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JOINT COMMITTEE ON WAR EXPENDITURE

SECOND PROGRESS REPORT

"COST-PLUS" CONTRACT SYSTEM -
INTERIM REPORT.

17th December, 1941.

JOINT COMMITTEE ON WAR EXPENDITURE.

(appointed 3rd July, 1941.)

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JOINT COMMITTEE ON WAR EXPENDITURE.

SECOND PROGRESS REPORT.

COST-PLUS CONTRACT SYSTEM - INTERIM REPORT.

1. As indicated in its First Progress Report, the Joint Committee on War Expenditure has, concurrently with other investigations, inquired into the system of contract known as "cost-plus" and extensively used in connection with munitions expenditure.
2. Widely differing viewpoints on the merits and demerits of the system are from time to time published but, apart from general expressions of opinion, and the quotation of certain individual cases as examples of its working, no comprehensive survey of the cost-plus system has yet been made in Australia. To this task the Committee has addressed itself, and with technical staff to assist it in matters of accountancy research is making an exhaustive inquiry. This inquiry covers not only the experience of persons engaged in the initiation of the system and its control, but also the reactions of industry from the management and labour viewpoints. It includes investigation of the actual operation of the system in the factory itself, the efficiency of the methods employed in establishing an accurate cost, a comparison of munitions prices under this and other systems, and the factors influencing the margin of profit, or "plus", allowed. Finally, it is essential that the inquiry conclude with a survey of Australian experience in its effect on finances of manufacturers operating under the system, to show the amount of profit derived thereby, the relationship of such profit to capital employed, and comparison with profit derived under normal trading methods. This section of the inquiry involves a large amount of investigation of the accounts of firms and companies in various States, but is essential because it is the only possible way in which the cumulative effect of the cost-plus system on Australian industry can be

assessed.

3. These subjects together form a considerable task, and the Committee will not be in a position to bring down its full report for some time. It feels, however, that the Parliament should in the meantime be made acquainted with the scope of the inquiry; the extent to which it has progressed, and the opinions that up to the present stage members have been able to form.

COST-PLUS CONTRACTS.

4. The form of contract known as "cost-plus" was conceived to meet circumstances when a fixed price could not be obtained for the work. Such circumstances are so well-known as scarcely to need repetition, but may briefly be stated to arise from either the lack of opportunity to call for tenders, the lack of tenderers, the inability or unwillingness of the contractor to estimate the value of the work because of its unknown nature, or the reluctance to accept estimates, when made, as a reliable and fair basis of contract. It can be readily understood that as a great deal of munitions work had never before been attempted in this country, no knowledge existed here as to the cost of the new processes involved.

5. The system presupposes that the cost of the article will be ascertained, and a certain margin of profit added thereto. The usual basis for a cost-plus contract is generally one of the following:-

- (1) cost, plus a percentage of cost for profit;
- (2) cost, plus a fixed profit or management fee;
- (3) maximum or ceiling price;
- (4) target price.

Cost-plus-percentage-profit.

6. The first system, whereby the margin of profit is a percentage of the cost, is the form most widely used in Australian munitions manufacture, and has brought forth the greatest amount of criticism. It has been claimed to place a premium on inefficiency in that the greater the cost, the
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greater becomes the profit; further, that the temptation to inflate costs by fraudulent methods is ever present. It is on the contrary stated that, so long as manufacturing is carried out with maximum efficiency and costs carefully checked, and the margin of profit strictly controlled, no more economical form of commercial contract can be arrived at. For purposes of clarity, this type of cost-plus contract is subsequently referred to in this report as the "cost-plus-percentage" contract.

Cost-plus-fixed-profit

7. Where a fixed sum or a management fee is paid as the margin of profit, the argument that increased costs provide greater profits does not arise; but it can still be claimed that costs allowed may be higher than necessary, either through inefficiency or malpractice. This class of contract is used in cases where it is desirable to associate profit margins with unit production, as in the case of a company producing an aircraft engine at a profit of, say, £20 per engine; or where the management of special plant being operated by the contractor on a varied manufacturing programme can more readily be associated with an administration establishment than with a margin of profit based on production. The fixing of a profit on a basis of unit production is directly an incentive to increased output, and indirectly, therefore, has relation to possible reduction of cost.

Cost-plus-profit with maximum price.

8. Under this arrangement, an estimate of cost is made as accurately as possible, and a price which is not to be exceeded is based thereon. But if ascertainment of the final cost shows the original estimates to have been too high, the contractor receives only the actual cost plus the agreed margin of profit. If the original price has been gauged with any degree of accuracy, there are sound business reasons for the contractor to use efficient manufacturing methods, and

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keep down costs, which may otherwise exceed the stated price.

Cost with target price.

9. This type of contract aims to secure efficiency in production and reduce costs by providing a direct profit incentive to the contractor. A price, estimated as accurately as possible and providing an agreed margin of profit, is set as a target; any savings from production under this price are shared between the Commonwealth and the contractor, in proportions which increasingly benefit the contractor as the savings rise. Although no rigid rule has been laid down, the standard practice is that on the first 10% of saving the contractor receives 20% and the Commonwealth 80%. Where the saving is more than 10% but does not exceed 15%, the contractor receives 33 1/3% of the excess and the Commonwealth 66 2/3%. If the saving exceeds 15% it is shared equally between the contractor and the Commonwealth.

10. The original costed form of contract intended for munitions supply, introduced by the Principal Supply Officers' Committee, aimed at establishing the "target price" system. It provided for the production of a trial order to establish a cost basis; the trial quantity was to be priced on the basis of cost plus a margin for profit, usually 4% on cost. This price was to be the target for further production, and savings made were to be shared by the Commonwealth and contractor. Very few contracts of this nature have been signed, and the original intention to benefit from the experience of the trial orders does not appear to have been carried into effect.

11. The important benefit of the provision for establishing a target price lies in the fact that the contract is open to revision in respect of the margin of profit allowed, whereas an executed agreement providing a basis of cost plus a fixed margin of profit cannot normally be reopened.

NECESSITY FOR VARIATION FROM NORMAL TRADE PRACTICE

12. Much evidence has been taken by the Committee as to
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the necessity for the cost-plus system, which up to recent times was not widely known in this country. It is interesting to note, however, that in some ship repair work it has long been the custom of at least the Port of Sydney to work on this basis.

13. That some form of cost-plus system is necessary is the opinion of practically every witness associated with the war production programme. The novelty of many types of munitions to the Australian manufacturer, the inability to deal with varying conditions of manufacture on a rigid basis of contract, the completely unknown nature of some repair work until opened up in the workshop, and the necessity for immediate commencement of production, are given as reasons for the initiation of the scheme. With these views the Committee agrees; it is difficult to visualize, so long as the war lasts, how we can escape some form of cost-basis contracts for armaments and munitions involving manufacturing processes new to this country. As manufacturing capacity becomes fully taken up, and competition for orders is therefore eliminated, an extension of the system may be necessary.

14. Many witnesses expressed the opinion that, once costs have been established, the earliest opportunity should be taken to convert cost-plus contracts to a fixed price basis, but even on this subject there is considerable discussion. One witness, associated with a large manufacturing company, whose prices for munitions have been reduced with every successive order, until at present a rate one-third of the original price has been reached, maintains that a cost basis is still the method of price agreement most favourable to the Government. He contends, with some reason, that no company operating on its ordinary business methods would estimate on the basis of absolute cost and make no provision in its quotation for unforeseen contingencies.

15. The Committee considers that, once a cost has been well established by experience, there is no necessity for the
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continuance of the arrangement in its original form. Rather, it regards "cost-plus-percentage" an unwelcome but unavoidable form of contract necessary only in the initial stages of manufacture - a stepping stone to a more reliable form of contract. A fixed price should be sought as soon as the costing of early orders enables the range of justifiable prices to be gauged.

16. Munitions production is, however, a matter of such national concern that even on fixed prices some form of check of profit is desirable. The Committee is in agreement with the provision inserted in some contracts for munitions manufacture on a fixed price basis, that if costing establishes the rate of profit to be over a certain margin, the fixed price will be subject to reduction. There are many examples of manufacturing concerns whose interest in the war effort is not measured in terms of the profit to be made therefrom, and who will offer no objection to this form of control of profit margins on munitions manufacture; in other cases where profit is still the contractor's main object, no sympathy will be felt if the restriction now suggested be imposed upon him.

17. Briefly, then, the Committee considers that the earliest opportunity should be taken to break away from contracts based on cost plus percentage or other margin of profit and convert them to fixed price contracts with a cost check clause, - in effect to a variety of "maximum price" contract. This type of cost-plus contract is the one regarded by the Committee as the best available for munitions manufacture, for while it retains the costing basis inherent in the cost-plus system, it achieves maximum control of profits.

CONTROL OF COST-PLUS CONTRACTS.

18. Working, then, on the Committee's view that some form of cost-plus contract cannot be avoided in our munitions manufacturing programme, it becomes necessary to ensure that the operation of the system will achieve its desired object

of minimum cost of production and strictly limited profits. Each element of the contract must therefore be controlled.

These elements may be set down as:-

(1) cost of material		
(2) cost of labour		
(3) cost of overhead		-----
		Total Cost
(4) profit		-----
		Contract Price.

Standard Conditions of Contract

19. In an effort to achieve effective control of munitions cost, the Ministry of Munitions has laid down standard conditions of contract under which prices of munitions produced on a cost-plus basis are ascertained. These provide that payment to the contractor shall be the sum of:

- (a) production cost;
- (b) the remuneration, or profits as agreed upon.

The production cost is the sum of:-

- (a) direct material cost;
- (b) direct labour cost;
- (c) direct expenses;
- (d) indirect expenses;

after all discounts, rebates, commission, price reduction, and proceeds of sales of any secondary products, have been credited to the production cost account. The standard conditions also set out the expenses, losses and outgoings which shall be excluded from the production cost, such as income and profits taxes, interest on capital, interest on borrowed money, and such directors' fees etc. as are not considered reasonable. Some of the other items excluded are advertising, publicity expenses, bad debts written off, and losses from sale of capital assets. Subject to the approval of the Minister, expenses such as charitable contributions, contributions to trade associations, royalties, and excess award rates to employees are also excluded from the production cost. Separate records for each contract must be kept by the contractor and be readily available for examination by

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officers of the Commonwealth appointed for the purpose.

Cost Investigation Staff

20. To ensure that these conditions of contract are adhered to, and that production costs are properly arrived at, the Department of Munitions has established a cost investigation branch. In Melbourne this staff operates under the direct control of the Director of Finance; in Sydney and Adelaide, under the Local Boards of Area Management. This staff visits all munitions contractors and either checks the cost arrived at by the contractor or makes it up from his records. It may be added that these records, being kept primarily for the contractors' own use, often need considerable adjustment to bring them into line with the standard conditions of contract, familiarly known in the munitions world as the "Yellow Peril".

21. The Committee regards it as essential that the work of the costing staff be carried out with the utmost efficiency. In comparison with the total expenditure on munitions, or indeed with that portion of it which, in the absence of sufficient check, might easily be wrongly incurred, the cost of investigation work is small. In the Committee's opinion, it is under present conditions too small. There is a shortage of staff in Sydney and Melbourne and work is considerably in arrears. The standard of salary paid to the men is not commensurate with the value of the work performed, nor sufficient to retain them against the competition of firms with whom similar services are in great demand and with whom they maintain official contact. The Committee recommends that the costing section be augmented, and reorganised under a Controller of Costing responsible to the Permanent Head of the Munitions Department, and that salaries be fixed on a basis sufficient to attract and retain men of high ability in this specialised form of accountancy. Further, it is considered that the reorganisation of the staff will not be complete unless it includes technical cost investigators - men with knowledge of machine workshop practice both from the production and accountancy angles. Specific instances of the necessity for such knowledge
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in relation to costing work are given later under the various elements of cost (para 22-30).

In addition to departmental cost investigation, it is noted that the Auditor-General exercises the usual control over expenditure on cost-plus contract work.

22. Cost of Material.

The general policy on provision of materials is to encourage annexe contractors to make their own arrangements for supplies. Under present conditions of contract, it is laid down that the price allowed for material included in production cost is the ruling market price at time of consumption, so that in times when rising prices are almost certain, there is considerable inducement for the contractor to buy his materials on a large scale. The risk of loss by fall of market price is small, and profit on material alone may be large. It is admitted that the possession by a contractor of raw materials, at the time when he receives his order, enables production to proceed without delay, but it is questionable as to whether this desirable object cannot be achieved by other means, especially as the present system may be responsible for wanted materials being tied up prematurely. The Committee feels that the price of raw material as included in the cost of munitions to the Government, should be the cost to the contractor. If this variation of system tends to stop building-up of contractors' stocks, then the Government should itself obtain bulk supplies of materials on favourable price bases, ready for distribution as required.

23. Generally speaking, material records are such that their costing is not a matter of great difficulty from an accountancy viewpoint. The general question, however, of the proper use of materials charged to production is one for the expert consideration of the technical cost investigator rather than for the costing clerk. This, together with the problems of the economical use of materials, the recovery of waste and the consequent reduction of material costs, emphasise the necessity for the costing staff to include men with this specialised knowledge. Greater attention should also be paid to the provision of adequate records of material consumed.

24. Only in some instances are the accounts of sub-contractors

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whose product becomes a material or component for later process work, subject to costing investigation, and a definite weakness in the system exists at this point. The reorganisation of the costing branch recommended in paragraph 21 should make provision for a more intensive check of sub-contractors' costs.

25. The question of special discounts allowed to purchasers of munition materials is a matter to which the Committee has not up to the present given more than passing attention, but full investigation of this phase will be undertaken.

26. Cost of Labour.

Theoretically, all labour production cost can readily be ascertained, wages are fixed by awards, and wages sheets and cost cards complete the necessary record required by the costing authority. In actual practice, the charging of labour costs is most difficult to control. Only a technical cost investigator, with knowledge of manufacturing practice and capable of assessing the class of machine work required and the value of work performed, is able to state whether or not labour charges are correctly made up. Wrong classification of labour, and the consequent payment of unwarranted rates, use of lower paid labour and the charging of skilled rates therefor; provision of staff in excess of requirements; and working of excessive overtime are matters on which only an expert on production costing is competent to express an opinion. As in the case of raw material costs, the necessity for further control of labour charges is a necessary function of the reorganised costing section recommended previously. In matters concerning wage rates, the cooperation of an industrial inspector to assist the costing authority is suggested as a valuable aid.

27. Certain matters related to rates of wages now being paid in munitions establishments, and stated not to be in accordance with the policy of standard rates adopted by the Government, are now engaging the attention of the Committee, and will be reported upon later.

/Overhead

28. Overhead Expenses.

There will always be a difference of opinion in regard to expenses incurred under this heading, but after due consideration of the special features surrounding war contracts, the Standard Conditions of Contract set out very definitely what items of overhead may or may not be included in the production cost (see para. 19).

29. Many items of overhead properly chargeable to ordinary commercial activities are not incurred in Government contracts. For instance, to obtain Government contracts it is not necessary to incur expenditure on advertising, sales organisation and commission, nor does the question of adequate provision for bad debts arise. Such items are properly disallowed as overhead expenses in munitions contracts.

30. On several other items a difference of opinion exists. The extent to which depreciation should be allowed has been the subject of much discussion, and the disallowance as an overhead charge of interest on capital and on borrowed money is also much criticised. These matters are the subject of further inquiry by the Committee.

31. The proportion of productive wages incurred in civil as compared with defence work is generally accepted as a basis for apportionment of overhead charges in plants operating on both classes of work. The tremendous increase in defence output due to the stepping-up of one-shift work to continuous operation, has its effect on certain items of overhead in their relation to production cost. Sufficient example is provided by the citation of rent paid for factory premises used for production, such rent being usually apportioned on an area basis. The working of three shifts, with no extension of space, provides treble output on which basis overhead is consequently re-apportioned. The effect is to load war production with a charge three times greater than previously whereas no greater proportion of rent is attributable to the increased output. A similar anomaly

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can be shown to apply to directors' fees. It is felt that insufficient consideration is given to this phase by the application of the present rule of thumb method of assessing overheads and the desirability of variation of the practice is now under the Committee's consideration.

32. Special Contracts for Machining Tools and Gauges.

During the course of the Committee's inquiries, its attention has been directed to a special form of contract drawn up by the Directorate of Machine Tools (familiarily known as the "D.M.T. contract") for the manufacture of machining tools (loose tools for operation in machine tools) and gauges. Contractors are paid at the rate of 5/- per machine-hour, plus a machine allowance of 6d. or 1/- per hour for each £1,000 new value of machinery used according to whether the machine is over or under ten years old. The contractor also receives a profit or administrative fee of 10% on the 5/- machine rate plus the allowance. Where benchwork is also undertaken, the contractor receives 5/- per man-hour but no profit or administrative charge. In addition to the above, a contractor is entitled to recover the actual cost of materials and any charges made to him for outside services, but without further allowance for profit.

33. Preliminary investigations made by the Committee have shown that this type of costing, based apparently on a normal working week of 44 hours, is not sufficiently flexible to meet wartime conditions of continuous shift operation, and profits made by some contractors are greatly excessive. Although the proportion of expenditure is not large, the Committee considers that immediate attention should be given to a revision of this form of contract, and with this object in view it proposes to submit a report immediately its investigations, now well advanced, are completed.

Costing Control

34. Enough has been said in preceding paragraphs to indicate that the proper administration of munitions production on a cost-plus basis is completely dependent on an efficient costing system

system. The Committee is convinced that such a system does not now exist, and that reorganisation, as recommended in paragraph 21, is essential. Efficient costing provides the best gauge of efficient production. The matter should be treated as urgent, because every failure to achieve a minimum basis of cost involves the Commonwealth in further additions to its heavy expenditure programme.

PROFIT MARGINS

35. Once the cost of production has been established, the margin of profit remains to be fixed. There is general agreement that national difficulties should not enable munitions manufacturers to make profits over a reasonable rate. A further body of opinion considers that no profit on munitions for the defence of the country should be permitted. In the face of considerable variation of opinion as to what constitutes a "reasonable rate", its fixation cannot be regarded as any easy matter.

36. Though the Commonwealth will collect, through higher rates of taxation, a large portion of any excessive profits earned, the principle of low margins of profit should be insisted upon. Not even at the top end of the taxation scale are all excess profits collected. Further, the allowance of State income tax as a deduction in the assessment of Commonwealth tax payable by a company approximates one-sixth of the total profit, and reduces the tax assessable by the Commonwealth accordingly.

Profits on Annexed Contracts

37. Up to the present, profits made on contracts carried out in annexes have varied from nothing in some cases up to 6% in others. The largest proportion of contracts, however, provides a margin of 4% on total cost. This rate was arrived at in 1938, after the Industrial Advisory Panel had considered the matter. It can be safely assumed that at that time the 40-44 hour working week was taken as a basis for production, and it is known that the form of agreement then designed provided for the adoption of a target price after experience of trial orders. Only in a small

number of cases was this type of agreement signed, and in the great proportion of cases where profit is allowed for, the contract adheres to a rigid scale of 4%. The effect of this rate is further discussed in paragraphs 41-43.

Profits on other (Non annexe) Cost-plus Contracts.

38. A substantial proportion of the plant used in establishments manufacturing munitions, other than annexes, is supplied by the Commonwealth at a rental rate of 10% per annum. The contractor is allowed, as part of his overhead cost, depreciation on plant at rates permitted by the Commissioner of Taxation. The rate is 5% per annum for a normal work's week of one shift per day and rises to 10% for three-shift work. As most contractors work continuously, they are allowed to charge a 10% depreciation rate to production cost, and thus offset the Commonwealth rental charge. While this is not a matter of profit margin, the Committee in passing draws attention to the anomaly that under the above agreement a contractor operating three-shift work with hired Commonwealth plant receives a similar treatment to the contractor using plant owned by himself. The Committee also notes a difference in the administration of departmental instructions on this point as between the Sydney and Melbourne costing sections.

39. In a large proportion of non-annexe contracts based on cost, the margin of profit is not an overall percentage. It is generally considered that that portion of the work which demands skill and close attention is worth a higher profit margin than that allowed on the cost of raw materials. A common practice, then, is to allow a margin of $7\frac{1}{2}\%$ on the cost of labour and overhead, and $2\frac{1}{2}\%$ on raw materials and sub-contractors' work.

40. An analysis of 74 Victorian contracts yields the following result.

No. of Contracts.	On Materials and Sub-contracts. %	On Labour and Overhead. %	Overall. %
1	$2\frac{1}{2}$	5	
1	$1\frac{1}{4}/2\frac{1}{2}$	10	
42	$2\frac{1}{2}$	$7\frac{1}{2}$	
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No. of Contracts.	Rate of Profit Margin		
	On Materials and Sub-contracts	On Labour and Overhead.	Overall.
	%	%	%
2	-	-	5
3			3
5			7½
2			10

In New South Wales a greater proportion of contracts carry a profit margin of 2½% on materials and 7½% on labour.

41. The Committee has given considerable attention to these margins of profit. Evidence taken indicates that these may be regarded in the average as those generally applicable to engineering trades, in normal times and under normal conditions.

42. It is trite to say that war conditions are not normal. The working week is no longer of 40/44 hours; it is generally of 124 hours and upwards. Wages have been loaded and prices of materials have increased, both adding to production costs; volume of turnover has doubled or trebled. Therefore, a profit margin quite reasonable in normal times may, in the new circumstances, be unjustifiable.

43. It is with these facts in mind that the Committee has set out to ascertain the cumulative effect on the finances of manufacturing companies of continuous cost-plus work. The task is not easy. It involves considerable research in the books of a large number of companies, the computation in each case of the ratio of defence to civil orders, and a comparison of present profits with those made under pre-war conditions. Considerable adjustment of the figures ordinarily used in trading accounts is necessary before this basis of comparison can be fairly established. Finally, the ratio of profit to capital employed can be assessed.

44. This heavy programme of work is proceeding. A number of companies engaged in war production have complied with the Committee's request to produce trading and profit and loss /accounts

accounts and balance sheets, covering the accounting periods from two years before the war up to the present time. These accounts are being dissected, and a report on the findings will be made as early as possible. At this stage, the Committee can state no more than that the inflexible application, to present war conditions, of profit margins fixed in more normal times will disclose that some variation of existing practice will be found necessary, in order to establish a clear relation between the margin of profit, turnover, and capital.

MUNITIONS EXPENDITURE GENERALLY

45. Many aspects of munitions expenditure, either not related to the cost-plus system or only partially connected therewith, have come to the notice of the Committee. As this Report is intended to convey only the extent of progress made in investigation of "cost-plus" as a present accepted practice in munitions manufacture, comment on these other matters is reserved for a separate report.


CHAIRMAN

Senate Committee Room,
Canberra.
17/12/41.

ADDENDUM BY MR. C.A. MORGAN, M.P.

Analysis of the 'cost plus' system and the history of its inauguration reveals that its real basis is a desire for the preservation of capitalist economy and the spirit of private enterprise.

In order to maintain the fundamental principles of capitalist production, private industry was, up to a point, prepared temporarily to accept reduced profits as compared with profits enjoyed in peace time rather than risk possible losses in undertaking a new and exceptional type of business. In the larger concerns, however, increased turnover more than made up for any reduction of profits in the early stages. The 'cost plus' system in relation to war contracts was, therefore, in the nature of an insurance measure for private enterprise and a guarantee of its continuance on a more solid basis after the war, especially by the larger concerns which were enabled to establish costly annexes to their premises at the Government's expense. Moreover, as the equipment to most annexes was leased or loaned by the Government it will place the companies concerned in a specially favoured position and may lead to greater monopoly control in industry. These concerns now show a disposition to abandon the system after having established their costs at the Government's expense and the setting up of a fixed price at this juncture would naturally give them a great advantage over competitors or smaller contractors who did not earlier enjoy the benefit of the "cost plus" system. The period of amortisation of this equipment allowed by the Munitions Department is from five to six years and this will mean that the plant will, at the end of that time, have been entirely written off in the books of the Department. The usual life of some of these machines is up to 25 years and allowing for greater depreciation under war conditions it is obvious that the machines will have some value when the Government is finished with same and that the concerns which have them installed on their premises will have a distinct advantage over their competitors in business.

The question of the disposal of such equipment at the end of the war therefore calls for careful investigation and the Committee's special investigator is following the matter up.

That the "cost plus" system is based on self preservation by private enterprise, and that its dominant motive is the maintenance of profits even in war time, is borne out by the fact that where its investigation is difficult abuses involving wastefulness and inefficiency, and even fraud, creep in; the degree of such abuse is related to the extent to which the scheme can be policed, and this is well illustrated by the "D.M.T.'s" rate instituted in certain machine shops by the Director of Machine Tools and which allowed for the making of profits which have been described as 'fantastic' in certain cases.

Departmental officials who gave evidence made no attempt to justify this "D.M.T." rate of cost plus and could adduce no reason why same was inaugurated. In fact a long questionnaire for the elucidation of the D.M.T. rate submitted over two months ago by the Sydney Branch of the Munitions Department to the Director of Machine Tools, Melbourne, still remains unanswered.

This particular cost plus scheme therefore still remains a mystery and confounds cost investigators who have to interpret it on behalf of the Government.

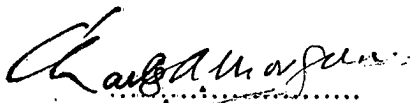
That the 'cost plus' system is unnecessary during war time is illustrated by the one outstanding example of a concern which set up its own annexe and is producing munitions at actual cost. In fact, it went further and presented the first sample order free to the Government.

Under the heading of "Costs" all the elements of production (including overhead and administration) are covered and this is all that should be necessary in the present crisis. Anything in the nature of unearned increment in war production is an unfair burden on the community and, in addition, must tend to divert the energies of the recipients of such increment from some useful avenue of employment in relation to the war effort.

There are, of course, some who contend that the incentive of the profit motive must be maintained even in war production. In this connection it is interesting to note that one Departmental witness stated that he did not know of a single instance in which the actual producers i.e. the workers in industry had participated in the "plus" or profit earned by war contractors, although he admitted that he thought such participation by way of a bonus or otherwise might prove an interesting experiment.

Another aspect of the system is that although it is contended that time is saved in production in the early phases of the scheme, this is more than counterbalanced by the congestion in Departmental channels caused by the investigation of cost plus arrangements which is having a retarding effect on war production. Significantly enough, this applies to private concerns only, and in the case of Government annexes the certificate of Departmental auditors is accepted. It is difficult to understand therefore why a magnificent and highly capitalised national undertaking such as Cockatoo Island Dockyard should have been handed over to a private concern operating on a 'cost plus' basis on Government contracts involving many millions of pounds.

In view of the infinitesimal amount of capital provided by the lessees, this constitutes a considerable unearned increment to the private shareholders. This, coupled with the fact that at least one prominent shareholder is associated with overseas shipping interests raises the question whether the arrangement referred to is in the best interests of the nation either during war time or in the post-war period.



(G.A. Morgan).

CANBERRA.
17.12.1941.