COMPENSATION TO PRESIDENTS, SENIOR EXECUTIVES, AND TECHNICAL STAFF AT FEDERALLY FUNDED RESEARCH AND DEVELOPMENT CENTERS

Report No. 95-182

May 1, 1995

This special version of the report has been revised to omit proprietary data.

Department of Defense
Additional Copies

Copies of the report can be obtained from the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate, at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch, Audit Planning and Technical Support Directorate, at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

Inspector General, Department of Defense  
OAIG-AUD (ATTN: APTS Audit Suggestions)  
400 Army Navy Drive (Room 801)  
Arlington, Virginia 22202-2884

Acronyms

CNA Center for Naval Analyses  
DCAA Defense Contract Audit Agency  
FAR Federal Acquisition Regulation  
FERS Federal Employees Retirement System  
FFRDC Federally Funded Research and Development Center  
IDA Institute for Defense Analyses  
LMI Logistics Management Institute  
MTS Member of Technical Staff  
OMB Office of Management and Budget  
SEI Software Engineering Institute
MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION AND TECHNOLOGY
ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers (Report No. 95-182)

We are providing this report for your review and comment. The audit was performed in response to House of Representatives Conference Report 103-701, "National Defense Authorization Act For Fiscal Year 1995," August 12, 1994.

Comments on a draft of this report were considered in preparing the final report, conformed to the requirements of DoD Directive 7650.3, and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. If you have questions on this audit, please contact Mr. Garold E. Stephenson, Audit Program Director, at (703) 604-9332 (DSN 664-9332) or Mr. Henry F. Kleinknecht, Audit Project Manager, at (703) 604-9324 (DSN 664-9324). The distribution of this report is listed in Appendix E. The audit team members are listed inside the back cover.

[Signature]
Robert J. Lieberman
Assistant Inspector General for Auditing
EXECUTIVE SUMMARY

Introduction. The audit was performed in response to direction contained in the House of Representatives Conference Report 103-701, "National Defense Authorization Act for Fiscal Year 1995," August 12, 1994, that the Secretary of Defense require the Inspector General, DoD, to review compensation paid by federally funded research and development centers (FFRDCs) to officers and employees. DoD funded services at 10 FFRDCs in FY 1994 for about $1.32 billion, and FFRDC funding is estimated for FY 1995 at about $1.25 billion.

Objectives. The overall audit objective was to evaluate the reasonableness of compensation provided to FFRDC officers and professional staff. Specific objectives were to assess the validity of data submitted by each FFRDC to Defense management to support compensation; to compare compensation provided to FFRDC officers and technical staff with compensation provided to officers and professional staff at for-profit and nonprofit organizations; and to examine areas such as bonuses, medical benefits, severance packages, retirement plans, housing allowances, moving expenses, and other forms of nonsalary compensation. We also reviewed management controls applicable to the audit objectives.

Audit Results. Available compensation surveys and a comparison of compensation practices among the FFRDCs show that:

- Salaries of FFRDC presidents and senior executives were generally in line with salaries at for-profit private industry companies, but higher than salaries at nonprofit organizations and in the Government;

- Salaries of technical staff at five FFRDCs were higher than salaries at other research and development organizations;

- Retirement plan contributions for presidents and senior executives at two FFRDCs were higher than contributions at other FFRDCs and in the Government; and

- Other elements of compensation varied among the FFRDCs.
Because compensation surveys often were not suitable, Defense management did not have sufficient information to make decisions on the reasonableness of FFRDC compensation and was generally unable to sustain reasonableness challenges to allowable elements of compensation. We found no material management control weaknesses relating to compensation reviews at FFRDCs. Audit results are discussed in Part II and potential benefits are summarized in Appendix C.

Summary of Recommendations. We recommend that cognizant administrative contracting officers challenge the reasonableness of technical staff salary costs and of retirement costs for FFRDC presidents and senior executives, and include costs for dependent scholarships in technical staff salary costs when determining reasonableness. We also recommend that the administrative contracting officers, in conjunction with the Defense Contract Audit Agency and the FFRDCs, decide which compensation surveys and methodology will be used to support the reasonableness of compensation at FFRDCs. We recommend that the Under Secretary of Defense for Acquisition and Technology determine whether the limitation on "rate" of compensation to FFRDC employees includes fringe benefits and whether the limitation includes only costs associated with the FFRDC contracts when salaries are allocated through overhead.

Management Comments. The Air Force and the Director, Defense Logistics Agency, agreed to instruct cognizant administrative contracting officers to challenge the reasonableness of technical staff salary costs and retirement costs for FFRDC presidents and senior executives at those FFRDCs that appear out of line. The Under Secretary of Defense for Acquisition and Technology agreed to seek clarification on the FFRDC compensation issues. The Defense Contract Audit Agency also provided comments to a draft of the report that address the responsibility of FFRDCs to maintain an adequate compensation system and management controls that demonstrate reasonable compensation and that negate the need for Defense management to introduce alternate pay surveys. See Part II for summary of the management comments and Part IV for the full text of management comments.
# Table of Contents

**Executive Summary**

- Part I - Introduction
  - Background
  - Objectives
  - Scope and Methodology
  - Internal Controls
  - Prior Audits and Other Reviews
  - Other Matters of Interest

**Part II - Finding and Recommendations**

- Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

**Part III - Additional Information**

- Appendix A. Missions and Functions of Federally Funded Research and Development Centers
- Appendix B. Background Information on Federally Funded Research and Development Center Compensation System Reviews, Surveys, and Criteria on Reasonableness
- Appendix C. Summary of Potential Benefits Resulting From Audit
- Appendix D. Organizations Visited or Contacted
- Appendix E. Report Distribution

**Part IV - Management Comments**

- Under Secretary of Defense for Acquisition and Technology Comments
- Department of the Air Force Comments
- Defense Contract Audit Agency Comments
- Defense Logistics Agency Comments
Part I - Introduction
Introduction

Background

Origin of Federally Funded Research and Development Centers. During World War II, the Government entered into contracts with universities and industrial firms to accomplish specialized research and development needs. The initial contracts were awarded for development of nuclear energy (Manhattan Project), for development of effective proximity fuses for anti-aircraft ammunition (Johns Hopkins University Applied Physics Laboratory), and for research in rockets (Jet Propulsion Laboratory of the California Institute of Technology). The critical roles of university scientists and private contractors in Defense work led to continuation of arrangements with universities and private contractors for advice on how to develop and assemble weapon systems.

The need for technical advice from people who were not Government employees arose partly because Government salary and personnel ceilings prevented DoD, and particularly the Air Force, from hiring enough scientists and technicians to satisfy demands. One of the primary reasons the Government was not able to attract the scientific and technological talent necessary to meet its broad research and development needs was because the Government paid less than the private sector.

The issue of conflicts of interest in contracting for research and development led the Air Force to establish the RAND Corporation (RAND) in 1948. RAND was the first independent, nonprofit research organization formed specifically to conduct research for DoD. Fundamental to the approach in achieving scientific and technical excellence was the recognition that substantial freedom of action was required in scientific support organizations to carry out their missions; that the research environment and management style could not be patterned after the military bureaucracy; and that the advice and recommendations needed to be independent, objective, and free of any organizational conflict of interest. RAND was designed to exemplify those principles and served as the prototype for other federally funded research and development centers (FFRDCs).

Functions and Mission of Federally Funded Research and Development Centers. At the onset of FY 1995, the Government sponsored a total of 39 FFRDCs. The Department of Energy sponsored the most FFRDCs, 19. DoD sponsored the second greatest number of FFRDCs, 10, which included the Aerospace Corporation (Aerospace), the Arroyo Center, the Center for Naval Analyses (CNA), the Institute for Defense Analyses (IDA), the Lincoln Laboratory (Lincoln Lab), the Logistics Management Institute (LMI), the MITRE Corporation (MITRE), the National Defense Research Institute, Project Air Force, and the Software Engineering Institute (SEI).
Defense FFRDCs. The Defense FFRDCs are classified into three functional areas:

- study and analyses centers,
- systems engineering and integration centers, and
- research and development laboratories.

RAND has overall responsibility for three of the FFRDCs (Project Air Force, the National Defense Research Institute, and the Arroyo Center) that, if combined, total 66 percent of its revenue. For the purposes of this report, however, the entire corporation is treated as if it were one FFRDC. Therefore, we will refer to only eight different FFRDCs. IDA performs missions in all three functional areas. See Appendix A for missions and functions of FFRDCs.

Defense FFRDC Funding. Table 1 shows Defense FFRDC funding for FYs 1994 and 1995.

<table>
<thead>
<tr>
<th>FFRDC</th>
<th>FY 1994 Funding (millions)</th>
<th>Estimated FY 1995 Funding (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Study and Analyses Centers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RAND</td>
<td>$69.2</td>
<td>$67.0</td>
</tr>
<tr>
<td>CNA</td>
<td>49.4</td>
<td>45.9</td>
</tr>
<tr>
<td>IDA</td>
<td>58.7</td>
<td>53.6</td>
</tr>
<tr>
<td>LMI</td>
<td>29.7</td>
<td>27.2</td>
</tr>
<tr>
<td>Subtotal Studies and Analyses Centers</td>
<td>$207.0</td>
<td>$193.7</td>
</tr>
<tr>
<td>Systems Engineering and Integration Centers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aerospace</td>
<td>$365.5</td>
<td>$335.0</td>
</tr>
<tr>
<td>IDA</td>
<td>13.3</td>
<td>13.7</td>
</tr>
<tr>
<td>MITRE</td>
<td>402.9</td>
<td>373.8</td>
</tr>
<tr>
<td>Subtotal Systems Engineering and Integration Centers</td>
<td>$781.7</td>
<td>$722.5</td>
</tr>
<tr>
<td>Research and Development Laboratories</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IDA</td>
<td>$34.1</td>
<td>$33.6</td>
</tr>
<tr>
<td>Lincoln Lab</td>
<td>268.1</td>
<td>274.0</td>
</tr>
<tr>
<td>SEI</td>
<td>30.5</td>
<td>29.6</td>
</tr>
<tr>
<td>Subtotal Laboratories</td>
<td>$332.7</td>
<td>$337.2</td>
</tr>
<tr>
<td>Total Funding for All FFRDCs</td>
<td>$1,321.4</td>
<td>$1,253.4</td>
</tr>
</tbody>
</table>
Introduction

Objectives

The House of Representatives Conference Report 103-701, "National Defense Authorization Act for Fiscal Year 1995," August 12, 1994, requires that the Inspector General, DoD, conduct an audit of the compensation provided by FFRDCs to officers and professional staff who are paid at a rate exceeding the Executive Schedule Level I rate. The audit was expanded to include a review of compensation provided by FFRDCs to all technical staff. Specific audit objectives were to:

- assess the validity of the data submitted by the FFRDCs to the Defense Contract Audit Agency (DCAA) as justification for the salary rates that exceed the Executive Schedule Level I rate;
- compare the compensation to FFRDC officers and technical staff with the compensation to similar officers and technical staff from for-profit and nonprofit organizations that must compete for Defense work and Government officials of comparable expertise and responsibility;
- examine areas such as bonuses, medical benefits, severance packages, retirement plans, housing allowances, moving expenses, and other forms of nonsalary compensation, as appropriate; and
- evaluate the effectiveness of applicable management controls.

Scope and Methodology

Compensation to Officers and Technical Staff at FFRDCs. We reviewed the salary (including bonuses) paid to officers and technical staff for FY 1994 at the eight Defense FFRDCs as of September 30, 1994. We also reviewed all other forms of compensation included in fringe benefits.

We reviewed compensation surveys used by the FFRDCs to support the reasonableness of compensation, as well as compensation surveys used by DoD to question the reasonableness of compensation. We reviewed compensation system reviews performed by DCAA at the FFRDCs and discussed the compensation system reviews with DCAA and the administrative contracting officers.

Audit Period, Standards, and Locations. This economy and efficiency audit was made from September 1994 through February 1995. The audit was made in accordance with auditing standards issued by the Comptroller General of the
United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of internal controls considered necessary. Organizations visited or contacted are listed in Appendix D.

Computer-Processed Data. We used computer-processed data from accounting systems at the FFRDCs. We compared the computer-processed data with payroll source documents and determined the data to be reliable.

Management Control Program

Management Controls Reviewed. DCAA has responsibility for compensation system reviews at FFRDCs, and the administrative contracting officers have responsibility for ensuring that any compensation system deficiencies identified by DCAA are corrected by the FFRDCs. We reviewed compensation system reviews performed by DCAA at the FFRDCs and discussed those compensation system reviews with DCAA and the administrative contracting officers. We also reviewed DCAA audit programs on compensation system reviews.

Implementation of a Management Control Program. We reviewed the management control program in place to ensure the reasonableness of compensation at the FFRDCs. Our review focused on evaluating the adequacy of the DCAA compensation system reviews at FFRDCs.

Adequacy of Management Controls. We identified no material management control weaknesses. DCAA performs two types of compensation reviews, reviews of a contractor's internal controls and compensation policies and more in-depth reviews of the actual reasonableness of compensation. The audit determined that DCAA was performing both types of reviews at the FFRDCs. Although we believe that the compensation surveys used were generally not suitable to determine the reasonableness of FFRDC compensation, the problem appears to be an inherent weakness with compensation surveys and not a management control weakness.

Prior Audits and Other Reviews

General Accounting Office. The General Accounting Office issued Report No. GAO/NSIAD-95-75 (OSD Case No. 9838), "Executive Compensation at the Aerospace Corporation," on February 7, 1995. The report states that as of September 1994, Aerospace employed 32 senior management personnel, 12 of whom were corporate officers. The officers' total annual compensation
averaged about $240,200, and each annual salary averaged about $176,400. Corporate officers’ benefits included a retirement plan that was not available to senior management personnel or other employees. As of September 30, 1994, 16 Aerospace executives had annual salaries of more than $148,400, the current Executive Schedule Level I salary amount. The report made no recommendations.

**Defense Contract Audit Agency.** The DCAA issued Report No. 2177-94F13020001-0437, "Audit of Compensation System for Massachusetts Institute of Technology Lincoln Laboratory," December 12, 1994. DCAA found that Lincoln Lab did not have sufficient support for selecting surveys used to compare technical staff with the relevant external market, did not maintain job descriptions to use in internal equity comparisons, and did not benchmark (establish a baseline for) either its technical staff positions or its maturity curve analysis. DCAA questioned about $1.6 million of supervisory technical staff costs. DCAA recommended that the administrative contracting officer issue a notice of intent to disallow future compensation costs if an adequate action plan was not received within a reasonable period of time. DCAA also recommended that the Government not reimburse Lincoln Lab at salary rates higher that current levels until Lincoln Lab demonstrated that its compensation system produced reasonable results.

The DCAA issued Report No. 2184-94AI3020001, "FY 1994 Compensation Audit, The MITRE Corporation," October 14, 1994. DCAA identified significant internal control weaknesses in the contractor’s preparation and control over its pay structure for senior technical personnel and technical management staff. The deficiencies resulted in unreasonable costs of $9.1 million. Additional weaknesses in the benchmarking process for officer salaries resulted in questionable costs totaling $356,000. MITRE did not make market comparisons of fringe benefits for officers; therefore, DCAA could not evaluate the reasonableness of those costs. DCAA recommended that the administrative contracting officer issue MITRE a written notice of intent to disallow compensation costs for senior technical and senior management personnel, unless within 60 days, MITRE submitted an action plan to resolve the deficiencies. The contractor agreed to reassess the methodology used to set salaries in conjunction with the development of its new compensation system for technical staff.

nonsupervisory employees. The excessive compensation was computed based on a comparison of the Wyatt Data Services, ECS [Executive Compensation Services] compensation surveys. Aerospace took exception to the finding because Aerospace did not agree with the compensation survey that DCAA used. The administrative contracting officer executed a contract modification requiring a withholding on billings until Aerospace demonstrated the reasonableness of compensation for the cited MTS labor categories and executive fringe benefits. The administrative contracting officer requested that DCAA and procurement personnel coordinate with Aerospace on commissioning special surveys compliant with the Federal Acquisition Regulation criteria. Aerospace has since obtained the additional special compensation surveys to support the reasonableness of the cited MTS labor categories.

The DCAA also issued Report No. 4231-93R13020044, "Audit of Compensation System - The RAND Corporation," December 1, 1993. DCAA performed an audit of the adequacy of the RAND compensation system to determine acceptability for establishing salary rates and fringe benefits and the reasonability and allowability of compensation costs. DCAA reviewed internal audits and performed compliance tests. The report states that RAND did not always comply with RAND procedures in establishing the initial salary levels of new employees. RAND concurred with the recommendations. DCAA concluded that the RAND compensation system was adequate to provide reasonable employee compensation costs to Government contracts.

The DCAA issued Report No. 6121-92C13020001, "Audit of Compensation System - The Center for Naval Analyses (CNA)," on August 19, 1992. DCAA performed an audit of the controls over the CNA compensation system. The report states that no position descriptions existed for executives, nor did written policies and procedures exist for employees with salaries exceeding grade salary maximum range. CNA concurred with the recommendations. DCAA concluded that the CNA compensation system was adequate to provide reasonable employee compensation costs to Government contracts.

Other Matters of Interest

We reviewed almost 300 resumes for FFRDC senior staff and found that most had impressive credentials, including advanced degrees in "hard sciences" from prestigious universities or colleges. For example, of the 300 FFRDC senior staff, 126 had doctorate degrees in hard sciences such as aeronautical and astronautical engineering, chemical engineering, electrical engineering, mathematics, and nuclear physics.
Senior staff also graduated from some of the most prestigious universities and colleges in the country. For example, we identified 16 graduates from Harvard University, 6 graduates from Yale University, 6 graduates from Princeton University, 9 graduates from Columbia University, 8 graduates from Cornell University, 31 graduates from the Massachusetts Institute of Technology, 8 graduates from Stanford University, and 5 graduates from the California Institute of Technology.

Of the 6,427 technical staff members at the FFRDCs, 1,865 had doctorate degrees, 2,831 had masters degrees, and 1,731 had bachelors degrees.

Figure 1 shows the percents of FFRDC technical staff with various degrees.

![Figure 1. Most FFRDC Technical Staff Had Advanced Degrees](image)
Part II - Finding and Recommendations
Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

Available compensation surveys and a comparison of compensation practices among the FFRDCs show that:

- salaries of FFRDC presidents and senior executives were generally in line with salaries at for-profit private industry companies, but higher than salaries at nonprofit organizations and in the Government;

- salaries of technical staff at five FFRDCs were higher than at other research and development organizations;

- retirement plan contributions for presidents and senior executives at two FFRDCs were higher than at other FFRDCs and in the Government; and

- other elements of compensation varied among the FFRDCs.

Compensation surveys were generally not suitable for determining the reasonableness of FFRDC compensation because data were not always broken out by specific industry, geographic region, and company size; sample sizes were sometimes too small to have stability in the data; survey companies were not always representative of the same industry; the selection process was generally not random in that the survey participants appeared to be self-selecting; the industry universe was not defined; and surveys did not address both salary and fringe benefits. In addition, Public Law 103-335, "Department of Defense Appropriation Act, 1995," September 30, 1994, which limited compensation to FFRDC employees and officers, did not adequately define "rate" of compensation. Without suitable compensation surveys, Defense management does not have sufficient information to make decisions on the reasonableness of compensation to FFRDC presidents, senior management, and technical staff, and is generally unable to sustain reasonableness challenges of allowable elements of compensation.
compensation to presidents, senior executives, and technical staff at federally funded research and development centers

background

see appendix b for background information on responsibility for compensation system reviews, compensation surveys, and criteria on reasonableness of compensation applicable to ffrdc's.

compensation surveys used by ffrdc's and doD

ffrcds select compensation surveys. compensation surveys that ffrdc's used to support compensation generally were not suitable for determining the reasonableness of ffrdc compensation. ffrdc's used numerous compensation surveys to support the reasonableness of compensation. however, since each ffrdc decides which compensation surveys to use, the results of the compensation surveys can potentially become self-serving.

compensation surveys used by ffrdc's. we reviewed compensation surveys used by the ffrdc's and found that although the data included large sample sizes sorted by company sales, the data used by the ffrdc's were not adequately sorted by comparable industries and geographic location. in addition, none of the compensation surveys reviewed addressed fringe benefits. one of the surveys had 350 high-technology companies participating, but 53 percent were from the san francisco bay area and 11 percent were from southern california. another of the compensation surveys used by several ffrdc's to support technical staff salaries was the davis salary survey. the davis salary survey provided a good mix of research and development companies (same industry) and was used for the audit.

other compensation surveys used by doD. compensation surveys that doD used to evaluate compensation generally were not suitable for determining the reasonableness of ffrdc compensation. in cases where ffrdc's did not have adequate compensation survey data, doD used commercially available surveys (principally surveys from wyatt data services and the u.s. chamber of commerce) to evaluate the reasonableness of compensation. the wyatt surveys provided better matches to similar industries, but the sample sizes often were too small to ensure stability in the data. both the wyatt survey and chamber of commerce survey were, nonetheless, used for the audit, and problems with the data are discussed herein.
Salaries of FFRDC Presidents and Senior Executives

Comparison of FFRDC President Salaries with Private Industry and Government Salaries. Insofar as we were able to determine using available data on non-FFRDC salaries, salaries of FFRDC presidents were generally in line with salaries at for-profit private industry companies, but higher than salaries at nonprofit organizations and in the Government.

RAND and MITRE do not receive 100 percent of their funding from DoD. About 66 percent of the funding for RAND is from DoD and 74 percent of the funding for MITRE is from DoD. Consequently, salaries for presidents and senior executives at RAND and MITRE would only be allocated to the Defense FFRDC contracts as indirect costs at either 66 percent or 74 percent. Therefore, Defense management and the FFRDCs need clarification on the limitation on rate of compensation for FFRDC employees and officers in Public Law 103-335, "Department of Defense Appropriation Act, 1995," September 30, 1994, in instances where compensation charged to FFRDC contracts is less than 100 percent.

Figure 2 shows that salaries (total cash compensation) of FFRDC presidents were generally in line with salaries of chief executive officers at for-profit engineering and research companies. Annual funding for each FFRDC is also given because the sales volume or size of a company also impacts compensation. For example, compensation surveys that sorted data by company sales showed higher compensation in relation to higher sales. Accordingly, the fact that the president of (P) had a higher salary than the other FFRDC presidents may be because (P) is the (P) of the DoD FFRDCs.

(P) Data removed for proprietary reasons.
Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

*Percentiles and median are for 1994 salaries of chief executives officers at for-profit engineering and research agencies taken from the Wyatt Data Services, 1994/95 Top Management Report.

Figure 2. Salaries of FFRDC Presidents Were Generally In Line With Salaries of Chief Executive Officers at For-Profit Engineering and Research Agencies

Data on percentiles and median in Figure 2 may not be reliable. The for-profit engineering and research agency data in Figure 2 are based on a survey size of only 13 agencies, which is too small to ensure stability of the data. Furthermore, two of the survey agencies are Defense FFRDCs. The survey also does not segregate data by size of the agency, which is an important factor in determining compensation.

(P) Data removed for proprietary reasons.
Figure 3 shows that salaries of FFRDC presidents were generally higher than salaries of chief executive officers at nonprofit organizations.

*Percentiles and median are for 1994 salaries of chief executive officers at nonprofit organizations taken from the Wyatt Data Services, 1994/95 Top Management Report.

Figure 3. Salaries of FFRDC Presidents Were Generally Higher Than Salaries of Chief Executive Officers at Nonprofit Organizations

Again, data used to determine percentiles and median may not be reliable. The nonprofit organization data in Figure 3 are based on a survey size of only 18 organizations, which again is too small to ensure stability of the data. In addition, most of the organizations in the survey are not from industries

(P) Data removed for proprietary reasons.
Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

comparable to the Defense FFRDCs. For example, the survey included the American Medical Association, the California Dental Association, the Christian Children’s Fund, and the Farm Credit Council.

Figure 4 shows that salaries of all FFRDC presidents were higher than the salaries of Executive Schedule Level I Government employees.

*FY 1994 Salary for Executive Schedule Level I Government employees was $148,400.

Figure 4. Salaries of FFRDC Presidents Were Higher Than Salaries of Executive Schedule Level I Government Employees

(P) Data removed for proprietary reasons.
Comparison of FFRDC Senior Executives Salaries with Private Industry and Government Salaries. Insofar as we were able to determine using available data on non-FFRDC salaries, salaries of FFRDC senior executives were generally lower than salaries of executive vice presidents at for-profit engineering and research agencies, in line with salaries for executive vice presidents at nonprofit organizations, and higher than salaries for Executive Schedule Level III Government employees.

Figure 5 shows the range (high, median, and low) of FFRDC senior executive salaries compared with median for-profit engineering and research agency salaries, median nonprofit organization salaries, and Government Executive Schedule Level III salaries. The number of senior executives at each FFRDC is shown at the bottom of the figure. For example, Figure 5 shows that 15 senior executives are at (P), that their salaries range from about $155,000 to about $200,000 per year, and that the median salary is $169,000. Funding information is again provided for comparison purposes.

(P) Data removed for proprietary reasons.
Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

Figure 5. Salaries of FFRDC Senior Executives Were Generally Lower Than Salaries of Executive Vice Presidents at For-Profit Engineering and Research Agencies, In Line With Salaries of Executive Vice Presidents at Nonprofit Organizations, and Higher Than Salaries of Executive Schedule Level III Government Employees

Again, the sample sizes were too small for the data in Figure 5 to be reliable. Only six engineering and research agencies identified executive vice presidents and five nonprofit organizations identified executive vice presidents. The comparability of the agencies in the sample was also questionable as previously indicated.

(P) Data removed for proprietary reasons.
Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

Salaries of FFRDC Technical Staff

Salaries of technical staff at five FFRDCs were higher than salaries of scientists and engineers at research and development organizations when highest degree and years of experience, two major contributors to salary level, were considered.

For our comparison, we looked at the Davis Salary Survey data and determined the salary level and years of experience that represented the 90th percentile for scientists and engineers based on highest degree. The 90th percentile for salary and experience based on the highest education level (bachelor's degree, master's degree, and doctorate degree) from the Davis Salary Survey was used as the standard to evaluate technical staff costs at the FFRDCs.

We then looked at the percentage of FFRDC technical staff that exceeded the 90th percentile for salary level and the percentage of technical staff that exceeded the 90th percentile for years of experience, also based on the highest degree of the technical staff.

Ideally, only 10 percent of the FFRDC technical staff for each degree level should have salary levels above the 90th percentile from the Davis Salary Survey. When FFRDCs had more than 10 percent of the technical staff receiving salaries above the 90th percentile, but the FFRDC also had a corresponding higher percentage of technical staff with experience levels above the 90th percentile, the salary levels could also be considered reasonable.

However, if 25 percent of the technical staff with master's degrees at an FFRDC exceed the 90th percentile for salary, but only 10 percent of the technical staff with master's degrees exceeded the 90th percentile for experience, the reasonableness of technical staff costs should be challenged because neither education nor experience supported the higher salary.

We questioned any instances, except for CNA, where the percentage of technical staff receiving salaries that exceeded the 90th percentile for salary were not supported by the same or a higher percentage with experience levels that exceeded the 90th percentile. We did not question the one percent unsupported variance between salary and experience for technical staff with doctorate degrees at CNA because the variance was small and because CNA had no unsupported variances for bachelor's or master's degrees.
Table 2 shows that higher percentages of technical staff (with bachelor's degrees as highest degree) at (P), (P), and (P) had salaries above the 90th percentile than could be supported by higher percentages of technical staff with experience levels above the 90th percentile.

Table 2. Three FFRDCs Had Higher Percentages of Technical Staff With Bachelor's Degrees Who Exceeded the 90th Percentile for Salary Without Corresponding Experience (standard is 1994 Davis Salary Survey of research and development scientists and engineers)

<table>
<thead>
<tr>
<th>FFRDC</th>
<th>Number of FFRDC Technical Staff With Bachelor's Degree as Highest Degree</th>
<th>Percent of FFRDC Technical Staff That Exceed 90th Percentile</th>
</tr>
</thead>
<tbody>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>42      33</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>19      16</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>37      32</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>11      8</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>11      18</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>16      17</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>31      23</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>7       29</td>
</tr>
</tbody>
</table>

*Experience is based on years since Bachelor's degree.

(P) Data removed for proprietary reasons
Table 3 shows that higher percentages of technical staff (with master's degrees as highest degree) at (P), (P), (P), and (P) had salaries above the 90th percentile than could be supported by higher percentages of technical staff with experience levels above the 90th percentile.

Table 3. Four FFRDCs Had Higher Percentages of Technical Staff With Master's Degrees Who Exceeded the 90th Percentile for Salary Without Corresponding Experience (standard is 1994 Davis Salary Survey of research and development scientists and engineers)

<table>
<thead>
<tr>
<th>FFRDC</th>
<th>Number of FFRDC Technical Staff With Master's Degree as Highest Degree</th>
<th>Percent of FFRDC Technical Staff That Exceed 90th Percentile</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Experience* (&gt;33 years)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Salary (&gt;90,812)</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>27</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>12</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>23</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>20</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>13</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>11</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>13</td>
</tr>
<tr>
<td>(P)</td>
<td>(P)</td>
<td>8</td>
</tr>
</tbody>
</table>

*Experience is based on years since Bachelor's degree.

(P) Data removed for proprietary reasons
Table 4 shows that higher percentages of technical staff (with doctorate degrees as highest degree) at (P), (P), (P), (P), and (P) had salaries above the 90th percentile than could be supported by higher percentages of technical staff with experience levels above the 90th percentile.

<table>
<thead>
<tr>
<th>FFRDC</th>
<th>Number of FFRDC Technical Staff With Doctorate Degree as Highest Degree</th>
<th>Percent of FFRDC Technical Staff That Exceed 90th Percentile Experience*</th>
<th>Salary (&gt; $104,900)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(P)</td>
<td>11</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>(P)</td>
<td>7</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>(P)</td>
<td>13</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>(P)</td>
<td>10</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>(P)</td>
<td>11</td>
<td>22</td>
<td>22</td>
</tr>
<tr>
<td>(P)</td>
<td>9</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>(P)</td>
<td>9</td>
<td>24</td>
<td>24</td>
</tr>
<tr>
<td>(P)</td>
<td>4</td>
<td>15</td>
<td>15</td>
</tr>
</tbody>
</table>

*Experience is based on years since Bachelor's degree.

Based on results of comparisons shown in Tables 2, 3, and 4, the responsible administrative contracting officers at (P), (P), (P), (P), and (P) should challenge the reasonableness of technical staff costs.

Technically, SEI and Lincoln Lab, which operate under the cost principles set forth in Office of Management and Budget (OMB) Circular No. A-21, "Cost Principles for Educational Institutions," are required to justify compensation costs based on the established policies of the educational institutions with which they are affiliated. However, SEI and Lincoln Lab should be required to support the reasonableness of compensation costs similar to the method used by

(P) Data removed for proprietary reasons
other FFRDCs. DoD should consider not awarding contracts to SEI and Lincoln Lab unless the Federal Acquisition Regulation (FAR) cost principles are applicable.

**FFRDC Retirement Plans**

**Retirement Plan Contributions.** Retirement plan contributions for presidents and senior executives at (P) and (P) were out of line with other FFRDCs and the Government.

**Types of Retirement Plans.** The two basic types of retirement plans are defined benefit plans and defined contribution plans. Under defined benefit plans, an employer is obligated to provide a defined benefit to the employee upon retirement, whereas under a defined contribution plan, the employer pays a specified amount into a retirement investment account for the employee.

**Government Retirement Plan.** The Government has two basic retirement plans: the Civil Service Retirement System and the Federal Employees Retirement System (FERS). For the audit, we compared the Government FERS plan to FFRDC retirement plans. The FERS retirement plan combines a defined benefit plan and a defined contribution plan.

For employees covered by the FERS retirement plan, the Government contributes 11.4 percent of salary to fund the defined benefit portion of the plan and will match a maximum of 5 percent of salary to help fund the defined contribution portion of the plan. Therefore, the maximum retirement cost to the Government for FERS employees is 16.4 percent of salary. The maximum Government cost for an Executive Schedule Level I employee covered under the FERS retirement plan would be $24,338 ($148,400 x 16.4 percent). The maximum Government cost for an Executive Schedule Level III employee covered under the FERS retirement plan would be $20,188 ($123,100 x 16.4 percent).

We did not consider Social Security contributions in our analyses, because the percentages contributed by the employer were the same for FFRDCs and the Government.

**FFRDC Retirement Plans.** Each of the FFRDCs has defined contribution retirement plans. Aerospace also has a defined benefit plan, but all employees hired after January 1, 1993, are covered by the defined contribution plan.

**Retirement Plans for FFRDC Presidents.** Costs of FFRDC retirement plans for presidents, except for (P) and (P), were in line with other FFRDCs.
Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

and Government Executive Schedule Level I employee retirement costs. (P) and (P) have supplemental retirement plans for the presidents that significantly increased costs.

(P) has a nonqualified corporate officers retirement plan that is a defined benefit plan with an annual accrual rate that averages 4.4 percent. The total benefit to (P) officers averages about 61 percent of final salary and is capped at 69 percent of final salary, including the standard and supplemental retirement plans.

(P) has a deferred compensation plan for officers that pays 50 percent of final compensation less payments from Social Security and the standard (P) retirement plan. The (P) deferred compensation plan has paid an average benefit equal to 22 percent of the officer's final salary. The plan calculates the value of the supplemental retirement plan and pays the present value of the plan upon retirement (over a maximum period of 5 years). For example, one (P) officer that retired with a final salary of $233,000 received $666,418 in deferred compensation under the plan.

Figure 6 shows that retirement plan contributions for (P) and (P) were out of line with other FFRDCs and Government contributions to FERS for Executive Schedule Level I employees.

None of the compensation surveys reviewed addressed retirement plans for corporate officers. Consequently, we believe that the cognizant administrative contracting officers should challenge the reasonableness of the retirement plans for the presidents at (P) and (P) based on the retirement plan costs for other FFRDC presidents. The administrative contracting officer, (P), Air Force Material Command, was in the process of challenging the reasonableness of costs for the corporate officer retirement plan at (P).

(P) Data removed for proprietary reasons
Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

Figure 6. Retirement Plan Contributions for Presidents at (P) and (P) Were Higher Than at Other FFRDCs and in the Government

Retirement Plans for FFRDC Senior Executives. Costs of FFRDC retirement plans for senior executives, except for (P) and (P), were in line with other FFRDCs and Government Executive Schedule Level III employee retirement costs. The (P) and (P) supplemental retirement plans covered the presidents and other corporate officers.

Figure 7 shows that retirement plan contributions for senior executives at (P) and (P) were out of line with other FFRDCs and Government contributions

(P) Data removed for proprietary reasons
Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

to FERS for Executive Schedule Level III employees. The range of contributions (high, median, and low) represents the different amounts contributed for the senior executives at each FFRDC.

Figure 7. Retirement Plan Contributions for Senior Executives at (P) and (P) Were Higher Than at Other FFRDCs and in the Government

Retirement Plans for FFRDC Technical Staff. Contributions to retirement plans for FFRDC technical staff as a percent of salary were compared with Government FERS contributions and industry retirement plan contributions. The industry retirement plan contributions came from the U.S Chamber of Commerce Employee Benefits survey and included both defined benefit and

(P) Data removed for proprietary reasons
defined contribution plans. Although significant problems existed with the Chamber of Commerce data, which will be discussed in detail later, they were the only survey data on industry retirement benefits available.

Figure 8 shows that retirement plan contributions for FFRDC technical staff (as a percent of salary) were less than maximum retirement plan contributions for Government employees, but higher than for industry employees. Ranges depict high, median, and low.

![Diagram showing retirement plan contributions](image)

1Maximum retirement cost to the Government for FERS employees is 16.4 percent of salary.
2Industry data from U.S. Chamber of Commerce, Employee Benefits Survey.

Figure 8. Retirement Plan Contributions (as a Percent of Salary) for FFRDC Technical Staff Were Less Than for Government Employees, but Higher Than for Industry Employees
Other Elements of Compensation

Other Compensation. Other elements of compensation varied among the FFRDCs, and no conclusions were made on specific elements of compensation.

Automobiles for Personnel Use by FFRDC Presidents and Senior Executives. (P), (P), and (P) financed cars for personal use by their presidents and senior executives. Those three FFRDCs operate under the FAR, which states that costs associated with personal use of automobiles are unallowable. However, representatives from the FFRDCs stated that the costs for personal use of automobiles were charged to non-DoD fee or other company assets.

Table 5 shows the FY 1994 compensation costs for personal use of FFRDC automobiles.

Table 5. FY 1994 Compensation Costs for Personal Use of FFRDC Automobiles

<table>
<thead>
<tr>
<th>FFRDC</th>
<th>Number of Individuals With Cars</th>
<th>Individual Costs</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>(P)</td>
<td>11</td>
<td>$4,273</td>
<td>$5,490</td>
</tr>
<tr>
<td>(P)</td>
<td>7</td>
<td>1,751</td>
<td>2,865</td>
</tr>
<tr>
<td>(P)</td>
<td>10</td>
<td>614</td>
<td>2,860</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Dependent Tuition Assistance for FFRDC Employees. (P), (P), and (P) provided dependent tuition assistance for their employees. (P) financed those costs from fee, while (P) and (P) charged the costs to DoD as direct costs. Although dependent tuition assistance costs are unallowable under the FAR, the costs are allowable under OMB Circular No. A-21 (applicable to (P) and (P)) and not addressed under OMB Circular No. A-122, "Cost Principles for Nonprofit Organizations" (applicable to (P)).

Even though dependent tuition assistance compensation at (P) and (P) was in accordance with the policies at the affiliated universities, (P) and (P), respectively, we believe that the administrative contracting officers for (P) and (P) should challenge the reasonableness of those costs in conjunction with challenges to the reasonableness of technical staff salary costs. The issue of using fee to finance dependent tuition assistance costs at (P) was

(P) Data removed for proprietary reasons

Table 6 shows the dependent tuition assistance costs at \((P)\), \((P)\), and \((P)\).

<table>
<thead>
<tr>
<th>FFRDC</th>
<th>Number of Employees</th>
<th>Individual Costs</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>((P))</td>
<td>31</td>
<td>$1,244</td>
<td>$ 3,169</td>
</tr>
<tr>
<td>((P))</td>
<td>192</td>
<td>480</td>
<td>6,155</td>
</tr>
<tr>
<td>((P))</td>
<td>27</td>
<td>500</td>
<td>14,195</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Life Insurance Coverage for FFRDC Employees. Each FFRDC provided life insurance coverage for employees ranging from $50,000 to 2 and 1/2 times salary.

Table 7 shows for comparison the amount of life insurance coverage provided by each FFRDC and the associated costs.
Table 7. FY 1994 FFRDC Life Insurance Coverage and Associated Costs

<table>
<thead>
<tr>
<th>FFRDC</th>
<th>Coverage</th>
<th>Total Costs</th>
<th>Percent FFRDC Pays</th>
</tr>
</thead>
<tbody>
<tr>
<td>(P)*</td>
<td>1 times salary</td>
<td>$718,000</td>
<td>100</td>
</tr>
<tr>
<td>(P)</td>
<td>1 times salary</td>
<td>81,680</td>
<td>100</td>
</tr>
<tr>
<td>(P)*</td>
<td>1 times salary</td>
<td>218,659</td>
<td>100</td>
</tr>
<tr>
<td>(P)</td>
<td>$50,000</td>
<td>200,000</td>
<td>100</td>
</tr>
<tr>
<td>(P)</td>
<td>2 times salary</td>
<td>18,246</td>
<td>100</td>
</tr>
<tr>
<td>(P) (staff)</td>
<td>2 times salary</td>
<td>105,789</td>
<td>80</td>
</tr>
<tr>
<td>(P)</td>
<td>1 times salary</td>
<td>394,067</td>
<td>100</td>
</tr>
<tr>
<td>(P)</td>
<td>2.5 times salary</td>
<td>419,000</td>
<td>100</td>
</tr>
<tr>
<td>(P)</td>
<td>1 times salary</td>
<td>43,776</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$2,199,217</td>
<td></td>
</tr>
</tbody>
</table>

*Life insurance and accidental death and dismemberment insurance are combined.

Health Insurance Coverage for FFRDC Employees. Health insurance coverage and employees costs of "fee for service" health insurance plans were similar for FFRDC and Government employees.

However, (P) paid 100 percent of the health insurance costs for single employees' coverage, while the employees paid a portion of the costs for dependent or family coverage. The president and senior executives at (P) did not pay any portion of their health insurance costs for single, dependent, or family coverage.

Relocation Costs. FFRDCs had relocation policies similar to the Government Joint Travel Regulations policies for relocation.

(P) provided additional housing allowances to several employees. One employee, the highest example, will receive $50,000 ($20,000 in FY 1993 and $10,000 each year in FYs 1994 through 1996) above the normal relocation costs. However, (P) charges these payments to fee or other company assets.

Vacation and Holiday Policy for FFRDC Employees. Vacation and holiday policies were different at the FFRDCs. Maximum annual vacation days and annual holidays at the FFRDCs ranged from 28 days to 42 days. The maximum annual vacation days and annual holidays for Government employees is 36 days.

(P) Data removed for proprietary reasons
Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

Table 8 shows a comparison of maximum annual vacation days and annual holidays for FFRDC and Government employees.

<table>
<thead>
<tr>
<th>FFRDC</th>
<th>Maximum Vacation Coverage</th>
<th>Holidays</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>(P)</td>
<td>20</td>
<td>8</td>
<td>28</td>
</tr>
<tr>
<td>(P)</td>
<td>26</td>
<td>10</td>
<td>36</td>
</tr>
<tr>
<td>(P)</td>
<td>20</td>
<td>10</td>
<td>30</td>
</tr>
<tr>
<td>(P)</td>
<td>20</td>
<td>12</td>
<td>32</td>
</tr>
<tr>
<td>(P)</td>
<td>20</td>
<td>10</td>
<td>30</td>
</tr>
<tr>
<td>(P)</td>
<td>20</td>
<td>10</td>
<td>30</td>
</tr>
<tr>
<td>(P)</td>
<td>20</td>
<td>8</td>
<td>28</td>
</tr>
<tr>
<td>(P)</td>
<td>30*</td>
<td>12</td>
<td>42</td>
</tr>
<tr>
<td>Government</td>
<td>26</td>
<td>10</td>
<td>36</td>
</tr>
</tbody>
</table>

* Sick leave and annual leave are combined.

Suitability of Compensation Surveys

Compensation Surveys. Compensation surveys were often not suitable to determine the reasonableness of FFRDC compensation because data were not always broken out by specific industry, geographic region, and company size; sample sizes were sometimes too small to have stability in the data; survey companies were not always representative of the same industry; the selection process was generally not random and the survey participants appear to be self-selecting; the industry universe was not defined; and surveys did not address both salary and fringe benefits. We used the compensation surveys that we thought were the most appropriate for the audit, but the compensation surveys had problems with their suitability.

(P) Data removed for proprietary reasons
Wyatt Data Services, 1994/95 Top Management Report. The report provided good position and industry matches, but did not have enough data points in the positions and industries that we were reviewing. Consequently, the sample sizes were too small to ensure stability in the data. With so few responses, an individual data point (company) could have a relatively large influence on the summary statistics. Position and industry information that was used was based on data from as few as five companies. In addition, the companies in the industry data that were used were not always representative of the FFRDCs.

1994 Davis Salary Survey of Research and Development Scientists and Engineers. The survey provides a good tool for comparison because research and development scientists and engineers are classified in nonsubjective positions. The data were classified by highest degree and years since bachelor’s degree. The data also segregated staff and first and second level supervisors. However, the survey did not consider size of company, geographic location, or fringe benefits, and no randomness to the selection process was evident.

U.S. Chamber of Commerce Employee Benefits Survey. The survey had 1,057 participating firms, but provided a disclaimer for using the data as a tool to assess the reasonableness of any specific employee benefit. The data did identify costs for various employee benefits as a percentage of salary, but the data were not industry-specific. For example, the miscellaneous nonmanufacturing industry data used in the audit include companies from research, engineering, education, Government agencies, construction, and others.

In addition, the employee benefit costs as a percentage of salary were based on a relatively low salary, $32,976, compared with salaries of FFRDC staff. Consequently, the benefits costs as a percent of salary could be way out of line. For example, health insurance costs for an individual making $32,976 or $150,000 could be the same. If the health insurance costs were $4,000, the costs as a percentage of salary would be 12.1 percent and 2.7 percent respectively, a significant difference.

DCAA Compensation Reviews at FFRDCs. DCAA often must apply a great amount of judgment in evaluation of the reasonableness of FFRDC compensation costs. In the last 2 years, DCAA performed extensive compensation reviews at Aerospace, Lincoln Lab, and MITRE and questioned the reasonableness of compensation at each FFRDC. However, the findings were difficult to sustain because MITRE and Aerospace generally argued that DCAA’s conclusions were based on data that were not suitable and that were no more reliable than the FFRDCs salary and benefit computations.

Generally, the FFRDCs use various industry compensation surveys to establish compensation levels and provide the resulting data to DCAA as support for.
salaries and benefits paid to employees. DCAA examines the FFRDC methodology for establishing compensation and, if the methodology is questionable, compares the results to computations made by DCAA. Amounts that exceeded DCAA estimates by more than 10 percent were considered to be unreasonable. However, problems occur when determining which compensation surveys are suitable, making it difficult for DCAA to sustain challenges to the reasonableness of compensation.

Compensation Review at MITRE. MITRE used a combination of eight compensation surveys to establish compensation levels (salary ranges) for senior technical and technical management staff. MITRE used a weighted average of the surveys to arrive at a benchmark for most of the technical management and senior technical staff positions. The analysis showed, by MITRE calculations, that average pay levels for selected positions were in excess of a 10-percent range of reasonableness.

However, rather than present DCAA with this analysis during the DCAA compensation review, MITRE revised the analysis by "reinterpreting" the survey data. The revised analysis, presented to the DCAA auditor, showed that all positions were within the 10-percent range of reasonableness. When the original documents were eventually provided during the audit, the auditor used the original analysis as a basis to challenge costs. Consequently, 77 percent of the cost avoidance for the group of employees, or $7 million, was based on MITRE benchmarks. An additional $2.1 million in cost avoidance for the employee group was based on recalculated benchmarks to adjust for selective matching to surveys and mathematical errors.

The DCAA field office is in the process of reviewing the MITRE corrective action plan, and has noted that MITRE already reduced pay for certain employees included in the senior technical and technical management staff. DCAA stated, "in our opinion, relying on the contractor's own analysis, to the extent we were able to at MITRE, is a sustainable quantitative method to estimate excessive compensation." DCAA was fortunate to obtain the original compensation data from MITRE. Unfortunately, the fact that the analysis by the contractor shows excessive compensation does not mean a sound quantitative method was used to estimate the excessive compensation.

Compensation Review at Aerospace. DCAA also noted deficiencies in the compensation system at the Aerospace Corporation. Those deficiencies included lack of job descriptions and exceeding established pay ranges for some supervisory and nonsupervisory positions. DCAA questioned about $3.5 million of salary costs using compensation surveys from Wyatt Data Services. DCAA also questioned $800,000 in excessive costs for executive fringe benefits using the U.S. Chamber of Commerce Employee Benefits Survey. However, Aerospace argued that the compensation survey data used by DCAA were not suitable. In coordination with DCAA, Aerospace obtained
additional compensation surveys that supported the reasonableness of the questioned salary costs and is in the process of obtaining additional surveys to address the questioned executive fringe benefit costs.

**Conclusion.** Obtaining suitable compensation surveys to support or question compensation costs at FFRDCs may not be completely possible because of systemic problems with the compensation survey process. However, when the reasonableness of allowable elements of FFRDC compensation is challenged, we believe that the FFRDCs, DCAA, and the administrative contracting officer should reach a consensus on which compensation surveys will be used and the methodology for using the compensation surveys to establish FFRDC compensation, preferably before the additional compensation surveys are obtained.

**Limitation on Compensation to FFRDC Officers and Employees**

Public Law 103-335, "Department of Defense Appropriations Act, 1995," September 30, 1994, limits the compensation to employees and executive officers at FFRDCs. Section 8054(d) "Limitation on Compensation," states that:

No employee or executive officer of a defense FFRDC may be compensated at a rate exceeding Executive Schedule Level I by that FFRDC: Provided, That the restriction contained in this subsection shall not take effect until July 1, 1995.

However, the law does not define "rate" of compensation. The FFRDCs and DoD were unclear as to whether "rate" referred to salary, or to total compensation, including fringe benefits. Further, if the limit is applied only to salary, FFRDCs will be motivated to increase fringe benefits, including deferred compensation. DoD Components and FFRDCs need additional clarification in cases such as MITRE and RAND where the FFRDCs allocate only a portion of the corporations executive salaries to the Defense FFRDC contracts as indirect costs. We believe that DoD Components need clarification as to the meaning of the term "rate" of compensation.
Recommendations, Management Comments, and Audit Response

Management Comments on the Report. For the full text of management comments, see Part IV.

1. We recommend that the Director, Electronic Systems Center, Air Force Materiel Command:

   a. Instruct the cognizant administrative contracting officers to:

      (1) Challenge the reasonableness of technical staff salary costs at the (P), the (P), and the (P).

      (2) Challenge the reasonableness of retirement costs for the president and senior executives at the (P).

      (3) Include costs for dependent scholarships at the (P) and the (P) when determining the reasonableness of technical staff salary costs.

      (4) Obtain agreement between the Defense Contract Audit Agency and the federally funded research and development centers on the compensation surveys and methodology that will be used to support the reasonableness of compensation costs at the (P), the (P), and the (P), preferably before the compensation surveys are obtained.

   b. Request an exclusion from Office of Management and Budget Circular No. A-21 provisions to use the commercial cost principles in the Federal Acquisition Regulation, if the (P) and the (P) do not provide suitable compensation surveys to support the reasonableness of technical staff salaries.

Management Comments. The Air Force concurred with recommendations 1.a.(1), 1.a.(2), and 1.a.(3), and stated contracting and oversight officials at Electronic Systems Center are implementing the recommendations.

The Air Force nonconcurred with recommendations 1.a.(4) and 1.b., and stated that DoD should not insert itself into the FFRDC management decision process by insisting that DCAA have prior approval of compensation surveys and methodology used by the FFRDC to support management decisions. Further, the Air Force stated that there is no evidence that the policies of OMB Circular No. A-21 are inadequate or result in inappropriate compensation and that no advantage would be gained by changing to the cost principles in the FAR.
Audit Response. The Air Force comments satisfy the intent of the recommendations. Recommendation 1.a.(4), was not intended to insert DoD into the FFRDC management decision process. The recommendation was made so that when DoD and the FFRDCs had disagreements on the reasonableness of compensation, the disagreements would be resolved based on a methodology agreeable to both parties. Recommendation 1.b. was made because OMB Circular No. A-21 states that costs for salaries, wages, and fringe benefits are allowable to the extent that the total compensation to individual employees conforms to the established policies of the educational institution, consistently applied, and that policies at educational institutions were found to be very flexible.

2. We recommend that the Director, Defense Logistics Agency, instruct the administrative contracting officers for the (P) and the (P) to:

   a. Challenge the reasonableness of technical staff salary costs at the (P) and the (P).

   b. Obtain agreement between the Defense Contract Audit Agency and the federally funded research and development centers on the compensation surveys and methodology that will be used to support the reasonableness of compensation costs at the (P) and the (P) preferably before the compensation surveys are obtained.

Management Comments. The Defense Logistics Agency concurred with the recommendation and stated the administrative contracting officers will be requested to reevaluate the reasonableness of technical staff salaries at the (P) and the (P). Compensation surveys and methodologies used will be coordinated with the Defense Contract Audit Agency. The estimated completion date is June 30, 1995.

3. We recommend that the Director, Space and Missile Systems Center, Air Force Materiel Command instruct the administrative contracting officer for (P) to:

   a. Challenge the reasonableness of retirement costs for the president and senior executives.

   b. Obtain agreement between the Defense Contract Audit Agency and (P) on the compensation surveys and methodology that will be used to support the reasonableness of retirement costs.

Management Comments. The Air Force concurred with recommendation 3.a., and stated the Space and Missile Systems Center is implementing the recommendation. The Air Force nonconcurred with recommendation 3.b., in general, on grounds that the recommended actions are already taking place.

(P) Data removed for proprietary reasons
Audit Response. The Air Force comments satisfy the intent of the recommendations. We recognize that the recommendations did address actions taken by the Space and Missile Systems Center that were ongoing during the audit. Those actions formed the basis for these and other recommendations.

4. We recommend that the Under Secretary of Defense for Acquisition and Technology obtain clarification on whether the limitation on "rate" of compensation to federally funded research and development center employees in Public Law 103-335:

   a. Includes fringe benefits such as retirement plans, deferred compensation, life insurance, and dependent tuition assistance.

   b. Includes only costs associated with the federally funded research and development center contracts when salaries are allocated through overhead.

Management Comments. The Under Secretary of Defense for Acquisition and Technology concurred with the recommendation and stated that it would seek clarification on both compensation issues.

The Under Secretary of Defense for Acquisition and Technology also commented the lack of suitability of the compensation surveys for Defense management raises questions concerning the use of the same surveys in the audit as a basis for the finding. Therefore, the basis for the conclusions of the audit seems unclear given the presumed unsuitability of the surveys.

Audit Response. The audit basically used the available surveys for comparative purposes and did not draw conclusions on the reasonableness of compensation at any FFRDC. In our opinion, the compensation surveys reviewed were unsuitable for determining the reasonableness of compensation at FFRDCs. However, we did question compensation at some FFRDCs that appeared out of line with other FFRDCs or the compensation surveys reviewed and recommended that the cognizant administrative contracting officers challenge the reasonableness of compensation costs at those FFRDCs. Consequently, the FFRDCs will be required to obtain more suitable compensation surveys to support the reasonableness of FFRDC compensation.

Defense Contract Audit Agency Management Comments. DCAA stated that the conclusions and recommended corrective actions regarding FFRDC compensation levels are based on comparative data in the report that are being drawn regarding FFRDC compensation levels without the benefit of actually performing compensation system reviews.

DCAA states that, while criticizing the suitability of compensation surveys, the report disregards the responsibility of the FFRDC to maintain an adequate
compensation system and internal controls. An adequate system provides for acceptable surveys, demonstrates reasonable compensation, and negates the need for Defense management to introduce alternate pay surveys.

DCAA further states that, while it recognizes difficulties in assessing the reasonableness of executive compensation at FFRDCs, it disagrees that the solution is to mandate DCAA and administrative contracting officer participation in the survey selection and interpretation process of the FFRDC. An adequate system of internal controls is the FFRDCs responsibility.

Audit Response. The report did show comparative data on FFRDC compensation and recommendations were made to challenge compensation levels that appear out of line. We also recognize that DCAA compensation system reviews form the basis for the administrative contracting officer to challenge the reasonableness of FFRDC compensation.

Again, we agree with DCAA that the FFRDCs are responsible for maintaining an adequate compensation system and internal controls that demonstrate reasonable compensation and negates the need for Defense management to introduce alternate pay surveys. However, we have a difference of opinion with DCAA as to what constitutes a suitable compensation survey.

Finally, we did not intend to "mandate" DCAA and administrative contracting officer participation in the FFRDC survey selection and interpretation process. However, we believe that when an FFRDC has surveys showing its compensation as reasonable and DCAA has other surveys showing the compensation as unreasonable, it may be appropriate to reach agreement on the surveys and methodology used to resolve the differences.
This page was left out of original document
Part III - Additional Information
Appendix A. Missions and Functions of Federally Funded Research and Development Centers

Study and Analyses Centers

Six of the FFRDCs perform missions that involve a wide range of studies and analyses.

Arroyo Center, RAND Corporation, Santa Monica, California. Sponsor: Department of the Army. The Arroyo Center, RAND, conducts a wide range of research, studies, and analyses in the areas of strategy, force design, force operations, readiness and support infrastructure, applied science and technology, manpower and training, threat assessment, and Army doctrine.

Project Air Force, RAND Corporation, Santa Monica, California. Sponsor: Department of the Air Force. The RAND Project Air Force conducts an integrated program of research and analyses on the preferred means of developing aerospace power, including studies of national security threats and strategies; Air Force missions, capabilities, and organization; strategic and tactical force operations; and technology, support, and resource management.

National Defense Research Institute, RAND Corporation, Santa Monica, California. Sponsor: Director, Defense Research and Engineering. The RAND National Defense Research Institute conducts a wide range of research and analyses in the areas of international security and economic policy; threat assessment; Defense strategy and force employment options; applied science and technology; information processing systems; systems acquisition; readiness and support systems; and active-duty and Reserve manpower, personnel, and training for the Office of the Secretary of Defense, Joint Staff, Unified Commands, and Defense agencies.

Center For Naval Analyses, Alexandria, Virginia. Sponsor: Department of the Navy. The Center for Naval Analyses performs work that encompasses tactical development and evaluation, operational testing of new systems, assessment of current capabilities, logistics and readiness, manpower and training, space and electronic warfare, cost and operational effectiveness analysis, assessment of advance technology, force planning, and strategic implications of political-military developments. Of the CNA analysts, 20 percent are assigned to fleet and field commands on 2-year tours.
Appendix A. Missions and Functions of Federally Funded Research and Development Centers

Institute for Defense Analyses, Alexandria, Virginia. Sponsor: Director, Defense Research and Engineering. The Institute for Defense Analyses performs studies and analyses for the Office of the Secretary of Defense, Joint Staff, Unified Commands, and Defense agencies in the areas of Defense systems, science and technology, strategy and forces, resource analysis, advanced computing and information processing, training, simulation, acquisition process, and industrial base.

Logistics Management Institute, Bethesda, Maryland. Sponsor: Deputy Under Secretary of Defense (Logistics). The Logistics Management Institute conducts research, studies, and analyses for the Office of the Secretary of Defense, Military Departments, Defense agencies, Joint Staff, and Unified Commands in its mission areas: material management, acquisition, installations, environment, operational logistics, international programs, force management, and information science.

Systems Engineering and Integration Centers

Three of the FFRDCs perform missions that involve systems engineering and integration.

Aerospace Corporation, Los Angeles, California. Sponsor: Department of the Air Force. The Aerospace Corporation operates an FFRDC that performs general systems engineering and integration for DoD space systems. Aerospace provides planning, systems definition, and technical specification support; analyzes design and design compromises to validate test results and verifies interoperability, manufacturing, and quality control; and assists with field tests, evaluation, launch support, flight tests, and orbital operations. Aerospace provides launch certification of spacecraft and launch vehicles, together with their associated ground systems.

Institute for Defense Analyses, Alexandria, Virginia. Sponsor: Director, Operational Test and Evaluation. The Institute for Defense Analyses provides test and evaluation support to the Office of the Secretary of Defense. IDA provides analyses of test plans, operational assessments, and test results for weapons and other systems, including new and proposed equipment of all types. IDA addresses a range of considerations to include the relationship of effectiveness to technical characteristics, required support, and deployability.

MITRE Corporation, Bedford, Massachusetts, and McLean, Virginia. Sponsor: Assistant Secretary of Defense (Command, Control, Communications, and Intelligence). The MITRE Corporation performs general systems engineering and integration for the DoD command, control,
communications, and intelligence community. MITRE provides direct support through program definition, specification of technical requirements, system integration, analyses of design and design compromises, hardware and software reviews, and test and evaluation. MITRE also appraises the technical performance of contractors.

Research and Development Laboratories

Three of the FFRDCs perform missions that involve research and development laboratory work.

Institute for Defense Analyses, Bowie, Maryland; Princeton, New Jersey; and La Jolla, California. Sponsor: Assistant Secretary of Defense (Command, Control, Communications, and Intelligence). The Institute for Defense Analyses conducts fundamental research for the National Security Agency in cryptology, including the creation and analysis of complex encipherment algorithms. Research is also conducted in various technologies associated with supercomputing and parallel processing, including new architectures, hardware, and software (including prototypes), as well as parallel processing algorithms and applications.

Lincoln Laboratory, Massachusetts Institute of Technology, Lexington, Massachusetts. Sponsor: Department of the Air Force. The Lincoln Laboratory carries out a program of research and development, emphasizing advanced electronics. Mission areas include strategic offense and defense, surface and air surveillance, high energy laser beam control technology, military satellite communications, space surveillance, and advanced electronics technology. Program activities extend from fundamental investigations through design, development, and field testing of prototype systems using new technologies.

Software Engineering Institute, Pittsburgh, Pennsylvania. Sponsor: Director, Advanced Research Projects Agency. The Software Engineering Institute is charged with bringing technology to bear on rapid improvement of the quality of operations software in mission-critical computer resource systems, modernizing software engineering techniques and methods, and establishing standards of excellence in software engineering practice.
Appendix B. Background Information on Federally Funded Research and Development Center Compensation System Reviews, Surveys, and Criteria on Reasonableness

Responsibility for Compensation System Reviews

Compensation System Reviews. On June 5, 1987, the Deputy Secretary of Defense decided that DCAA would be given responsibility for reviewing the system that a contractor uses to determine employee compensation. The function had previously been performed by the Defense Logistics Agency.

Resolution of Compensation System Deficiencies. The administrative contracting officer has responsibility for notifying the contractor of compensation system deficiencies, evaluating the response of the contractor to the compensation system deficiencies, and resolving deficiencies to include disallowing or suspending payments.

Compensation Surveys


Wyatt Data Services, Top Management Report. The 1994/95 Top Management Report was based on responses of 1,055 organizations that provided compensation information on 9,729 executives. The data are maintained in absolute confidentiality and individual participant data are never revealed.
Appendix B. Background Information on Federally Funded Research and Development Center Compensation System Reviews, Surveys, and Criteria on Reasonableness

Davis Salary Survey. The 1994 Davis Salary Survey of Research and Development Scientists and Engineers was based on data submitted from 40 organizations whose basic and applied research and development work is generally recognized as being in the forefront of science and technology. The survey provided compensation information on 66,790 scientists and engineers and 6,323 associates.

U.S. Chamber of Commerce Employee Benefits Survey. The employee benefits survey was based on responses from 1,057 firms representing various industries, geographic locations, and sizes. All the firms in the survey together employed more than 2.6 million persons.

Applicable Criteria on Reasonableness of Compensation

Different Criteria for Applicability of Cost Principles. FFRDCs fall under one of three different sets of criteria for determining the reasonableness of compensation.

Aerospace, RAND, LMI, MITRE, and IDA are considered similar to commercial concerns for determining applicability of cost principles; therefore, those FFRDCs operate under Federal cost principles applicable to commercial concerns, as set forth in the FAR.

SEI and Lincoln Lab are considered similar to educational institutions for the purpose of applicability of cost principles and, therefore, operate under cost principles applicable to educational institutions, set forth in OMB Circular No. A-21, "Cost Principles for Educational Institutions."

CNA is considered similar to nonprofit organizations for the purpose of applicability of cost principles and operates under Federal cost principles applicable to nonprofit organizations, contained in OMB Circular No. A-122, "Cost Principles for Nonprofit Organizations."

FAR Guidance on Compensation. FAR 31.205-6, "Compensation for Personal Services," states that compensation for personal services paid or accrued to each employee must be reasonable for the work performed. Compensation is considered reasonable if each of the allowable elements making up the employee's compensation package is reasonable. Facts that may be relevant include general conformity with the compensation practices of other firms of the same size, the compensation practices of other firms in the same industry, the compensation practices of other firms in the same geographic area, the compensation practices of firms engaged in predominantly non-Government work, and the cost of comparable services obtainable from outside sources.
FAR 31.205-6 also states that, based on an initial review of the facts, contracting officers or their representatives may challenge the reasonableness of any individual element or the sum of the individual elements of compensation paid or accrued to particular employees or classes of employees. In such cases, no presumption of reasonableness exists and, upon challenge, the contractor must demonstrate the reasonableness of the compensation item in question. In doing so, the contractor may introduce, and the contracting officer will consider, not only any circumstances surrounding the compensation item challenged, but also the magnitude of other compensation elements that may be lower than would be considered reasonable in themselves.

FAR 31.205-6(m), "Fringe benefits," states that fringe benefits are allowable to the extent that they are reasonable and are required by law, employer-employee agreement, or an established policy of the contractor. The portion of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable.

FAR 31.205-44, "Training and education costs," (j) "Employee dependent education plans," states that costs of college plans for employee dependents are unallowable.

OMB Circular No. A-21 Guidance on Compensation. Section J8, "Compensation for Personal Services," of OMB Circular No. A-21, provides that costs for salaries, wages, and fringe benefits are allowable to the extent that the total compensation to individual employees conforms to the established policies of the institution, consistently applied.

Section J8f(2) states that tuition or remission of tuition for individual employees or their families and the like are allowable, provided such benefits are granted in accordance with established institutional policies, and are distributed to all institutional activities on an equitable basis.

Section J8g, "Institution-furnished automobiles," states that the portion of the cost of institution-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees.

OMB Circular No. A-122 Guidance on Compensation. Attachment B, paragraph 6, "Compensation for Personal Services," states that when the organization is predominantly engaged in Government-sponsored activities, compensation for employees on Government-sponsored work will be considered reasonable to the extent that the compensation is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved.
Appendix C. Summary of Potential Benefits Resulting From Audit

<table>
<thead>
<tr>
<th>Recommendation Reference</th>
<th>Description of Benefit</th>
<th>Type of Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.a.(1)</td>
<td>Economy and Efficiency. Requires the administrative contracting officers for (P), (P), and (P) to challenge the reasonableness of technical staff salary costs.</td>
<td>Undeterminable.*</td>
</tr>
<tr>
<td>1.a.(2)</td>
<td>Economy and Efficiency. Instructs the administrative contracting officer for (P) to challenge the reasonableness of retirement costs for the president and senior executives.</td>
<td>Undeterminable.*</td>
</tr>
<tr>
<td>1.a.(3)</td>
<td>Economy and Efficiency. Instructs the administrative contracting officer for (P) and (P) to include costs for dependent scholarships in technical staff salary costs when determining reasonableness.</td>
<td>Undeterminable.*</td>
</tr>
<tr>
<td>1.a.(4)</td>
<td>Economy and Efficiency. Instructs the administrative contracting officers for (P), (P), and (P) to obtain agreement between the FFRDCs and DCAA on the compensation surveys and methodology that will be used to support the reasonableness of compensation costs.</td>
<td>Nonmonetary.</td>
</tr>
</tbody>
</table>

*Amount of monetary benefits cannot be determined until analysis is completed by the administrative contracting officer.

(P) Data removed for proprietary reasons
### Appendix C. Summary of Potential Benefits Resulting From Audit

<table>
<thead>
<tr>
<th>Recommendation Reference</th>
<th>Description of Benefit</th>
<th>Type of Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.b.</td>
<td>Economy and Efficiency. Requires (P) and (P) to use the FAR provisions instead of OMB Circular No. A-21, if they cannot provide suitable compensation surveys to support the reasonableness of technical staff salaries.</td>
<td>Nonmonetary.</td>
</tr>
<tr>
<td>2.a.</td>
<td>Economy and Efficiency. Instructs the administrative contracting officers for (P) and (P) to challenge the reasonableness of technical staff salary costs.</td>
<td>Undeterminable.*</td>
</tr>
<tr>
<td>2.b.</td>
<td>Economy and Efficiency. Instructs the administrative contracting officers for (P) and (P) to obtain agreement between the FFRDCs and DCAA on the compensation surveys and methodology that will be used to support the reasonableness of compensation costs.</td>
<td>Nonmonetary.</td>
</tr>
<tr>
<td>3.a.</td>
<td>Economy and Efficiency. Instructs the administrative contracting officer for (P) to challenge the reasonableness of retirement costs for the president and senior executives.</td>
<td>Undeterminable.*</td>
</tr>
<tr>
<td>3.b.</td>
<td>Economy and Efficiency. Instructs the administrative contracting officer for (P) to obtain agreement between the FFRDC and DCAA on the compensation surveys and methodology that will be used to support the reasonableness of retirement costs.</td>
<td>Nonmonetary.</td>
</tr>
</tbody>
</table>

*Amount of monetary benefits cannot be determined until analysis is completed by the administrative contracting officer.

(P) Data removed for proprietary reasons
### Appendix C. Summary of Potential Benefits Resulting From Audit

<table>
<thead>
<tr>
<th>Recommendation Reference</th>
<th>Description of Benefit</th>
<th>Type of Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.a.</td>
<td>Economy and Efficiency. Requests clarification on which elements of compensation are included in the limitation on rate of compensation in Public Law 103-335.</td>
<td>Nonmonetary.</td>
</tr>
<tr>
<td>4.b.</td>
<td>Economy and Efficiency. Requests clarification on limitation of compensation rate in Public Law 103-335 when various percentages of salaries are charged through overhead.</td>
<td>Nonmonetary.</td>
</tr>
</tbody>
</table>
Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense
Under Secretary of Defense for Acquisition and Technology, Washington, DC
Director, Defense Research and Engineering, Washington, DC
Assistant Secretary of Defense (Command, Control, Communications, and Intelligence), Washington, DC
Deputy Under Secretary of Defense (Logistics), Washington, DC

Department of the Army
Auditor General, Department of the Army, Washington, DC

Department of the Navy
Assistant Secretary of the Navy (Financial Management), Washington, DC
Office of Naval Research, Arlington, VA

Department of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
Air Force Materiel Command, Wright-Patterson Air Force Base, OH
Electronics Systems Center, Hanscom Air Force Base, MA
Space and Missile Systems Center, Los Angeles Air Force Base, CA

Defense Organizations
Director, Advanced Research Projects Agency, Arlington, VA
Director, Defense Contract Audit Agency, Cameron Station, VA
Branch Offices:
Alexandria, VA
Boston, MA
Los Angeles, CA
Philadelphia, PA
Pittsburgh, PA
Director, Defense Logistics Agency, Washington, DC
Appendix D. Organizations Visited or Contacted

Non-Government Organizations

Aerospace Corporation, Los Angeles, CA
Arroyo Center, RAND Corporation, Santa Monica, CA
Center for Naval Analyses, Alexandria, VA
Institute for Defense Analyses, Alexandria, VA
Lincoln Laboratory, Massachusetts Institute of Technology, Lexington, MA
Logistics Management Institute, Bethesda, MD
MITRE Corporation, Bedford, MA
National Defense Research Institute, RAND Corporation, Santa Monica, CA
Project Air Force, RAND Corporation, Santa Monica, CA
Software Engineering Institute, Carnegie-Mellon University, Pittsburgh, PA
Appendix E. Report Distribution

Office of the Secretary of Defense
Director, Defense Research and Engineering
Assistant Secretary of Defense (Command, Control, Communications, and Intelligence)
Deputy Under Secretary of Defense (Logistics)

Department of the Army
Auditor General, Department of the Army

Department of the Navy
Assistant Secretary of the Navy (Financial Management)

Department of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller)

Defense Organizations
Director, Advanced Research Projects Agency
Director, Defense Contract Audit Agency
Director, Defense Logistic Agency

Non-Defense Federal Organizations
Office of Management and Budget
Small Business Administration
Technical Information Center, National Security and International Affairs Division,
    General Accounting Office
Appendix E. Report Distribution

Non-Defense Federal Organizations (cont'd)

Chairman and Ranking Minority Member of each of the following Congressional Committees and Subcommittees:

- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on National Security, Committee on Appropriations
- House Committee on Government Reform and Oversight
- House Committee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security
Part IV - Management Comments
MEMORANDUM FOR THE INSPECTOR GENERAL

SUBJECT: Review of Draft Audit Report on "Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers (FFRECs)" (Project No. 4CH-5072)

Thank you for the opportunity to comment on the subject draft report. The following responds to the recommendation directed at the Under Secretary of Defense for Acquisition and Technology. I am also providing for your consideration comments on the overall report.

Recommendation 4: We recommend that the Under Secretary of Defense for Acquisition and Technology obtain clarification on whether the limitation on "rate" of compensation for federally funded research and development center employees in Public Law 103-335:

a. Includes fringe benefits such as retirement plans, deferred compensation, life insurance, and dependent tuition assistance.

b. Includes only cost associated with the federally funded research and development center contracts when salaries are allocated through overhead.

Concur: The USD(A&T) will seek clarification on both these important compensation issues.

Additional Comments:

The audit indicates that "Defense Management generally does not have compensation surveys that are suitable for determining the reasonableness of FFRDC compensation." If the surveys are unsuitable for "Defense Management" to use then how are these same surveys capable of being used in the audit to obtain the four findings regarding compensation in the report? The basis of the conclusions seems unclear given the presumed unsuitability of the surveys. Further, these same surveys are used by other DoD contractors in establishing reasonable compensation rates.
Related to this issue is the fact that it is not "Defense Management", but the contractors who are required to have suitable compensation surveys. By the terms of the contract, the FFRDC is responsible for establishing and maintaining adequate compensation systems. If the contracting officer challenges the contractor's compensation cost, it is the contractor who is responsible for justifying its compensation, not defense management.

Comments in the audit relating to the selection of surveys tends to indicate that we should hold FFRDCs to a different standard than we hold other DoD contractors. Based on the information provided by the report it is clear that no one survey would be capable of addressing the compensation rates for all the FFRDC employees. It would appear to be a good business practice to use a variety of surveys, or one that allows for weighted averages to those portions of the relevant labor market that the FFRDCs compete in for personnel in order to ensure a valid basis for pricing. The contractor is going to compare its pay levels to its product and employee competitors.

The audit suggests that the FFRDCs sponsored by Carnegie Mellon (Software Engineering Institute (SEI)) and Massachusetts Institute of Technology (Lincoln Lab (LL)) should be evaluated against the commercial cost principles in the Federal Acquisition Regulation (FAR) (Part 31.2). Currently, these FFRDCs operate under the cost principals of Office and Management and Budget Circular A-21, "Cost Principals for Educational Institutions", FAR Part 31.3. The audit would require these two organizations be subject to a different set of cost principals merely because they are sponsored by DoD. The guidance in OMB Circular A-21 covers all Educational Institutions, to include the two DoD sponsored FFRDCs. There is nothing in the Circular that precludes a test of reasonableness applicable to employee compensation. Thus, other than potentially creating a situation of additional confusion regarding applicability of prevailing guidance there seems to be no gain to DoD in requiring that SEI and LL comply with FAR requirements rather than with the OMB Circular requirements.

Suggest that in Recommendation 1a be changed from "responsible" administrative contract officers to "cognizant," and that only those FFRDCs which were identified as having high staff costs have to undergo this additional scrutiny. The way the report is currently structured it appears all FFRDCs need the reasonableness of technical staff salary costs reviewed when, in point of fact, only a few were affected.
The audit should clarify what compensation is included and what is not. For example, FFRDC executive pay would have been relatively lower given that none of the FFRDCs provides any equity incentives—stocks, options, golden parachutes, etc. Because the surveys used to compare FFRDCs with the for-profit sector did not include these widely used forms of compensation, you cannot adjust the data to reflect these differences.

As you know, the DDR&E sponsored a study on FFRDC compensation. It selected the Hay Group to study the reasonableness and competitiveness of the compensation of officers and senior employees of DoD FFRDCs compared to the relevant labor market. The report will be completed in April and you will be provided a copy.

Finally, the data in the report needs to be structured in such a way as to ensure the confidentiality of the compensation information that is specific to the FFRDC or to individuals. The Internal Revenue Service Form 990 shows compensation only for officers and trustees and includes such a variety of data that it would be hard to estimate base salary without more information. However, the audit provides substantially more detail on a broader set of employees. Knowledge of FFRDC pay and compensation levels could adversely affect both recruiting efforts with potential new employees and with employee morale.

Anita K. Jones
MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

FROM: SAF/AQ
1060 Air Force Pentagon
Washington DC 20330-1060

SUBJECT: Draft Audit Report on Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers (Project No. 4CH-5072)

This is in reply to your request for Air Force comments on the subject report. Our comments to your recommendations are provided at attachment one. We have also included for your review a complete set of comments from the Air Force Materiel Command as attachment two.

In addition, we are concerned with the basic message conveyed in the report. While the report recognizes the difficulty and subjectivity of determining reasonableness of FFRDC compensation, the report does draw conclusions based on its own, very caveated data. By including these conclusions in the report this implies that the DoDIG's conclusions are more correct than those reached by DCAA or individual contracting officers.

We disagree with this implication and request that you change how the conclusions are presented to more clearly affirm that the individual product centers are adequately complying with current guidance and policy in making determinations about reasonableness of allowable costs for our contracts.
Department of the Air Force Comments

AIR FORCE COMMENTS ON RECOMMENDATIONS
from
Draft Audit Report on Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers (Project No. 4CH-4072)

RECOMMENDATIONS 1a(1), 1a(2), 1a(3), and 3a

CONCUR: Contracting and oversight officials at the Electronic Systems Center and the Space and Missile Systems Center are implementing the DoD's recommendations.

RECOMMENDATIONS 1a(4), and 3b

NON CONCUR: While we recognize that recommendation 3b merely states a situation already taking place at the Space and Missile Systems Center, we do not concur with the recommendation that this same process should necessarily occur at the Electronic Systems Center or that this recommendation in general be considered as establishing new policy with regards to all compensation surveys. The DoD should not insert itself into the FFRDC management decision process by insisting that DCAA have prior approval of compensation surveys and methodology used by the FFRDC to support management decisions.

RECOMMENDATION 1b

NON CONCUR: There is no evidence that the policies of OMB Circular A-21 are inadequate or result in inappropriate compensation, and no advantage would be gained by changing the cost principles from FAR Subpart 31.3 (OMB Circular A-21) to FAR Subpart 31.7.
MEMORANDUM FOR SAF/AQX

SUBJECT: Audit Report on Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers (Project No. 4CH-5072)

FROM: HQ AFMC/EN

1. We have reviewed the report as requested in your 24 Mar 95 letter. Contracting and oversight officials at ESC and SMC are implementing the DoD IG's recommendations. High priority items, such as the retirement plan contributions for senior executives at MITRE and Aerospace Corporations, are being addressed at appropriate levels at ESC and SMC. In addition, we are including ESC/ENK staff comments in our response and attaching SMC/SDC staff comments.

2. The report recognizes the difficulty and subjectivity of reasonableness of FFRDC compensation due to their unique dualistic nature. While providing technical expertise on a par with industry's finest, the FFRDCs are still non-profit corporations operating in a non-competitive environment. Compared to for-profit engineering and research agencies, the compensation is relatively low; however, compared to other non-profit corporations and the government, the compensation levels of some FFRDC executives may appear high according to the DoD IG report. Since FFRDCs do not neatly match either category, these factors complicate decisions regarding executive compensation.

3. These decisions should be handled by ESC and SMC contracting and oversight officials, working closely with DCAA and DLA reviews, to minimize overall contract cost through the "award fee like" contracting process. ESC and SMC have successfully implemented this approach with MITRE and Aerospace, respectively. Preliminary feedback from the Defense Science Board review of DoD FFRDCs indicates the executive compensation issue should be part of the contracting process and not handled separately.

4. We do not concur with the DoD IG's recommendations that DoD insert itself into the FFRDC management decision process by insisting that DCAA have prior approval of compensation surveys and methodology used to support management decisions. DCAA could, and should, select its own survey and methodology to validate compensation levels.

5. In a related matter, we also question the recommendation to request an exclusion from OMB Circular A-21 provisions to use commercial cost principals if MIT and CMU do not "provide suitable compensation surveys." There is no evidence that the policies of OMB Circular A-21 are inadequate or result in inappropriate compensation, and no advantage would be gained by changing the cost principals from FAR Subpart 31.3 (OMB Circular A-21) to FAR Subpart 31.7.
6. Our recommendations regarding this report are: 1) address any potential for excesses identified by the DoD IG through contracting and oversight procedures at ESC and SMC, and 2) future executive compensation issues should continue to be incorporated into the "award fee like" contracting process at ESC and SMC, when fees are appropriate, including the continued use of DCAA audits and oversight. If you have any questions regarding our position, please contact Mr. Andrew Lynch, HQ AFMC/ENRM, DSN 787-5575.

FOR THE COMMANDER

[Signature]

DANIEL C. DALEY, Colonel, USAF
Actg Deputy Director, Engineering and Technical Management

Attachment:
SMC/SD Ltr, 3 Apr 95, w/Atch
MEMORANDUM FOR AFMC/EN

FROM: SMC/SD
160 Skynet Street, Suite 2315
Los Angeles AFB, CA 90245

SUBJECT: DODIG draft audit report entitled: "Compensation of Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers," dated March 8, 1995 (Project No. 4CH-5072)

1. We have reviewed the subject report and have several concerns about the inferences that that be drawn from the report, as well as recommendations through which the DODIG might mitigate our concerns. We must recognize that, as the DODIG noted in their executive summary, in attempting to evaluate the compensation of FFRDC personnel, the DODIG faced a difficult task, in that there are few organizations comparable to the FFRDCs, and consequently the data available tends to be insufficient to sustain reasonable comparisons or challenges to elements of FFRDC compensation.

2. Our general concerns tend to key around the fact that, having acknowledged the insufficiency of reasonable information, the DODIG then draws some very broad conclusions. Our detailed concerns are addressed in attachment 1. However, the following summarizes our more critical concerns:

   a. The draft report fails to acknowledge the 31 Jan 95 DCAA report on its most recent audit of Aerospace compensation, in which the DCAA resolved the last of its issues/exceptions with Aerospace compensation policies and concluded that they were in fact reasonable. Although we acknowledge that the DODIG has no obligation to agree with the DCAA findings, we believe that incorporation of the DCAA's surveys might radically alter the DODIG's conclusions concerning the compensation of Aerospace personnel in particular, if not FFRDC personnel in general.

   b. The draft report also fails to acknowledge that many of its recommendations are matters of normal business practice at some of the Government/FFRDC centers. We believe that, whereas it is true that every center can clearly improve in some areas, it is equally true that some of the centers already use the practices recommended by the DODIG. This is particularly true for the SMC/Aerospace relationship. For example:

      (1) On page 24, the DODIG recommends that SMC's contracting officers should challenge the reasonableness of retirement plans for the presidents of the Aerospace Corporation.
Department of the Air Force Comments

In fact, since Sep 94, in cooperation with the DCAA, SMC has been pursuing a review of all Executive benefits, including retirement plans; the results of that review are expected to be complete in Jul 95. By not acknowledging this initiative, the DODIG report unfairly biases the inferences that will be drawn from this report.

(2) In its conclusions, the DODIG report suggests that a disagreement still exists between DCAA and the Aerospace Corporation concerning which surveys should be used as valid benchmarks for examining the compensation of Aerospace personnel. In fact, whereas such disagreements DoD exist in surveys and audits conducted prior to Sep 94, SMC, DCAA, and Aerospace agreed very specifically to the surveys to be used for the on-going survey mentioned above. Again, by not addressing current data, the DODIG report creates an incorrect image of SMC’s current oversight and management practices.

c. Finally, in its “Recommendations for Corrective Actions” on page 36 of the report, we specifically recommend that the DODIG report either (1) delete its recommendations concerning SMC’s management of the Aerospace Corporation, since both of those recommendations were being implemented before the DODGE’s review began, as noted above, or (2) at least acknowledge that SMC has already implemented the recommended practices.

3. We believe very strongly that the draft DODIG report unfairly fails to acknowledge the initiatives that SMC has begun over the past few years, especially given that those initiatives have contributed to the continuous decline in overhead costs for the Aerospace Corporation since 1989. At the very least, since the DODIG found our practices worthy enough to recommend that everyone should adopt them, a minimal acknowledgment of the SMC and DCAA team’s pathfinder efforts seems appropriate.

4. We at SMC continuously seek to improve our management processes over all contractors, including the Aerospace Corporation. Many of those processes are undergoing extensive review and revision today, and we are always pleased to discuss those processes and plans in greater detail upon request. If further information would be useful, please direct inquiries to our point of contact for management of the Aerospace contract, Lt Col Mikael Bono, DSN 833-3718.

CHARLES E. WHITED, Colonel, USAF
Deputy Director of Program Management

Attachment: SMC Detailed Response
Attachment 1: SMC Detailed Response to the DODIG draft audit report entitled:
"Compensation of Presidents, Senior Executives, and Technical Staff at Federally Funded
Research and Development Centers", dated March 8, 1995 (Project No. 4CH-5072)

1. The following SMC comments on the subject audit report are provided.

2. Some of the specific review requirements mandated by Attachments A and B appear to be missing.

   a. The Act requires "all the officers and employees paid at a rate exceeding the Executive Schedule Level I rate" be reviewed. This report appears to focus only on two corporate officers, i.e., the President and the Executive Vice President.

   b. There is no nonsalary or data rate for Executive Schedule Level I available or even mentioned by DODIG. Nevertheless, the report still suggests the possibility that this undefined, unpublished rate must be considered and resolved (paragraph 4, page 36). SMC agrees and asks how is nonsalary compensation to be determined, by whom, and when. What is the DODIG recommendation? Without this data, a comparison between Level I's and FFRDC employees can not be made.

   c. The Act requires a review of salary and nonsalary compensation "paid to" certain individuals but only focuses on the cost to the Government of a few nonsalary benefits (i.e. retirement plan). What is the overall finding with regard to all nonsalary benefits?

   d. The draft report omits any assessment by the DODIG of data submitted by Aerospace to DCAA for the selected individuals. Is this an omission? In audit reports on compensation prepared as early as 26 January 1994, DCAA concluded that the salary rates for all corporate officers and all general managers were reasonable. In a report issued on 31 January 1995, the DCAA concluded that salaries for remaining technical personnel (Level 4 and Level 5 MTS) also were reasonable. Does the DODIG find this data relevant? Perhaps it should be addressed at some level.

   e. The Act requires that the DODIG "Compare compensation to similar technical and profession staff for profit and nonprofit organizations that must compete for defense work". The draft report compared Aerospace compensation to staffs and to organizations that were not "similar" to the specified group at Aerospace. For example, Page 10 of the report states that "salaries of FFRDC presidents and senior executives were...higher than
salaries at nonprofit organizations...". To an uninformed reader, these conclusions are misleading due to the inappropriateness in comparing the salaries of a company performing FFRDC tasks with, for example, the salaries of the Allegheny Community College or Planned Parenthood. We do not believe that this is the intent of DODIO. In addition to being dissimilar, these organizations do not "compete for defense work" as is required by the Act.

f. Compensation to government officials. The Act requires that the review "Compare compensation to government officials of comparable expertise and responsibility". Is there or should there be, a discussion on the type of work performed by the selected group and what the comparisons are to governments workers? The draft audit report compares the President to Executive Level I and the Executive Vice President to Executive Level III with out any discussion of the expertise or responsibility of those individuals or of Government officials. Did the DODIG conduct some form of comparability analysis, and if so, should it not be included in the report? This also effects retirement plan comparisons of Aerospace senior executives with either the other FFRDCs or the Federal Executive Level III's.

g. The report needs to go into more detail on examining Aerospace's policies on company automobiles, life insurance, and maximum paid leave. As mentioned earlier, although one element of nonsalary compensation may be higher or lower than some norm, our view is that the total package must be looked at to form an opinion of fairness.

2. Here are some specific comments on the draft report:

a. The information presented in the first paragraph on page 23 on Aerospace's nonqualified corporate officers retirement plan is incomplete as it fails to mention that officers at Aerospace are required to retire at age 62, therefore cannot earn salary or retirement benefits from age 62 to age 65 and are prohibited from working for a competitor after retirement.

b. Page 32. DCAA Compensation Reviews at FFRDCs: The last sentence in this paragraph is incorrect; we cannot address the comment on MITRE. Please either eliminate the reference to Aerospace or separate out the Aerospace reference to read: "However, the compensation findings by DCAA could not be sustained because Aerospace was able to prove their salary levels were allowable."

c. In its report the DODIG suggests that internal controls were inadequate (see page 33). Request that the DODIG review this finding. DCAA reviewed the compensation
system in-depth in 1989 and found it satisfactory. There were no significant changes in the system since that time. Comments about a handful of new or changed job descriptions are certainly, in our opinion, minor at best. Aerospace quickly finalized the job descriptions for new or changed positions.

d. Also, on page 33 in the third paragraph, the DODIG draft report discuss the status of the DCAA audit at Aerospace prior to the January 31, 1995 DCAA Audit Report. What should be stated here is that there is no outstanding recommended compensation disallowance for Aerospace by DCAA. There is only a challenged cost on executive benefits at Aerospace by DCAA, and a joint (Aerospace, DCAA) survey through a third party (William M. Mercer, Inc. consulting firm) is in process. Requests that the DODIG Audit Report be updated to reflect the January 31, 1995 DCAA Audit Report.

e. Page 45, Appendix C. Summary of Potential Benefits Resulting From Audit: The Description of Benefit listed under 3.a. is misleading since Aerospace in coordination with DCAA and the Air Force Contracting Officer already have designed and mailed a survey on executive benefits. The survey results will be released in early June. Aerospace in coordination with DCAA and the Air Force Contracting Officer already have reached agreement on compensation surveys and methodology that will be used to support the reasonableness of compensation costs.

3. Please change Page 36, Recommendations For Corrective Action to as follows:
Insert: "For SMC: none. SMC and Aerospace are already conducting all the additional analysis required. SMC should monitor the progress and ensure to completion the joint Aerospace and DCAA Executive Benefit Survey". Delete all other SMC recommendations as they have already been done or are being done.

2 Attachments
1. FY95 Defense Authorization Act
2. DODIG Memo, 31 Aug 94
ATTACHMENT 1

FY 1995 DEFENSE AUTHORIZATION ACT (P.L. 103-337)

§217(h) REVIEW BY DEFENSE INSPECTOR GENERAL OF COMPARISON OF EXECUTIVE COMPENSATION OF FFRDC.

(1) The Secretary of Defense shall require the Inspector General of the Department of Defense to conduct a review of the compensation paid by federally funded research and development centers to all the officers and employees of such centers who are paid at a rate exceeding the Executive Schedule Level I rate.

(2) In conducting the review, the Inspector General shall

(A) assess the validity of the data submitted by federally funded research and development centers to the Defense Contract Audit Agency as justification for the salary rates that exceed the Executive Schedule Level I rate;

(B) compare the compensation paid to those individuals with (i) the compensation of similar technical and professional staff from for-profit and nonprofit organizations that must compete for defense work and (ii) government officials of comparable expertise and responsibility; and

(C) examine areas such as bonuses, medical benefits, severance packages, retirement plans, housing allowances, moving expenses, and other forms of monetary compensation, as appropriate.

(3) The Inspector General shall submit to the Committees on Armed Services of the Senate and the House of Representatives a report on the review not later than May 1, 1995. (emphasis added)
ATTACHMENT 2

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2664

August 31, 1994

MEMORANDUM FOR DIRECTOR, DEFENSE RESEARCH AND ENGINEERING
ASSISTANT SECRETARY OF DEFENSE (COMMAND,
CONTROL, COMMUNICATIONS AND INTELLIGENCE)
DEPUTY UNDER SECRETARY OF DEFENSE FOR LOGISTICS
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF AIR FORCE (FINANCIAL MANAGEMENT AND
COMPTROLLER)
DIRECTOR, ADVANCED RESEARCH PROJECTS AGENCY
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit of Compensation Paid by Federally Funded Research and
Development Centers to Officers and Professional Staff (Project No. 4CH-5072)

We plan to start the subject audit in September 1994. The National Defense
Authorization Act for Fiscal Year 1995 requires that the Inspector General, DoD, conduct
an audit of the compensation paid by federally funded research and development centers
(FFRDCs) to officers and professional staff. Specific objectives will be to:

o assess the validity of the data submitted by the FFRDCs to the Defense
  Contract Audit Agency (DCAA) as justification for the salary rates that
  exceed the Executive Schedule Level I rate [Objections 1-4];

o compare the compensation paid to officers and professional staff with the
  compensation paid to similar officers and professional staff from for-profit
  and nonprofit organizations that must compete for Defense work and
  Government officials of comparable expertise and responsibility
  [Objections 5-6].
o examine areas such as bonuses, medical benefits, severance packages, 
retirement plans, housing allowances, moving expenses, and other forms 
of nonsalary compensation, as appropriate [Objection 7]; and

o evaluate the effectiveness of applicable internal controls. [Objection 8]

We will fully consider suggestions from managers or additional or revised objectives.

Principal locations to be visited will be the FFRDCs, their principal DoD sponsors, 
and DCAA offices.

Mr. Garold E. Stephenson is the Audit Program Director and Henry Kleinknecht is the 
Audit Project Manager for the audit. Please provide points of contact with this audit to 
Mr. Stephenson (703) 604-9324 (DSN 664-9324).

Robert J. Lieberman 
Assistant Inspector General 
for Auditing

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force
Under Secretary of Defense for Acquisition and Technology
MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, 
DEPARTMENT OF DEFENSE

ATTENTION: Mr. Henry Kleinknecht

SUBJECT: DCAA Comments on DoDIG Draft Report, "Audit of 
Compensation Paid by Federally Funded Research and 
Development Centers (FFRDCs) to Officers and 
Professional Staff" (Project No. 4CH-5072)

This memorandum is in response to your verbal request for a 
copy of the DCAA comments sent to you on 7 April 1995 minus the 
"For Official Use Only" (FOUO) marking. We understand the final 
IG report will be issued without the FOUO exception and will 
include the DCAA comments.

Please direct any questions regarding this matter to 
Mr. John A. Wares, Program Manager, Policy Liaison Division, at 
(703) 274-7521.

Lawrence P. Uhlfelder
Assistant Director
Policy and Plans

Enclosure
DCAA Comments on Draft Report
DCAA Comments on Draft DoDIG Report on Audit of Compensation Paid to Officers and Professional Staff (Project No. 4CH-5072)

IG Comment - Page 6 of Draft Report, Last Paragraph, First Sentence


DCAA Response


IG Comment - Page 6 of Draft Report, Last Paragraph, Third Sentence

That excessive compensation was computed based on a comparison of of the Wyatt Data Services compensation surveys.

DCAA Response

Clarification. The sentence should be clarified to state: That excessive compensation was computed based on a comparison of the Wyatt Data Services, ECS compensation surveys.

IG Comment - Page 8 of Draft Report

DCAA and Aerospace agreed that Aerospace would commission additional compensation surveys that both parties agreed were more suitable.
Defense Contract Audit Agency Comments

DCAA Comments on Draft DoDIG Report on
Audit of Compensation Paid to Officers and
Professional Staff (Project No. 4CH-5072)

DCAA Response

Clarification. The sentence should be clarified to state:
The ACO executed a contract modification requiring a withhold
on billings until Aerospace demonstrates the reasonableness of
its compensation for the cited MTS labor categories and
executive fringe benefits. The ACO requested DCAA and
procurement personnel to coordinate with Aerospace on
commissioning special surveys compliant with the FAR criteria.

IG Comment - Page 10 of Draft Report

Defense management generally does not have compensation
surveys that are suitable for determining the reasonableness
of FFRDC compensation.

DCAA Response

Nonconcur. It is not "defense management," but the
contractors who are required to have suitable compensation
surveys. By the terms of their contract, FFRDCs are
responsible for establishing and maintaining adequate
compensation systems. A sound compensation system should
assure that compensation levels are reasonable for the work
performed and in accordance with applicable government laws
and regulations. Adequate internal controls include well
defined written policies and procedures for survey selection
and benchmarking.

Under FAR 42.302(a)(1) the contracting officer is responsible
for reviewing compensation structures. DCAA is the executive
agency responsible for performing these reviews. If DCAA
observes weaknesses in the contractor's internal controls, a
contractor's compensation levels may be subject to
reasonableness tests as defined in FAR 31.205-6(b).

In such cases, the contractor's surveys and benchmark
methodology can be used to conduct reasonableness tests to the
extent the surveys and benchmarking procedures are relevant,
reliable, and objective. Using pay surveys not used by the
contractor is usually one of the last options of the auditor, and is a direct result of an observed weakness in the contractor's system, i.e. a lack of acceptable surveys.

If the contracting officer challenges the compensation costs, there is no presumption of reasonableness. Once challenged, the contractor is responsible for justifying its compensation, not defense management.

IG Comment - Page 10 of Draft Report

(Defense Management and FFRDCs') Compensation surveys were generally not suitable to determine the reasonableness of FFRDC compensation because data were not always broken out by specific industry, geographic region, and company size; sample sizes were sometimes too small to have stability in the data; survey companies were not always representative of the same industry; the selection process was generally not random and the survey participants appeared to be self-selecting; the industry universe was not defined; and surveys did not address both salary and fringe benefits.

DCAA Response

Nonconcur. As the DoDIG notes, FAR 31.205-6, Compensation for Personal Services, provides the guidelines for determining the reasonableness of compensation. These guidelines are used by DCAA in our audits of contractor compensation systems. We take exception to the six reasons cited by the DoDIG as to why available compensation surveys were generally not suitable to determine the reasonableness of FFRDC compensation. Our comments pertain to the adequacy of both salary and benefit surveys.

1. Industry/Geographic Region/Company Size.

FAR 31.205-6(b)(1) states that consideration should be given to all relevant facts when determining the reasonableness of compensation:
Facts which may be relevant include general conformity with the compensation practices of other firms of the same size, the compensation practices of other firms in the same industry, the compensation practices of other firms in the same geographic area, the compensation practices of other firms engaged in predominately non-Government work, and the cost of comparable services obtainable from outside sources. While all of the above factors, as well as other relevant ones should be considered, their relative significance will vary according to the circumstances.

Accordingly, it is neither necessary nor the intent of FAR to always have survey data broken out by industry, geographic region, and company size. It is up to the contractor to adequately justify which factor or combination of factors is relevant. Then, based on review of the facts, contracting officers or their representatives may challenge the reasonableness of the contractor-identified relevant factors.

Depending upon the survey used and the job classification being reviewed, the rationale offered by the IG for rejecting the suitability of a survey may not be relevant. For example, if executive and senior management positions are recruited nationally, it may not be necessary to have survey data broken out by geographic area. Relevant factors, as indicated in FAR 31.205-6, will vary according to circumstances.

2. Sample Size. As we note above, it is up to the contractor to adequately justify which factors are relevant when making a determination of reasonableness. It is also necessary for a contractor to justify its choice of pay survey data. The minimum information necessary to justify use of a pay survey should include:

a. The company name, society, or group that collected the data.

b. The expertise in job evaluation and job analysis possessed by the individuals collecting the data.
c. The names of the companies contributing data and the
geographic location of the source data; the relationship
to and influence of these companies in the contractor's
labor markets.

d. The size of the sample of companies reporting data and the
size of the companies reporting data for each job.

e. The extent that the data is based on job titles and job
descriptions.

f. The number of years that the survey has existed.

Based on a review of the facts, contracting officers or their
representatives may challenge the reasonableness of the
contractor-provided information. However, "the lack of sample
sizes, that may not have stability in data", is only one
factor to consider, and it does not make the survey unsuitable
to determine the reasonableness of compensation. The
contractor-provided justification has to be considered in
conjunction with all potentially relevant factors.

If sample size for one survey is an issue, more than one
survey can be used and a weighted average developed. For
example, Mitre uses a weighted average of data contained in
eight surveys for the purpose of making external pay
comparisons for its technical management and senior technical
staff. To potentially reject one of the eight surveys because
of inadequate sample size ignores that it is used in
conjunction with other data, to develop a weighted average
comparison, of similarly surveyed positions.

3. Industry Relevance. While all factors should be considered
when making a determination of reasonableness, their relative
significance will vary according to the circumstances.
Accordingly, it is neither necessary nor the intent of FAR to
have survey data always broken out by the same industry.
While in most cases an industry grouping should form a
reasonable basis for comparison, all companies within a broad
industry grouping may not be equally comparable to the
contractor. Conversely, if industry groupings are more refined, smaller sample sizes are likely to result, thus creating another potential problem. This remains an area of judgment for the contractor and the auditor.

4. Not Random/Self-Selection. There are three sources of pay surveys that a contractor may use for making market comparisons:

a. Private surveys based upon data from survey company clientele and which only participants may purchase.

b. Contractor self-conducted surveys.

c. Published surveys which are available for the general public to purchase regardless of participation in the survey.

Contractors generally use private surveys and self-conducted surveys. The contractor can tailor these surveys to represent its selected competitive market by including specific companies and jobs. However, it is still incumbent on the contractor to justify the source of pay survey data and the reasonableness of all relevant factors. In addition, DCAA auditors evaluate these surveys to determine why certain companies were excluded or included, and decide whether to challenge the survey and the reasonableness of compensation.

The publicly available surveys are used by DCAA auditors (1) where there is little or no support provided by the contractor to justify the reasonableness of compensation, or (2) to assess the reasonableness of the contractor's private and self-conducted surveys. This assessment also aids in the determination of whether to challenge the reasonableness of compensation.

A contractor's pay survey selection process is rarely going to be random because the contractor is going to compare its pay levels to its product and employee competitors -- i.e., its relevant labor market. Since companies must be similar in
some characteristic to form a basis of comparison, there will always be a degree of self-selection. A degree of "non-randomness" is inherent in this process.

5. Industry Universe. It is unclear to us what the IG means by "industry universe." When pay surveys are conducted, the survey company establishes criteria for participation. Participants usually fill out questionnaires which require them to indicate industry classification. Introductory data within the survey usually describes the survey participants and how the industry groups were established. Surveys may also contain listings of participants by industry group, i.e., the survey universe.

Surveys that concentrate only on the industry factor are not required by FAR and may be outweighed by other factors such as company size; the geographic area from which employees are recruited; the profitability of the company; and what firms involved in predominately non-government work are paying. In addition, the contractor can tailor these surveys to represent its selected competitive labor market by including specific companies and jobs.

6. Fringe Benefits Excluded. Pay surveys need not include both salaries and fringe benefits to be acceptable. In fact, few, if any, surveys cover both areas. Consequently, a contractor often uses separate salary and fringe benefit surveys.

FAR 31.205-6 (b)(1) states that compensation will be considered reasonable if each of the allowable elements making up an employee's compensation package is reasonable. Offsets are allowable between an employee's compensation elements such as wages, bonuses, pension and savings plan benefits, health insurance benefits, deferred compensation, life insurance benefits, and compensated personal absence benefits, per FAR 31.205-6 (b)(1)(i). Contractors may present offsets to a challenge of an unreasonable compensation element. Accordingly, it is neither necessary nor the intent of FAR to have the same survey data address both salary and fringe...
Defense Contract Audit Agency Comments

DCAA Comments on Draft DoDIG Report on Audit of Compensation Paid to Officers and Professional Staff (Project No. 4CH-5072)

benefits. Surveys already exist that address each element separately. In addition, surveys that separately address salary (cash compensation) and fringe benefits provide greater visibility into which elements of compensation may be unreasonable.

We believe that adequate salary and fringe benefit surveys already exist that meet the FAR criteria. Additional clarification is required regarding the DoDIG comments on the adequacy of the U.S. Chamber of Commerce Employee Benefits Survey. The DoDIG states on page 32 "The survey had 1,057 participating firms, but provided a disclaimer for using the data as a tool to assess the reasonableness of any specific employee benefit." The DoDIG failed to include the language of the next sentence following the survey’s disclaimer, which states "This is an assessment that can only be made in the context of the entire package of benefits, in both absolute terms and in terms relative to entire compensation and workplace specific circumstances."

DCAA considers contractor benefits reasonable if the total benefit package does not significantly exceed the survey data. To that extent, the U.S. Chamber of Commerce Survey is an acceptable tool to use in assessing total fringe benefits. If the total benefit package rate is determined unreasonable, only then do we conduct an analysis of each of the individual elements comprising the total benefits package.

IG Comment - Page 18 of Draft Report

Salaries of FFRDC Technical Staff

Salaries of technical staff at five FFRDCs were higher than salaries of scientists and engineers at research and development organizations when highest degree and years of experience, two major contributors to salary level, were considered.
For our comparison, we looked at the Davis salary survey data and determined the salary level and years of experience that represented the 90th percentile for scientists and engineers based on highest degree. The 90th percentile for salary and experience based on the highest education level (bachelors degree, masters degree, and doctorate degree) from the Davis Salary Survey was used as the standard to evaluate technical staff costs at FFRDCs.

We then looked at the percentage of FFRDC technical staff that exceeded the 90th percentile for salary level and the percentage of technical staff that exceeded the 90th percentile for years of experience, also based on the highest degree of the technical staff.

Ideally, only 10 percent of the FFRDC technical staff for each degree level should have salary levels above the 90th percentile from the Davis salary survey. When FFRDCs had more than 10 percent of the technical staff receiving salaries above the 90th percentile, but the FFRDC also had a corresponding higher percentage of technical staff with experience levels above the 90th percentile, the salary levels could also be considered reasonable.

However, if 25 percent of the technical staff with masters degrees at an FFRDC exceed the 90th percentile for salary, but only 10 percent of the technical staff with masters degrees exceeded the 90th percentile for experience, the reasonableness of the technical staff costs should be challenged because neither education nor experience supported the higher salary.

**DCAA Response**

Nonconcur. The IG introduces its own methodology, based solely on a maturity curve analysis, to challenge technical staff salary costs. The IG’s approach ignores generally accepted compensation practices, the FAR criteria for determining reasonableness, and DCAA audit findings. In our opinion, the IG’s approach is not superior to DCAA’s as a
DCAA Comments on Draft DoDIG Report on Audit of Compensation Paid to Officers and Professional Staff (Project No. 4CH-5072)

basis to challenge FFRDC compensation. Additionally, the IG methodology provides no basis for assessing materiality of the statistics; i.e., no range of reasonableness is presented. Instead, only numbers of employees above the 90th percentile for pay and experience are compared, with no allowance for reasonable deviation.

For example, the IG challenges technical management and senior technical staff compensation costs at Mitre. DCAA challenged the reasonableness of costs for this group of technical staff in our audit. We calculated a cost avoidance of $9.1 million utilizing Mitre's primary benchmark pay surveys for the subject staff. Of the total, 77 percent, or $7 million of the reported cost avoidance, is based on Mitre's own benchmarks.

In our opinion, reliance on the contractor's own analysis and surveys, as we were able to at Mitre, is a sustainable position to challenge these costs. Our analysis met the established criteria for determining reasonableness under FAR 31.205-6(b).

In contrast, the maturity curve survey that the IG introduces is used by Mitre as a secondary survey. Mitre's pay ranges are established using benchmark pay surveys, which we consider to be a more acceptable method than a maturity curve approach since the latter does not distinguish between the job classification of employees, thus indirectly allowing offsets between classes of employees which is contrary to the FAR criteria (31.205-6(b)(1)(i)). By disregarding Mitre's system of internal controls and its surveys, the IG is not considering all potentially relevant facts as required by FAR.

In another example, the IG on page 45 of its report, in summarizing potential benefits resulting from the audit, references recommendation 2.a that the ACO challenge the reasonableness of compensation at the RAND corporation (Undeterminable Benefit). This recommendation was based on how many employees were above the 90th percentile in salary but were not above the 90th percentile for experience (maturity curve). In the DCAA review of compensation at RAND, Audit Report No. 4231-93R13020044 dated 1 December 1993 (referenced by IG on page 7), we performed a system review and
Defense Contract Audit Agency Comments

DCAA Comments on Draft DoDIG Report on Audit of Compensation Paid to Officers and Professional Staff (Project No. 4CH-5072)

verified the RAND Corporation's analysis and application of the surveys used for the MTS personnel. We found that RAND used the same Davis Survey used by the IG (1993 data). However, RAND's methodology focused on variance from the average salary at each degree level. Based on these results, RAND demonstrated that while MTS salaries exceeded the average in some cases, the compensation paid was still within the range (10 percent) deemed to be reasonable. The IG's approach does not allow the visibility for making an assessment based on a range of reasonableness.

IG Comment - Page 21 of Draft Report

Technically, SEI and Lincoln Lab, which operate under the cost principles set forth in Office of Management and Budget (OMB) Circular A-21, "Cost Principles for Educational Institutions," are required to justify compensation costs based on the established policies of the educational institutions with which they are affiliated. However, SEI and Lincoln Lab should be required to support the reasonableness of compensation costs similar to other FFRDCs. DoD should consider not awarding contracts to SEI and Lincoln Lab unless Federal Acquisition Regulation (FAR) cost principles are applicable.

DCAA Response

Partially Concur. Adding to OMB Circular A-21 the language contained in FAR Part 31.205, Contract Cost Principles and Procedures, would eliminate any differences between the treatment of contractors subject to FAR and those subject to the OMB circular. However, we believe that OMB Circular A-21 C.2 also requires costs to be reasonable to be allowable, as does the FAR. Furthermore, OMB Circular A-21 C.3. states that a cost may be considered reasonable if it reflects the action that a prudent person would have taken under the circumstances prevailing at the time the decision to incur the cost was made.

In our audit of Lincoln Labs, we found that the institution's compensation levels were in excess of those firms performing relatively similar functions, and were without adequate justification. We believe that this condition was not the
Defense Contract Audit Agency Comments

DCAA Comments on Draft DoDIG Report on Audit of Compensation Paid to Officers and Professional Staff (Project No. 4CH-5072)

action of a prudent business person, and therefore, the excess compensation was questioned in accordance with OMB Circular A-21 C.3.

Nothing in OMB Circular A-21 suggests that educational institutions are exempt from the tests of reasonableness applicable to employee compensation. To the contrary, section J.8.a. on Compensation for Personal Services states that "Charges to sponsored agreements may include reasonable amounts for activities contributing and intimately related to work under the agreements, such as delivering special lectures about specific aspects of the ongoing activity, writing reports and articles, participating in appropriate seminars, consulting with colleagues an graduate students, and attending meetings and conferences."

IG Comment - Page 32 of Draft Report

DCAA Compensation Reviews at FFRDCs. DCAA often must apply a great amount of judgment in evaluation of the reasonableness of FFRDC compensation costs. In the past 2 years, DCAA performed extensive compensation reviews at Aerospace, Lincoln Lab, and Mitre and questioned the reasonableness of compensation at each FFRDC. However the findings were difficult to sustain because Mitre and Aerospace generally argued that DCAA’s conclusions were based on data that were not suitable and that were no more reliable than the FFRDC’s salary and benefit computations.

DCAA Response

Nonconcur. The audit results regarding Aerospace Corporation contained in the DCAA audit report no. 4111-92T13020017,S2 (referenced by the IG on page 6) were sustained by the ACO. In that report, we recommended that the contractor submit an action plan within 60 days. As a result, the ACO executed a contract modification requiring withholds on the billings until Aerospace could demonstrate the reasonableness of its compensation for the cited labor categories and executive fringe benefits.
DCAA Comments on Draft DoDIG Report on Audit of Compensation Paid to Officers and Professional Staff (Project No. 4CH-5072)

The above IG comment, as it relates to Mitre, is premature. We have not yet expressed a final opinion regarding the reasonableness of officer compensation costs at Mitre. Our audit report was qualified with regard to executive benefits pending receipt of an acceptable fringe benefit survey from Mitre. We are currently awaiting the results of two executive benefits surveys in which Mitre is participating.

We are also in the process of reviewing Mitre's corrective action plan with regard to the recommendations contained in our report. As to the audit findings for Mitre officers, it is premature at this point for the IG to determine whether our findings are sustainable or not.

With regard to auditors applying "a great amount of judgment," like any other system of financial controls, a contractor's compensation system relies on the expertise and integrity of the people who operate it. Many judgments are similarly made by the contractor within its compensation system. When evaluating a contractor's internal controls and any potential deficiencies in them, the auditor will need to exercise judgement, as is done in every audit, to determine the acceptability of the controls and the potential impact of any deficiencies on the government.

IG Comment - Page 33 of Draft Report

Generally, the FFRDCs use various industry compensation surveys to establish compensation levels and provide the resulting data to DCAA as support for salaries and benefits paid to employees. DCAA examines the FFRDC methodology for establishing compensation and, if the methodology is questionable, compares the results to computations made by DCAA. Amounts that exceed DCAA estimates by more than 10 percent are considered to be unreasonable. However, problems occur when determining which compensation surveys are suitable, making it difficult to sustain challenges to the reasonableness of compensation.
DCAA Comments on Draft DoDIG Report on Audit of Compensation Paid to Officers and Professional Staff (Project No. 4CH-5072)

DCAA Response

Partially Concur. DCAA evaluates FFRDCs' compensation system internal controls. As previously stated, an adequate system of internal controls, not the pay surveys alone, establishes reasonable compensation. If the system is deficient, reasonableness testing under the FAR criteria may be indicated.

In cases where we conduct reasonableness testing, we rely on the contractor's surveys and methodology to the extent possible and perform an analysis similar to that described by the IG above. In some cases, if acceptable contractor surveys are not available, and the survey data is relevant, we will utilize other surveys available to us to assess reasonableness. If this is not possible, we will recommend that the contractor make required improvements and return at a later date to evaluate the system.

Depending upon our results, we may recommend that the ACO challenge a contractor's compensation costs. The ACO is the decision-maker in terms of challenging compensation. Once the ACO challenges compensation, there is no presumption of reasonableness. The contractor is ultimately responsible for demonstrating the reasonableness of its compensation levels, not DCAA.

IG Comment - Page 33 of Draft Report

For example, Mitre used a total of eight compensation surveys to establish compensation levels for employees. During the compensation system review at Mitre, DCAA noted that Mitre selectively used different compensation surveys to support compensation for various positions. This resulted in higher pay levels for these positions. DCAA established a weighted average of salaries from the eight surveys in which Mitre participated. A weight of 66 percent was applied to survey data from for-profit corporation, while weights of 17 percent were applied to both nonprofit activities and Government agencies. The weights were based on the...
percentages of Mitre employees recruited from the various sectors. DCAA then questioned any costs that exceeded the weighted average by more than 10 percent. The DCAA compensation review identified $9.1 million in excessive compensation at Mitre. Even though DCAA was able to demonstrate that Mitre had used subjective measures to establish compensation levels, the methodology that DCAA used to estimate excessive costs did not provide a sustainable quantitative method to estimate excessive compensation.

**DCAA Response**

Nonconcur. The IG's statement contains factual errors and also misrepresents the audit findings at Mitre. Mitre used a combination of eight compensation surveys to establish compensation levels (salary ranges) for its senior technical and technical management staff, not for officers and not for other employees. Mitre used a weighted average of the surveys (not the percentage methodology attributed to DCAA) to arrive at a benchmark for most of its technical management and senior technical staff positions. This analysis showed, by Mitre's own calculations, that its average pay levels for selected positions were in excess of the 10 percent range of reasonableness.

Rather than present DCAA with this analysis during the audit, Mitre revised this analysis by "re-interpreting" the survey data. The revised analysis, presented to the DCAA auditor, showed that all positions were within the 10 percent range of reasonableness. When the original documents were eventually disclosed during the audit, the auditor used the original analysis as a basis to challenge costs. In fact, 77 percent of the cost avoidance for this group of employees, or $7 million, is based on Mitre's own benchmarks. Certain benchmarks were recalculated to adjust for selective matching to surveys and mathematical errors, accounting for the remaining $2.1 million in cost avoidance for this employee group. In our opinion, relying on the contractor's own analysis, to the extent we were able to at Mitre, is a sustainable quantitative method to estimate excessive compensation.
Defense Contract Audit Agency Comments

DCAA Comments on Draft DoDIG Report on Audit of Compensation Paid to Officers and Professional Staff (Project No. 4CH-5072)

The field audit office is in the process of reviewing Mitre's corrective action plan, and has noted that Mitre has already reduced pay for certain employees included in the senior technical and technical management staff.

Although, in general, we do agree that the IG has some merit regarding the sustainability of compensation findings, in the Mitre case the IG has not considered all of the facts and circumstances surrounding the audit.

IG Comment - Page 33 of Draft Report

Conclusion. Obtaining suitable compensation surveys to support or question compensation costs at FFRDCs may not be completely possible because of systemic problems with the compensation survey process. However, we believe the FFRDCs, DCAA, and the administrative contracting officer should reach consensus on which compensation surveys will be used and the methodology for using the compensation surveys to establish FFRDC compensation, preferably, before the compensation surveys are obtained.

DCAA Response

Partially Concur. While we agree that there is some difficulty in evaluating the appropriateness of executive compensation at FFRDCs, we disagree that the ACO should obtain agreement between the above parties regarding survey selection and methodology.

For example, as discussed previously, the IG's recommendation disregards the contractor's basic responsibility to establish and maintain an adequate compensation system. This includes well defined written policies and procedures for survey selection and benchmarking.
DCAA Comments on Draft DoDIG Report on
Audit of Compensation Paid to Officers and
Professional Staff (Project No. 4CH-5072)

The dilemma with executive compensation stems from the nature of the FFRDC: a nonprofit, government funded operation that, in some cases, competes in the commercial market for labor. In terms of evaluating officer pay levels against the external marketplace, should FFRDC officers be paid similarly to the government, nonprofit, or commercial companies? Should officer pay levels at FFRDCs be consistent, regardless of differences in revenue and operations? Who should decide?

Recommending ACO/DCAA/FFRDC agreement on surveys and their interpretation attempts to resolve this issue on a case-by-case basis. Each party will have a different opinion on which survey data is relevant and, indirectly, on the appropriate pay levels for FFRDC officers. It would be better accomplished at a policy level rather than recommending an agreement of this type that, in terms of DCAA, may appear to compromise our independence.

**IG Comment**

Reported FY 1994 Salary for Mitre's President -- $290,000

*IG Draft Report Pages 13, 14, and 15*

**DCAA Response**

Correction. The FY 1994 salary for Mitre’s President was $325,000.

**IG Comment**

*IG Draft Report Page 24, Figure 6*

**DCAA Response**

Clarification. FAR 31.205-6(b), Reasonableness, says "Compensation will be considered reasonable if each of the allowable elements making up the employee's compensation package is reasonable" [underlining added]. Allowable costs for retirement plans or pensions may be calculated using any
one of several actuarial methods. Comparison of allowable costs in a particular accounting period may not be valid because different actuarial methods will assign costs to different accounting periods. Also, FAR allowability criteria may limit allowable costs to actual payments to retirees.

IG Comment

IG Draft Report Page 27, Comparison Using the Chamber of Commerce Survey

DCAA Response

Correction. The IG inappropriately includes officers when comparing FFRDC fringe benefits to the U.S. Chamber of Commerce Survey. Page 36 of the U.S. Chamber of Commerce survey states that officers are excluded from the survey.

IG Comments

(Page 35 and 36 of Draft Report) Recommendations for Corrective Action 1.a(1), 1.a.(2), 1.a.(4), 1.b., 2.a, 2.b, 3.a, and 3.b. [Citations indicate where IG recommends DoD Commands have their ACOs (1) challenge the reasonableness of costs based on IG findings/comparative analysis and (2) obtain agreement between DCAA and the FFRDCs on the compensation surveys and methodology that will be used to support the reasonableness of costs.]

DCAA Response

Nonconcur. The draft report’s conclusions and recommended corrective action regarding FFRDC compensation levels are based on comparative data as presented in the draft report. It appears that the IG is drawing conclusions regarding FFRDC compensation levels without the benefit of actually performing compensation system reviews. The IG’s analysis does not
Defense Contract Audit Agency Comments

DCAA Comments on Draft DoDIG Report on
Audit of Compensation Paid to Officers and
Professional Staff (Project No. 4CH-5072)

consider DCAA's audit findings and generally accepted compensation practices as embodied in FAR 31.205-6.

While the IG "qualifies" its report for some of the above factors, in our opinion the IG's approach precludes forming a basis to challenge compensation costs or otherwise assess the acceptability of FFRDC compensation levels.

While we recognize difficulties in assessing the reasonableness of executive compensation at FFRDCs, we disagree that the solution is to mandate DCAA and ACO participation in the contractor's survey selection and interpretation process. An adequate system of internal controls is the FFRDC's responsibility. It is not the government's responsibility to assume or supplement management's role when those responsibilities are already adequately defined.

ENCLOSURE
Page 19 of 19
MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on Compensation to Presidents, Senior Executives and Technical Staff at Federally Funded Research and Development Centers, 4CH-5072

Enclosed is our response to your request of 8 March 1995.

Encl

JACQUELINE G. BRYANT
Chief, Internal Review Office
TYPE OF REPORT: Audit  

PURPOSE OF INPUT: Initial

AUDIT TITLE: Compensation to Presidents, Senior Executives and Technical Staff at Federally Funded Research and Development Centers, 4CH-5072

RECOMMENDATION 2: Recommend that the Director, Defense Logistics Agency, instruct the administrative contractings officers for the Logistics Management Institute and the RAND Corporation to:

a. Challenge the reasonableness of technical staff salary costs at the Logistics Management Institute and the RAND Corporation.

b. Obtain agreement between the Defense Contract Audit Agency and the federally funded research and development centers on the compensation surveys and methodology that will be used support the reasonableness of compensation costs at the Logistics Management Institute and the RAND Corporation preferably before the compensation surveys are obtained.

DLA COMMENTS: Concur. The Administrative Contracting Officers (ACOs) will be requested to reevaluate the reasonableness of technical staff salaries at Logistics Management Institute and Rand Corporation. Compensation surveys and methodologies used will be coordinated with the Defense Contract Audit Agency.

DISPOSITION:
(X) Action is Ongoing. Estimated completion Date: 30 Jun 95

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur

ESTIMATED REALIZATION DATE: 31 Dec 95

ACTION OFFICER: R. E. Kern, AQCOE
PSE REVIEW/APPROVAL: Robert P. Scott, Ass't Executive Director
COORDINATION: LaVaeda Coulter, DDAI

DLA APPROVAL:  

[Signature]  11 Apr 95

LAWRENCE P. FARRELL, Jr.
Major General, USAF
Deputy Director
Audit Team Members

This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Paul J. Granetto
Garold E. Stephenson
Henry F. Kleinknecht
Robert A. McGriff
Kimble L. Powell
Kathryn M. Hoffman
Lynn S. Carlson
Beeson P. Cho
INTERNET DOCUMENT INFORMATION FORM

A. Report Title: Compensation to Presidents, Senior Executives, and Technical Staff at Federally Funded Research and Development Centers

B. DATE Report Downloaded From the Internet: 02/01/99

C. Report’s Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
   Inspector General, Department of Defense
   400 Army Navy Drive (Room 801)
   Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
   DTIC-OCA, Initials: __VM__ Preparation Date 02/01/99

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.