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Nixon Appointee Tied To '50s Irregularities

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1/2/73 54

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Los Angeles—In the early 1950s, the Air Force was unknowingly paying millions of dollars extra to Hughes Aircraft for weapons-control systems.

The parent Hughes Tool Co., owned by multi-millionaire Howard Hughes, was in ignorance, too. Hughes Tool, like the Air Force, was getting phony financial reports from the Hughes Aircraft Division.

The irregular practices set off an epic executive suite struggle in which one of the principals was Roy Lawrence Ash, the man picked by President Nixon a few weeks ago to be director of the Office of Management and Budget.

Ash's principal antagonists were several high-ranking certified public accountants who finally quit rather than go on working for him and his boss, Charles B. (Tex) Thornton.

Later, Ash and Thornton left, going on to found Litton Industries, the giant conglomerate now in disputes with the Navy over hundreds of millions of dollars in shipbuilding claims. Howard Hughes went on to become the most publicized recluse in history.

The struggle took place more than 20 years ago. But it is destined to be re-enacted here this spring, when there will be a retrial of a libel suit brought against Thornton and Litton Industries by Noah Dietrich, who for 32 years was Howard Hughes' chief executive officer.

The suit is but one of a half-dozen, dating back to 1959, that detail the key role played by Roy Ash in the revolt of the Hughes Aircraft CPAs. This maze of litigation had its bizarre aspects, and these drew sporadic publicity. But the involvement of Ash appears to have attracted negligible public attention.

The following account was reconstructed from records in Superior Court and the Court of Appeal, including trial transcripts, depositions, exhibits, lawyers' briefs and judges' rulings:

The story begins at the end of World War II. Roy Ash got out of the Army Air



ROY ASH

... linked to irregularities

Corps. He was 27. He had no college degree but he had served in a unit that was re-vamping military procurement along business lines. He entered Harvard's Graduate School of Business Administration and was graduated in 1947, first in his class. He then joined the statistical department of the Bank of America in San Francisco.

In Dearborn, Mich., meanwhile, Thornton had been jockeying for the chance to run Ford Motor Co. and had aroused hostility from certain other executives. He had found that his timetable for climbing the executive ladder didn't coincide with Henry Ford II's and was preparing, at age 35, for a parting that everyone concerned wanted to be amicable, outwardly.

The parting came in 1948, when Howard Hughes hired him on the recommendation of Ira C. Eaker, a retired Air Force general who was the Hughes Tool vice president in charge of Aircraft Division operations.

Executive titles are not always a reliable guide to the levers of power. They weren't at Hughes Aircraft. On the organization chart, Eaker was at the top. A fellow retired Air Force general, Harold George, had the title of general manager. Thornton's title was assistant general manager. Ash's was assistant comptroller

(although he is listed as "chief financial officer" in an entry he supplied for "Who's Who in America" and in the recent White House press release on his appointment to head the federal budget bureau).

The reality was much different. No one has been blunter about this than Noah Dietrich who, reigning from the peak of the Hughes Tool Co. pyramid, was the man closest to the Howard Hughes sphinx.

Eaker and George were mere "customers' relations" men, according to Dietrich. Himself a CPA, he said that neither of the generals was knowledgeable about accounting, or, for that matter, about corporate management. Eaker, in his own testimony, described his job as "liaison" with Hughes Tool.

As for George, he was "not running the plant," Dietrich said. In a memo to Dietrich in September, 1953, an expert in corporate management, Prof. Harold Koontz, spoke of the general as a sort of "pleasant spiritual leader who has furnished a symbol of unity..."

A setup of this sort "invariably sets the stage where some aggressive individual runs with the ball," Koontz said. "We know, of course, that Thornton has been this individual..." Thornton once acknowledged that the real power was his. "Most administrative and business management decisions were made in my office," he said in a letter to Howard Hughes.

Ash, on the organization chart, was subordinate to division comptroller William B. McGee. Actually, Ash was Thornton's man, reporting to him directly—not through McGee—several times each week. Thornton belatedly made it official in October, 1951, when he designated Ash "acting comptroller."

Long before this, Thornton had put Ash in charge of all accounting at Hughes Aircraft although Ash is not an accountant. "I was in charge of accountants," Ash has said. Among them were the CPAs who eventually revolted.

See ASH, A10, Col. 1

ASH, From A1

One of them was James O. White, chief accountant in the comptroller's organization throughout 1951. An authority on aerospace accounting, who has taught the subject at four universities, he was responsible for the general ledger and supervised 300 men through six department managers.

During the summer of 1951, White began to notice irregularities in record keeping. He reported them to McGee, his nominal boss. Initially, McGee thought that the irregularities "could be errors, . . . but gradually he became convinced, as we became convinced, that they were deliberate," White has recalled.

White kept on complaining to McGee until it "became obvious that this was doing no good." Finally, McGee told him that "Roy Ash was now in charge" and that he should "accept his orders."

For a time, White did just that, to the point of becoming an admitted accomplice in accounting practices he regarded as improper.

"Ash is one of the world's great talkers," White has said. ". . . he would go into the oratory . . . that we weren't ever really cheating the government . . . and there were even times when I went away believing it—momentarily."

The spell didn't last, giving way finally to violent arguments not only between Ash and White, but also between Ash and White's superior, C. E. (Bill) Ryker, manager of accounting.

Some of these arguments concerned Ash's orders to over-credit inventory accounts, that is, to record larger withdrawals of materials than actually had occurred. White testified that the appearance of authentic—the appearance of authenticity of false affidavits supporting applications to the Air Force for payments for work completed.

White said Ash told him that over-crediting "will enable us to get more money from the Air Force." Eventually, Hughes Aircraft repaid \$43 million to the Air Force.

By over-crediting inventory accounts, the division also caused a fictitious inflation in the costs of selling the weapons system. The result was a reserve of profits hidden in the inventory accounts, which enabled the division to claim to the Air Force that it was operating within the 10 per cent profit limit agreed to in the contract.

The process caused some accounting nightmares. Certain inventory accounts were showing "credit balances" that more went out than was there—a signal to accountants that something is wrong. This went on for months on end, meaning, said White, "that either somebody is deliberately putting wrong entries" in, "or is completely ignoring what might be actual error."

Ordered 'Impossible'

White said he told Ash it would be impossible to make additional entries in such accounts. "Make the entry anyway," he said Ash told him. "That was it."

Under questioning by attorneys for Thonton, White said Ash made it clear he was carrying out Thornton's orders. If White or other CPAs would say, "Well, gee, he is not the boss," Ash would counter with, "Oh, yes, he is," or, "He is really running this show," White said.

In the monthly reports to Hughes Tool, White testified, Ash turned around 180 degrees and told White to post entries that would cover up the over-crediting and thereby make the Aircraft Division's profit performance look brighter. Without a piece of paper to support it, White said, Ash might order an entry debiting inventory and crediting cost of sales.

"They were entries that were just false entries," White said. Ash's cost accountants handed them to White's people, who posted them. "I have heard Roy Ash say, 'Make an entry debiting so-and-so and crediting so-and-so,'" White said. "Half-an-hour or two hours later or so the entry was in my hands, and they were just figures needed to balance a predetermined profit."

White said Ash turned away protests by saying about such entries, "You've got to make them. Thornton promised the Tool Co. he'd make so much money this month and we're to make it. So here's the entry . . . you put it in the books."

White obeyed. On many occasions, he and Bill Ryker "argued rather violently that it wasn't right," but Ash prevailed. He said "that we shouldn't be questioning these things, that . . . they weren't our responsibility . . . that I ought to take my orders like a good company man does and like he did." White also recalled Ash saying, "You should be loyal to



CHARLES B. THORNTON
... a Litton founder

the division" and to him and Thornton. Loyal to the division over the parent company? White couldn't swallow that.

Denied in Court

In a courtroom appearance Ash denied White's charges. He testified that he had never been ordered by Thornton to have improper entries made and had never issued such orders.

Ash was asked if he had ever made a statement that he himself had objected to the practice at Hughes Aircraft of "hiding profits in inventory." His answer was, "Never made the statement."

Lawyer Harold Rhoden then tried to show that Ash had impeached himself because the answer was inconsistent with deposition testimony in which they had had this exchange, slightly abbreviated here:

"Q. Did Mr. White ever say that he objected to hiding profits in inventory or use that expression?"

"A. He may have objected to me just as I was objecting on the same points . . ."

"Q. . . . you also objected to it?"

"A. I did . . ."

In a second deposition, Ash affirmed those answers.

But confronted with them in court, he said, "I think I was confused . . . tricked . . ."

Gorden MacDonald, an accountant who actually made the disputed entries, denied in court that he had ever heard White or Ryker arguing with Ash against over-crediting the inventory accounts. MacDonald was reminded that in a deposition earlier, he had not only heard such arguments, but had quoted Ash as saying "You run the general books. Cost people will worry about the cost accounting. Keep out of this function."

"His memory refreshed, MacDonald said it was his deposition testimony that was correct. In this way, he became a reluctant witness against Ash.

Sometime in 1951, Ash ordered an end to physical control of the inventory, in which storekeepers in locked, caged areas issued parts in exchange for requisitions. He replaced this system with another in which the parts were made accessible to the workmen, who then were supposed to fill out requisitions and drop them in a specified box. But after a time a check showed that far more parts had been taken than had been requisitioned.

The check demonstrated the lack of an adequate inventory control system which, White said, "always results in excessive usage of parts," and, as a result, higher costs to the ultimate customer—in this case, the

White said Ash met the Air Force.

situation by bringing in a large number of his cost-accountants nights and a weekend "to cover up the shortages."

Working overtime under Gorden MacDonald's supervision, White told Thornton's lawyers, the accountants made a list of the parts for which requisitions had not been submitted, then prepared thousands of new ones.

Clocks Set Back

These "midnight requisitions" were stamped by time clocks set back to various dates and were signed by Ash's men, White said.

"The people deliberately dirtied them, threw them on the floor, wrinkled them, handled them with dirty hands in order to make them look as though they had been prepared and processed by shop personnel," White said. "They were complete forgeries."

White said he protested to Ash that there had been a "proper way" to handle the problem: "prepare inventory shortage reports and write the inventory shortage off." "What did Ash say?" White was asked. "He said he wanted to do it this way."

As for the affidavits to the Air Force, White had seen some that overstated the percentage of work completed. Ash, White said, "admitted" that inflated percentages were being reported "so we can get the money . . . Tex wants to get the money, and we're to do it in any way we can to get

it." Ash testified he had signed some of the affidavits.

Sometime in mid-1951, White, Ryker and three other CPAs became convinced that further complaints to Ash were futile because he, as White put it, was "merely a henchman . . . for Thornton"; that Ash and Thornton both had to go, and that if they didn't the CPAs would quit rather than jeopardize their professional and personal reputations any longer by allowing themselves to be used to defraud the government.

The CPAs secretly contacted Frederick J. (Jack) Strickland, who only recently had gone to work for Roy N. Sherwood, comptroller of Hughes Tool's West Coast operations. During the first half of 1951, Strickland had been in charge of a team for Haskins & Sells, an independent firm of CPAs, that audited the Air Force's records.

Records Smuggled Out

At the time of the audit certain crucial records were missing — now, however, Strickland got these and other records from the division CPAs, who smuggled them out.

Strickland relayed his preliminary findings to Sherwood and Executive Vice President Noah Dietrich, who was getting additional indications of irregularities from Malcolm Devore of Haskins & Sells and from A.V. Leslie, Hughes Tool's vice president for finance.

Dietrich sent Strickland to the aircraft plant to gather more evidence. He also called in Thornton to tell him that the CPAs, orally and in writing, had reported they were being required to credit inventory accounts that already had credit balance and to engage in other improper accounting activities.

Thornton told him, Dietrich testified, that the Air Force contract limited profits to about 10 per cent and that the books, as a result, were indeed adjusted as necessary to indicate that rate of profit. "He admitted it," Dietrich testified.

As for himself, he said, he was "concerned and alarmed" to learn that inventory accounts were being vore-credited—a practice Thornton had kept secret from him. As a CPA, Dietrich said, he recognized the ultimate impact to be fraudulent: ". . . you are improperly borrowing money from the Air Force on which you are not paying interest."

By September, the CPAs had assurances that Ash and Thornton would be fired. The assurances were taken seriously. Dietrich, after all, was the one man with access to the elusive Howard Hughes even if he lacked authority on his own to fire the executives.

In the interim, the CPAs were asked to stay on. They did so, expecting Ash and Thornton to be fired quickly so that they could, in White's words, "come back and straighten out the mess." But a hitch developed: Hughes refused for almost two years to give Dietrich the firing authority he wanted.

In October, Dietrich said, he confronted Thornton with a copy of a request of a progress payment backed by a false affidavit on costs Thornton contended that all defense contractors were doing the same thing and he saw nothing wrong with it, Dietrich testified. Dietrich ordered a halt to the practice.

On Nov. 1, Ash, having learned of the CPAs' contacts with Strickland, barred him from the plant.

On Dec. 4, Haskins & Sells gave Dietrich a summary memo listing "observations . . . based on statements made to us by Aircraft personnel" and on the condition of division records. The memo was harsh on Thornton, expressing the belief that he "is unprincipled and ruthless and is universally disliked; cannot be trusted." Ash, the memo said, "appears to be rather deeply involved, directly or indirectly, in the deception."

The memo also registered the belief that division management regards its interests as "separate and apart" from Hughes Tool; discloses a little information as possible to "outsiders," including Gen. Eaker; employs "obfuscation" as the device that "best serves their policy of nondisclosure," assumes that "any desired objective justifies any necessary means."

Clean Audit Refused

Finally, Haskins & Sells warned that the records were in a state that it might have to qualify its certification of them (ultimately, the firm did refuse to give the division a "clean" audit; the Mellon National Bank then refused to renew a \$35 million loan.)

On Dec. 20, Bill Ryker, in a memo to Comptroller McGee, said that a three-month effort to find the basic defects in the cost-accounting

system had isolated 23 of them, including an apparent attempt to "pad" certain costs. He looked forward to remedying the situation "if we receive the promised cooperation and authority."

He never got it. On the first Sunday in January, 1952, Ryker and White drafted an "ultimatum" letter to Dietrich. The next day, Jan. 7, they told a Haskins & Sells official that they intended to resign en masse.

The "ultimatum," delivered on Jan. 11, had five signers—Ryker; White; J.N. Barker, supervisor of fixed price cost accumulation; H. J. Johnston, supervisor of the general ledger section, and cost analyst H. C. Waken. The letter briefly recited the irregularities and recalled the September promise of swift corrective action.

If the delays continued, the five warned, they would resign rather than "jeopardize our reputations as certified public accountants."

Dietrich called the CPAs in. He testified they told him the Air Force had been overcharged millions of dollars by "improper practices." One of them told him, "You can't rule out the possibility of fraud. . . ."

Dietrich asked the CPAs to stay for at least a month or two, admitting he still lacked the authority from Howard Hughes to grant their one implacable demand: to fire Ash and Thornton. Dietrich couldn't do it.

'Place to Hide It'

Dietrich summoned Thornton for more talks. Finally, he said, Thornton told him:

"Noah, I want to tell you in confidence that we are actually making more than 30 per cent on this contract, and in order to keep it, we are going to have to hide it some place, and the best place to hide it is in the inventory account."

As for the affidavits that made excessive claims on the Air Force, Thornton "didn't see anything wrong" in the practice, saying it was "generally indulged in by military contractors," Dietrich testified.

He confronted Thornton with the CPAs' evidence of fake financial statements made by the Aircraft Division to Hughes Tool. "He didn't deny it," Dietrich said.

Thornton was also told of the CPAs' threat to resign, and "took the position that the plant had autonomy and that I should keep my hands out of it," Dietrich continued.

Gen. Eaker asked Ash to bring the five CPAs to his office.

Later in January, Eaker, who along with Gen. George was credited with "good personal integrity" in the Haskins & Sells memo, talked to the men, one at a time. It was to no avail. The five sent Eaker resignation letters on Jan. 23, 1952.

"I am unable to accept your request that I be a 'good company man,' since this term was used to indicate that I was to be loyal to the division and its policies rather than being loyal to the Tool Company," James White told Eaker.

Two more CPAs followed, including H. Bradshaw, supervisor of the Aeronautical Cost Group. "Inasmuch as the use of the word 'fraud' is apparently ill advised," he said in a memo to Barker and Ryker, "I will say only that the clean and workable accounting system it was our end purpose to effect is not considered desirable by top management."

Thornton and Ash stayed on. Dietrich, trying to bounce them, tried to get permission from Hughes. No response.

June brought a counter-thrust: Thornton, Gen. George and scientists Simon Ramo and Dean E. Wooldridge sent a letter to Hughes through Gen. Eaker. Dietrich, they charged, was trying to "seize personal power without regard to the consequences to this company" and had engaged in a "plot" that could have "seriously injured our national security."

Dietrich and Thornton, meanwhile, were having another dispute about refunds to the Air Force.

Refund Made

Dietrich decided early in 1952 that he wanted a "token" refund of \$5 million made, pending a determination by Haskins & Sells of the true amount owed. Thornton, he said, resisted.

Early in 1953, an Air Force contracts official, Barry Shillito, now an Assistant Secretary of Defense, threatened legal action if a refund were not made. In the summer about \$5 million was actually paid over. Thornton claimed the refund was voluntary. Dietrich said it wasn't.

The audit was completed by Haskins & Sells, that fall, on Oct. 31, 1952. The report said Hughes Aircraft had overcharged the Air Force by

\$43.4 million; Hughes paid the balance during late 1953 and early 1954.

In mid-1953, by Dietrich's testimony, he had finally gotten Howard Hughes' permission to tell Thornton and Ash to resign or be fired. They resigned—they said voluntarily. Thornton testified that Dietrich even asked him to withdraw his resignation, stay with the company, and "be a candidate to succeed him." Dietrich, who was 65 at the time of the resignation, denied he had said anything of the sort.

Ash and Thornton, as has been noted, went on to found Litton Industries. The litigation that put the Hughes Aircraft case on the public record was born at Litton.

A man named Emmett T. Steele participated with Ash and Thornton in the founding. In 1959 Steele filed a suit accusing Litton Industries and Thornton of fraud in depriving him of certain stock allegedly promised him in an oral contract.

A jury awarded Steele \$7.6 million. The case was appealed and remanded for a new trial. The upshot was a settlement of \$2.5 million.

In 1962 in preparing for the trial that led to the \$7.6 million award, Steele's lawyer, Harold Rhoden, took a deposition from Dietrich. Answering questions as a prospective witness, Dietrich recounted the CPAs' revolt episode and told of other matters involving Thornton.

In December of that year, Thornton charged in a press release that Dietrich had been "maliciously defamatory" in his deposition. Thornton filed a \$40 million slander suit.

Called False

At the same time, Litton sent a letter to 12,000 employees, accusing Dietrich of "irresponsible and malicious attacks" and denouncing as "completely false" a charge attributed to Dietrich that the Air Force had been overcharged several million dollars as a result of improper accounting methods at Hughes Aircraft.

The Thornton slander suit was rejected by the Superior Court of Los Angeles and then by the Court of Appeal in September of 1966. Dietrich, meanwhile, had filed a libel suit against Litton and Thornton, in which he asked 40 cents in actual damages and \$1 million in punitive damages. This action was tried in early 1968 in Superior Court.

Awarded \$6 Million

After a two-month trial, a jury awarded Dietrich punitive damages of \$5 million against Thornton and of \$1 million against Litton.

Judge Bayard Rhone, who had said he would set aside any verdict that was not what "I think is an obvious correct decision," set it aside.

He said he would grant a motion for a new trial, and did when one was made later.

Rhoden, appealed with a 531-page brief accusing the judge of "unabashed bias and patent prejudice" against Dietrich.

The Court of Appeal, in a decision in November, 1970, said that Rhone, who is now dead, erred in overturning the jury verdict. But the court ordered a new trial, saying it could reverse a motion for a trial "only when, as a matter of law, there is no substantial evidence to support a contrary judgment."

The new trial may begin in April.