Command	Nov. 1967	Repair of traveling wave tubes and parts	4,659,400	-
6-29-71	do.	Apr. 1969	Steam-turbine generator, sets	8,993,400	201,300
6-30-71	do.	June 1968	Components-navigation systems	302,700	-
4-21-71	Naval Air Systems Command	Dec. 1968	Radar components	662,000	78,400
		Dec. 1968	do.	461,000	-
		Feb. 1968	do.	875,800	94,200
		Feb. 1968	do.	652,900	38,700
5-25-71	Air Force Procurement Office, Denmark	July 1969	Base operations and	4,068,500	231,000
		July 1970	maintenance services	4,135,600	260,600
		July 1969	do.	9,987,300	823,400
		July 1970	do.	9,867,900	218,500
6-30-71	Navy Aviation Supply Office	May 1970	Aircraft spare parts	178,700	-
6-30-71	Edgewood Arsenal, Army Munitions Command	June 1966	Launchers, 35 mm cannister	<u>16,131,600</u>	<u>1,448,800</u>
	Total			<u>\$216,867,100</u>	<u>\$8,724,500</u>
Reports	23				
Procurement offices	13				

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