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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, DC 20548

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B-173205

DEC 29 1975

The Honorable William Proxmire
Chairman, Subcommittee on Priorities
and Economy in Government
Joint Economic Committee



Dear Mr. Chairman:

This is in reply to your request dated January 27, 1975, for a full investigation of the procurement of foreign and domestic petroleum products by the Department of Defense over the last several years.

Our review was made primarily at the Defense Supply Agency and the Defense Fuel Supply Center, Cameron Station, Virginia. These activities are responsible for the procurement of bulk petroleum for the military services. We examined contract files, reports, and other agency records; procurement policies and procedures; and data submitted by contractors. We also discussed pertinent matters with knowledgeable officials.

Your primary concern seemed to address the question of whether procedures followed by the Agency and the Center assured the procurement of needed petroleum products at reasonable prices. We concluded that although the Center had made a genuine effort to procure petroleum products at the best available prices, the procedures followed in many instances had not given the Center adequate assurance that the prices paid were fair and reasonable.

Until early 1973 the Center procured domestic petroleum needs through formal advertising--the preferred method of procurement. It is assumed that formally advertised procurements will cause the greatest degree of competition and the lowest price available in the market place. However, procedures followed by the Center, which allowed the suppliers to bid on a part of the total quantity required and by lots of various sizes at succeeding higher prices, might have limited the effectiveness of competition in providing reasonable bid prices.

Because bids received in response to invitations issued in early 1973 did not elicit offers to provide enough fuel to satisfy requirements, the Center was forced to negotiate contracts with suppliers. Market price data reported

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by trade publications, primarily Platt's Oilgram, was used for evaluating the reasonableness of prices offered during 1973 and 1974. The data represented a mixture of actual prices paid by other customers, prices asked, and offers made, generally without identification of sales volume. We concluded that this data was not adequate for evaluating the reasonableness of proposed prices, particularly during a critical fuel shortage period.

Oil companies did submit market data for the early 1975 procurements, after they were granted exemptions from providing supporting cost or pricing data required by Public Law 87-653 because prices offered were based on market prices of commercial items sold in substantial quantities to the general public. This data included various combinations of total average sales, actual sales, intracompany transactions, and quoted prices, all covering a variety of time periods. The data showed there were commercial sales in substantial quantities of the products, or similar products, acquired by the Government. We concluded, however, that there was not enough data to insure that the prices paid by the Government were based on market prices paid by comparable customers on recent transactions. Particularly, we believe price and quantity information should have been obtained for recent large sales to other customers.

We reviewed a sample of the data submitted for the July 1975 procurement cycle and concluded that the data submitted by the contractors had improved little over that submitted during early 1975.

We also concluded that the economic price adjustment clauses included in 65 of the 68 contracts awarded in the first quarter of 1975 could result in questionable price adjustments.

We believe competition was adequate to insure reasonable prices for the January to June 1975 negotiated contracts for foreign petroleum requirements. Evaluation of procurements for prior periods was not possible because of incomplete records.

On the basis of our audit work since the Truth-in-Negotiations Act, Public Law 87-653, was passed in 1962, we believe that it has generally been effective in providing procurement officials with a sound basis for negotiating fair and reasonable prices when competition is lacking. However, we are still finding that procurement agencies are having problems carrying out the act.

BACKGROUND

The Center procures and manages bulk petroleum products for the military services. Until 1973 the Center was able to procure adequate supplies of petroleum products for domestic requirements by formal advertising. Between early 1973 and December 1974, however, the Center experienced a number of serious problems in obtaining petroleum products. Traditional suppliers would no longer compete for contracts because of fuel shortages, uncertainties in the crude oil market, and Government price controls.

The Defense Production Act of 1950 had to be invoked in late 1973 to require oil companies to supply petroleum products for the Government's needs. The act, as amended, authorizes the President to require acceptance and performance of defense contracts or orders, in preference to others, by any person he finds capable of their performance.

In January 1974 the Emergency Petroleum Allocation Act became effective. Under this act the Federal Energy Administration designated the firms that would supply fuel to the Department of Defense, generally on the basis of 1972 supplier-purchaser relationships. The emergency allocation system eliminated competitive procurements.

The changes in the fuel supply situation had a considerable impact on prices paid by the Department of Defense for fuel. Between 1972 and 1975 the average cost for a gallon of fuel almost tripled. The procurement process was also adversely affected because noncompetitive negotiated procurements were more complex than formal advertising. The reasonableness of prices offered must be established by extensive analysis of all available cost or market data and negotiations must be held with contractors to establish prices. The additional requirements for processing negotiated contracts increased the workload for the Center's procurement personnel who had limited experience with this type of procurement.

ADVERTISED PROCUREMENTS

We examined the formal advertising procedures followed by the Center until 1973 in awarding contracts for petroleum products. We wanted to determine whether the procedures followed resulted in obtaining needed fuels at fair and reasonable prices. We found that the use of two special techniques, block bidding and multiple awards, as well as a low

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level of industry interest, limited the effectiveness of competition in providing reasonable bid prices.

A major determining factor in obtaining a fair and reasonable price is the extent of the competition. The Armed Services Procurement Regulation does not contain criteria for evaluating the adequacy of competition for advertised procurements. For negotiated procurements, however, it states there should be two or more offerors, each capable of supplying the total requirement and each contending for a single award. For the petroleum procurements examined, multiple awards were made because no single bidder could supply the total quantity needed.

For example, in procuring JP-4 fuel for the first 6 months of fiscal year 1973, 68 of 82 firms bidding received awards and for the second 6 months, 65 of 68 bidders received awards. For other products the percentage of bidders receiving awards ranged from 33 to 82 percent.

The total quantities offered by all bidders compared with the quantities required for successive procurements indicated lessening interest on the part of refineries in competing for Government business, particularly for jet fuels. For example, for the procurement in the fall of 1972 the total quantities bid were only 120 percent of the requirements for JP-4 and 130 percent for JP-5. The bids received for jet fuel in the last advertised procurement in early 1973 covered only about 60 percent of requirements, and almost all bidders received contracts for the entire quantities bid. Bidders were also allowed to bid on a series of product lots at different prices. Thus, a bidder might receive several orders at different prices for the same product under the same advertised procurement. For example, in a procurement of JP-4 fuel, one company submitted bids for five separate lots of 38.6 million gallons at prices ranging from .0645 to .0755 a gallon. He received orders for four lots.

Suppliers generally offered the lowest price on the first lot and increased the unit price on each succeeding lot. The more lots purchased from a supplier, the higher the average unit price paid.

The practice of bidding on a series of lots, called block bidding, has been used for formally advertised jet fuel procurements since the early 1960s. The Center has justified

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block bidding on the basis that increased quantities were offered and that more competition resulted. A Center official said that unit prices were increased on each additional lot offered to the Government because the additional quantities represented part of the refineries' output which could have been sold to other buyers at the same or higher price than the price bid on the first lot.

The multiple awards and block bidding procedures assured most firms of an award for some or all of the product offered. Since bid openings were public, bidders were generally aware that limited quantities were being offered and that most bidders were receiving awards. Thus, we concluded that there was little assurance that all firms were actively competing for Government contracts. We believe that the opportunity for collusion is enhanced under any competitive procurement where adequate competition does not exist. However, we did not find any evidence of collusion on the procurements reviewed.

In view of the limited competition the Center should have considered using negotiated procedures.

Center officials told us that they believe the petroleum market conditions would not be conducive to the use of formal advertising in the foreseeable future. The Center recently canvassed suppliers and found they would not respond to an invitation for bids.

DATA USED FOR NEGOTIATING PRICES
FOR 1973 AND 1974 PROCUREMENTS

We examined contracts negotiated in 1973 and 1974 to determine whether competition was adequate to insure reasonable prices and whether the Center obtained enough data to evaluate prices for noncompetitive awards. We concluded that competition was limited or nonexistent and that the Center did not have enough data to make a thorough price analysis to insure that the prices paid were fair and reasonable.

The Center solicited competitive proposals in early 1973 for the fuel it previously attempted to obtain by formal advertising. Suppliers responded with offers for about 355 million gallons, but this was considerably short of the quantity needed. Nevertheless, the proposals were considered competitive, and prices were evaluated on the

basis of data contained in Platt's Oilgram and prices paid on prior advertised contracts.

The total quantity offered by all interested suppliers, which was less than one-half of the amount needed, did not provide enough competition to insure reasonable prices. Also, the limited competition for the previously advertised procurement and the data in Platt's Oilgram did not provide an adequate basis for price evaluation.

The additional quantities of fuel needed to satisfy requirements for the period July through December 1973 were obtained from a small number of suppliers under a voluntary allocation program and mandatory allocations issued under the Defense Procurement Act of 1950. About 700 million gallons of fuel were obtained under these two allocations, using noncompetitive contracts. However, prices quoted by suppliers were accepted without further negotiation. Procurement officials said that oral negotiations were conducted before written offers were received and that price reductions were obtained. We found no evidence of such negotiations in the contract files. The Center determined that the quoted prices were reasonable by comparing them with estimated prices for on-the-spot (one-time, single purchase/delivery), cargo purchases on the gulf coast as shown in Platt's Oilgram. In our opinion this data did not provide the agency with an adequate basis for determining the reasonableness of prices offered.

In 1974 all contracts were negotiated with suppliers under mandatory allocations issued by the Federal Energy Administration. Although the contracts were subject to the requirements of Public Law 87-653, the agency continued to use market price data from industry publications, primarily Platt's Oilgram, for evaluating the reasonableness of prices. Contractors were not required to furnish cost or pricing data or market price data to justify an exemption. In the latter half of the year, contracting officials also used Civil Aeronautics Board reports showing prices of kerosene-based fuel to airlines for developing prenegotiation objectives.

We do not believe that there was enough data available to contracting officials to insure that any of the prices negotiated in 1973 and 1974 were fair and reasonable. The agency should have required oil companies to submit cost or pricing data or to submit market price data to justify an exemption from the cost or pricing data provisions of Public Law 87-653 and to demonstrate the reasonableness of prices offered.

1975 MARKET PRICE EXEMPTIONS

We reviewed the data which the Center used as a basis for granting oil companies' exemptions from submitting certified cost or pricing data in support of proposed prices as required by Public Law 87-653. We believe the exemptions were proper to the extent that the products acquired were the same as, or similar to, products sold commercially in substantial quantities. But the market price information obtained, from either the contractors or elsewhere, was not complete enough to insure that prices paid were based on suppliers' market prices paid by comparable customers on recent transactions. In many cases the data that was obtained from the contractors was not complete or current. Further, some reliance was placed on price information contained in industrial and Government publications, which, we believe, was of questionable value for analyzing prices.

In September 1974 the Center notified the petroleum suppliers designated by the Federal Energy Administration that they must submit certified cost or pricing data with their offers or submit the market price exemption form (DD 633-7) with market price data to support their claim. Initially, most oil suppliers claimed the exemption but refused to supply any market price data. Between September 1974 and January 1975, there was extensive formal and informal correspondence between the Government and the oil companies over the refusal to submit the data.

On November 27, 1974, Assistant Secretary of Defense, Mendolia, wrote to the Chairman of the Cost Accounting Standards Board seeking waivers of the requirement for oil companies to comply with cost accounting standards. The Secretary stated that while Defense had hopes of obtaining sufficient data to establish market prices, thus making the waivers unnecessary for later procurements, the needed data could not be obtained for a substantial number of procurements necessary by December 16, 1974. Two specific requests were submitted for waivers in connection with contracts for procurement of fuel for delivery overseas. These requests and a subsequent request for reconsideration were denied by the Cost Accounting Standards Board. Eventually, 61 of the 63 companies involved in sales of oil to the Department of Defense for domestic use submitted some cost or market price data.

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In January, February, and March 1975, the Center awarded 68 domestic contracts for petroleum products amounting to about \$671 million. The Center determined that all 68 non-competitive suppliers should be exempted from requirements for supplying supporting cost or pricing data and from complying with cost accounting standards, because prices offered were based on market prices of commercial items sold in substantial quantities to the general public. This determination, as well as the reasonableness of the prices offered, was based on an analysis of market price data submitted by 52 of the companies, along with supplementary analysis of price data appearing in governmental and industrial publications.

Regulations permit the use of data other than that provided by the contractor in question to establish the existence of substantial commercial sales. The regulations indicate, however, that actual sales price information should be obtained from each contractor.

The 52 contractors that did submit data submitted 430 pages of diverse information not easily subject to evaluation. The data consisted of various combinations of total average sales, selected average sales, actual sales, and internal transactions or quotations. Of the 42 contractors submitting data on the JP-4 jet fuel contracts, only 26 submitted identifiable actual sales data. Further, the data submitted covered a variety of time periods between January and December 1974. Few, if any, submissions could be characterized as current, accurate, and complete sales data.

Although average prices and selected actual sales may be useful in any pricing analysis, we believe that comparing prices offered for required bulk quantities with comparable commercial sales would provide the best measure of price reasonableness. The contractors' supporting data, however, contained no bulk commercial sales approximating or exceeding the required quantities.

We were told that the sales data obtained from the contractors was verified by comparing it with information contained in industrial and Government publications. The publications used were Platt's Oilgram, Oil Buyer's Guide, Civil Aeronautics Board reports, and Federal Power Commission reports. We reviewed a number of these to determine the contents but did not verify the information contained in them. Platt's Oilgram was the publication most frequently relied on. The Oilgram is a daily publication providing detailed information on prices quoted and actual sales.

The Defense Supply Agency, however, criticized the Oilgram's use as a primary price analysis source, because it did not contain an adequate number of comparable bulk commercial sales. A Platt's Oilgram official said that the information was gathered by telephone surveys and that suppliers often initiated the calls to Platt's. Platt's did not audit or verify the information it received. There is no assurance that the information is current, accurate, or a representative sample of independent sales transactions.

In commenting on our evaluation of the market data oil companies submitted and used in pricing procurements from January through March 1975, Center officials said that all companies had submitted usable market data on the July 1975 buy and that the quality of the data was better than that on the previous buy. We reviewed the data submitted by 15 of the 62 companies involved. This sample included eight major suppliers.

We found that the 15 companies submitted various combinations of average sales, actual sales prices, and posted prices (offers to sell). There was no identifiable actual sales data, however, among the market data submitted by four of the eight major companies and five of the remaining seven companies. We therefore concluded that the market price data received from contractors had not shown any marked improvement.

Recommendation

We recommend that where companies are exempted from furnishing cost or pricing data on the basis of substantial sales to the general public, the Secretary of Defense take the necessary action to obtain enough data to adequately establish that the prices offered are based on market prices paid by comparable customers on recent transactions. Specifically, each supplier should be required to provide price and quantity information for every bulk sale during the past 3-month period. Intercompany sales should be separately identified. If adequate market data is not obtained, then the market price exemption would not be available, and cost or pricing data, and compliance with cost accounting standards, would have to be obtained.

PRICE ANALYSIS AND FILE DOCUMENTATION

We reviewed the Center's price analysis process in detail. The Center analyzed the data submitted by the contractors and the data from industry and Government publications. This work

was adequately documented. The price analysis would have been more effective, however, had the Center required the contractors to provide detailed data on actual sales of comparable quantities to commercial customers.

Before analyzing offered prices on a contract-by-contract basis, the contracting officers developed market price ranges for each procuring area and product line. A contracting official said the purpose of establishing market ranges was to give the contracting officers a close fix on the market price of a given type of product in a given area. The Center divides the United States into four procuring regions: east, west, gulf coast, and inland. Each of the 68 suppliers was placed into one of these regions. Data obtained from the contractors was compiled to construct a market range of prices where substantial sales of petroleum products were made to the general public. Contracting officers compared the sales data with pricing information available in various industrial and governmental publications.

After the market price ranges were constructed, the contracting officers performed price analysis on a contract-by-contract basis. If the military product was about the same as a product sold commercially, a direct comparison of offered prices and market prices was made. If the military product was not the same as a product sold commercially, the offered prices for the product were compared with market prices for the product's components in a relative ratio. For example, a ratio of 70 percent regular gasoline and 30 percent kerosene is used for JP-4 fuel. Offered prices were then compared to the combined price of gasoline and kerosene.

Using the market price range objectives developed by price analysis and knowledge of each contractor's operations, the contracting officers were able, in nearly all cases, to obtain prices lower than those initially proposed by the contractors. The total negotiated amount for the 68 contracts was \$38.3 million lower than the initial proposed amount of \$709.3 million.

In addition to obtaining market data from contractors and other Government agencies, the Center has taken other actions to improve petroleum procurement. In September 1974 the Office of Market Research and Analysis was established and staffed to maintain data on price trends of petroleum products, to analyze market data submitted by contractors, and to provide support to contracting officers. The Federal Energy Administration was requested to provide access to

monthly reports required from each domestic refiner which Fuel Center officials believed would be useful in their price analysis. The Energy Administration provided reports on about three-fourths of the oil companies, but the data was received too late to be of use for the July 1975 procurements.

The Center's Cost and Price Analysis Branch, a group directly involved in the negotiated procurement process, was not properly staffed. Its function is to help insure that contract award prices are fair and reasonable, primarily through price analysis. The change to negotiated procurements has greatly increased the pricing workload and the importance of price analysis. Until recently the Branch had two employees who did analysis for the Procurement Division. In June 1975 five new positions were authorized, bringing the authorized positions to seven. But, as of the end of July, the two employees in the Branch had left and none of the new positions had been filled. As a result, the Center's buyers have had to make their own analysis.

AUDITS OF DATA RECEIVED FROM CONTRACTORS

The Fuel Center did not ask the Defense Contract Audit Agency to audit any of the market price data submitted by the contractors. A Center official said that there was not enough time between data submission and contract negotiation to perform audits and that audits were not necessary because the data could be verified with such publications as Platt's Oilgram.

In our opinion, audits, at least on a sample basis, are necessary to determine whether the data submitted is representative of substantial sales to the general public and does not omit large-volume, low-price sales which could influence the negotiation of prices. We believe that the information contained in the Oilgram or other sources is not an acceptable substitute for verification by audit.

Recommendation

We recommend that the Center obtain audits of the sales and market price data submitted by the companies before conducting contract negotiations.

COST DATA SUBMISSIONS

Of the 68 contractors submitting price proposals for the early 1975 contract awards, 12 submitted supporting cost or pricing data. The Center, however, determined that it

could not rely on the cost or pricing data as a basis for price negotiations because the data did not adequately identify all product costs or appropriately identify the costs to the various jointly produced products.

The petroleum industry commonly uses the sales realization technique to distribute costs among its products for inventory valuation and income tax purposes. This technique is the process of assigning costs to products in proportion to the percentage of each product's sales to total sales. Although it is accepted by the Internal Revenue Service as a basis for valuing inventories, this technique does not identify actual product cost.

Because of the inadequacies in the supporting cost data, the contracting officers decided it would be more advantageous to the Government to negotiate a price with these contractors on the basis of available market price data. Lower prices were negotiated than indicated by the cost data furnished.

FOREIGN PROCUREMENTS

We believe that, for foreign procurements made during January to June 1975, competition was adequate to insure the reasonableness of prices paid. In contrast to the domestic situation, there were foreign suppliers willing to compete for the sales to the Government.

Before the January to June 1975 buy, documentation was not adequate to permit an evaluation. We noted, however, that prices paid foreign suppliers in 1973 were generally lower than those paid domestic suppliers.

ECONOMIC PRICE ADJUSTMENT CLAUSES

Of the 68 contracts awarded in early 1975, 65 contained an economic price adjustment clause. These 65 contracts contained 82 separate base references for computing adjustments. Of these, 53 were based on the individual contractor's acquisition cost of crude petroleum, 24 on the company's posted price for a product, 1 on the posted price in Platt's Oilgram, and the remainder on miscellaneous other bases. We concluded that many of the clauses could result in inappropriate adjustments to the contract prices.

Price adjustment clauses based on an individual company posting of a refined product do not represent an industry-wide contingency but merely a price at which one company is offering to sell its product. The danger in using this arrangement is the possibility of a contractor increasing its

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posted price even though there may not have been a general market change. A Center official said the Center tried but was unsuccessful in getting the clauses in the 24 contracts tied to the acquisition cost of crude oil.

The use of acquisition cost of crude oil also has its pitfalls. There are some companies that have their own sources of crude oil. Thus the transfer prices for these crude oils are not necessarily the same as those which would be arrived at through independent sales transactions.

Recommendation

We recommend that the Center explore the feasibility of basing escalation payments on changes in a price index designed to measure movement in petroleum prices. The necessary indexes could be developed in cooperation with the Bureau of Labor Statistics, Department of Labor.

A Center official said that he believed contractors would not agree to using Government-developed indexes as a base reference for economic price adjustment clauses. He added that agreement to mutually acceptable terms and conditions for economic price adjustment had been one of the most difficult areas of contract negotiation, primarily because of all the market uncertainties.

PROCUREMENT PERSONNEL

We reviewed the training and experience of the Center's procurement personnel. Although most of the personnel have attended the basic mandatory procurement training courses, some additional training would be beneficial. Also most of the buyers and other procurement personnel have had only about 2 years' experience in handling negotiated procurements--obtained mostly since the Center switched from formally advertised to negotiated procurements. Some personnel obtained experience through involvement in the Center's limited negotiated contracting or involvement at other procurement activities.

The Department of Defense has established a mandatory career program for civilian procurement personnel. The program identifies courses which provide the skills and information needed for the employees to properly perform their duties and to advance in the procurement field. About 75 percent of the Center's buyers have attended all the required basic procurement courses. There is, however, less

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emphasis placed on requiring buyers to attend an intermediate level course on contracting pricing techniques. This, we believe, is essential for those procurement personnel responsible for analyzing proposed prices and negotiating contracts.

We interviewed 27 buyers to get their views on the adequacy of training received. They agreed there is a need for specialized training relative to the petroleum industry. Specific areas mentioned included industry terminology, operations, products, and marketing techniques.

In conjunction with the American Petroleum Institute, the Center has developed a 1-week survey course on the petroleum industry. This course, however, addresses only generalized information about the industry. Further, in the past 4 years most of those attending the course were at the supervisory level.

Recommendation

Additional training, particularly in regard to contract pricing techniques and the petroleum industry, would be highly beneficial. We recommend that the Agency review the training program established for its petroleum buyers and revise it as necessary to insure that maximum beneficial training is obtained on a timely basis.

LONG-TERM CONTRACTING

Our review of the feasibility of procuring petroleum products on an annual basis indicated that, although purchases could be made covering requirements for 1 year or longer, the only savings likely to occur would be the administrative costs associated with the purchases. We believe that considerable savings in the price of fuel would not be realized because most oil companies insist that escalation clauses, providing for the contract price to escalate as costs increase, be included in contracts.

The military services compute and submit requirements semiannually for some products and annually for others. These submission periods were established to coincide with the Center's procurement cycles. The services, however, can project fuel requirements in yearly increments for periods up to 5 years. The requirements computation process therefore does not preclude long-term contracting.

The Center did solicit long-term offers in 1973 for the January to June 1974 domestic procurements. Only 12 companies

responded. As the fuel crisis worsened with the Arab embargo, 10 of the 12 companies withdrew their offers. Two long-term contracts were finally signed. Both contracts included economic escalation clauses.

FUEL REQUIREMENT DETERMINATIONS

We examined how fuel requirements were computed. We found no evidence at the Center which would indicate major errors in the requirements determinations. Requirements are computed by many Defense Department user organizations, consolidated by the various services, and provided to the Fuel Center, usually semiannually. The Center has no authority to change these requirements and acts primarily as the broker for each service to acquire and distribute the fuel needed.

Each military service arrives at its projected peacetime operational fuel needs through a similar process. Each major command estimates its fuel needs for coming periods on the basis of the command's mission and past experience. The command first projects, for example, the number of flying hours or ship-steaming hours needed to support the mission. These projections are then multiplied by known fuel consumption factors for each type of plane or ship to get total mission fuel requirements. Safety level and other such factors are then applied. Certain fuel requirements, such as for heating oil, are projected by base or installation commanders. Heating fuel requirements are based on past experience modified by the degree-day estimates for the coming heating seasons.

Each service has a centralized fuel office which consolidates and reviews requirements before their submission to the Center. Each of these offices serves as a liaison for the Center and a logistics planning office for the service. None of the three central fuel offices are involved in the original generation of fuel requirements.

Although the Center does not have any authority to change fuel requirements, it does request an explanation when wide discrepancies occur between requested and past needs. The Center also tracks fuel consumption by users to insure that consumption is within projections and that contract coverage is adequate. For example, if an activity appears in danger of needing more fuel than contracted for, the Center notifies that activity and asks if a fuel requirement adjustment is needed.

War reserve requirements are based on force structure and war plans.

EFFECTIVENESS OF THE
TRUTH-IN-NEGOTIATIONS ACT

Since passage of the Truth-in-Negotiations Act in 1962, the provisions of the Armed Services Procurement Regulation implementing the act have been revised numerous times. Many of these changes have increased the effectiveness of the act and were in response to our recommendations.

In our contract-pricing reviews after the act was enacted, we have noted improvements in the extent and quality of cost or pricing data submitted by contractors in support of proposals and in the analysis and use of the data by Government procurement personnel. Recent reviews, however, have shown a continuing need for agency attention to the implementation of regulations and policies. For example, in a review of 183 contracts valued at about \$2.1 billion, we found that although DOD's procurement offices generally were effective in negotiating noncompetitive contracts, improvements were needed in both the practices followed and in management controls established. About 15 percent of the total cost examined was not adequately supported by cost or pricing data to the extent required. In addition, we noted deficiencies in advisory reports on evaluation of contractors' proposals, in price negotiations, and in internal reviews of the compliance with established procurement policies and procedures. Our report on this review was issued to the Congress on August 5, 1974 (B-168450).

Price proposals generally include cost estimates that must be thoroughly evaluated by qualified technical personnel to determine whether the techniques and concepts used are valid. In a recent review of technical evaluations of 40 noncompetitive price proposals, totaling about \$132 million, we found that evaluators had not adequately reviewed about 40 percent of contractors' proposed direct costs. In some cases the cause of the poor performance was the failure to obtain complete cost or pricing data from the contractor.

In postaward reviews of individual contracts we, as well as the Defense Contract Audit Agency, continue to identify contracts which are overpriced because of conditions the Truth-in-Negotiations Act was designed to remedy--contractors' submission of incomplete, inaccurate, and non-current data. Public Law 87-653 provides a legal remedy in such cases, which was not generally available before its enactment.

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The procurement of petroleum products shows the problems in administering the act. When the Center told oil companies in September 1974 that they must comply with requirements of the act, they initially refused to provide any data. After extensive agency efforts all but seven companies submitted either market price data or cost or pricing data. In the subsequent procurement cycle, all companies submitted some type of market data; however, as noted on page 7, the data was inadequate.

Most contractors recognize the Government's need for cost or pricing data to establish fair and reasonable prices for noncompetitive contracts. Although outright refusal to furnish such data is not widespread, a problem does exist in some industries and for certain classes of products. For example, forging companies have consistently refused to submit cost or pricing data for noncompetitive procurements. In fiscal years 1974 and 1975, a total of 48 waivers, including three blanket waivers for a 3-year period, were granted by the three services and the Agency. We have found that efforts were generally made to persuade companies to comply with the requirements of the act before waivers were approved.

In our opinion, the Truth-in-Negotiations Act has generally been effective in providing procurement officials with a sound basis for negotiating fair and reasonable prices. Since effectiveness of the act depends largely on how well it is administered, continued attention will be required by Defense procurement management review groups and internal audit staffs of the military services and the Defense Supply Agency. We plan to continue to make selected reviews of noncompetitive procurements to check on the implementation of the act.

We do not have any recommendations for revising the act at this time.

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We have informally discussed the factual matters set forth in this report with Defense personnel. Their comments were considered in preparing this report.

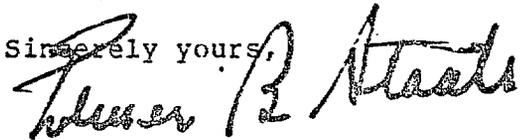
As agreed with your office, this report is also being provided today to the Chairman, Senate Permanent Subcommittee on Investigations.

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We believe this report will be of interest to other committees. Accordingly, we will be in touch with your office in the near future to arrange for its release.

We want to invite your attention to the fact that this report contains recommendations to the Secretary of Defense which are set forth on pages 9, 11, 13, and 14. As you know section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Government Appropriations with the agency's first request for appropriation made more than 60 days after the date of the report. We will also be in touch with your office in the near future to arrange for copies of this report to be sent to the Secretary of Defense and the four Committees to set in motion the requirements of section 236.

Sincerely yours,



Comptroller General
of the United States

Enclosure

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United States Senate

WASHINGTON, D. C.

January 27, 1975

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The Honorable Elmer Staats
Comptroller General of the United States
441 G Street, N. W.
Washington, D. C. 20548

Dear Mr. Staats:

This is to request a full investigation of the procurement of foreign and domestic petroleum products by the Department of Defense during 1973, 1974 and 1975. I am making this request in both my capacities as Chairman of the Senate Banking Committee, and Chairman of the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee, as well as Vice Chairman of the Joint Committee on Defense Production.

You will recall my letter of December 11th, in connection with the request for waivers from cost accounting standards requirements from Mobil Oil Company. For your information, I am attaching copies of a statement I made about petroleum procurement generally, on January 18, 1975, a telegram I sent to the Attorney General on January 19, and a letter to the Secretary of Defense, dated January 17th.

In the last several days, the Defense Department has awarded several petroleum contracts under exemptions to the Truth in Negotiation Act. The exemptions were granted on the grounds that there were established market prices for the items purchased.

The present method of petroleum procurement is through negotiation rather than competition. In the past nearly all petroleum products were purchased through formal advertising and competitive bids. This was changed in the wake of the Arab oil embargo and the fuel allocation system established by the Federal Energy Administration. Most Department of Defense petroleum was purchased through negotiation rather than competition in 1974, but contracts were awarded under the market price exemption.

In September 1974, the Department of Defense concluded that there was no longer adequate data for determining market prices and cost and pricing data was requested from the oil firms. Subsequently, almost all of the firms refused or failed to supply cost data or to comply with uniform accounting standards.

Now I am informed that the Department of Defense intends to grant wholesale exemptions in the next few weeks. This represents a shift in position by the Pentagon which could only be justified if, in fact, data became recently available enabling it to determine market prices. But as there was no such data from September 1974 until at least the middle of January 1975, the reversal remains somewhat of a mystery.

ENCLOSURE I

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I am also interested in the procurement methods used prior to 1974, when contracts were ostensibly awarded on the basis of competitive bids. However, competition for petroleum contracts was conducted in a curious fashion. Normally, DOD's potential suppliers submit proposals with regard to a specific item or number of items, such as air craft or motor vehicles. In such cases, the Service has an identifiable item of hardware or series of items that it wants to buy and potential suppliers are bidding against one another for the right to sell the same product.

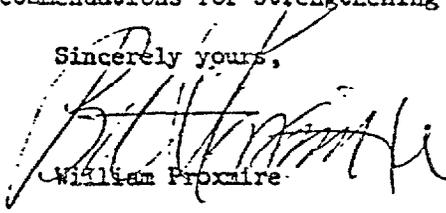
In the case of petroleum, the situation was quite different. As I understand the procedure, the Department of Defense would invite proposals for its total petroleum requirements for a period of time such as six months or a year. Potential suppliers would bid for various portions of the requirements, that is for a fraction of what the Pentagon wanted to buy. In this case, potential suppliers are not necessarily bidding against one another and there is a question in my mind as to how "competitive" those proposals were and whether the possibility of collusion is enhanced under procurement methods such as those used for petroleum.

In your report, which I would like submitted to me prior to obtaining written comments from the Department of Defense or any contractor, please include an evaluation of the method of procurement for 1973 before the allocation system went into effect and since that time. In addition, I would like to know how the Department of Defense was able to negotiate contracts in 1974 on the basis of established market prices, the criteria used to determine whether there are market prices and the adequacy or appropriateness of those determinations in 1974.

I would like to have an evaluation of the procurement of petroleum since September 1974 and your judgment as to the management of the petroleum procurement program. Included in this evaluation should be an examination of the data supplied by the oil companies and otherwise obtained by the Department of Defense with respect to market prices for the 1975 purchases, your findings as to whether in fact DOD had sufficient information on which to base a market price exemption, and your findings as to the adequacy of the procedures employed by DOD in making market price determinations and granting exemptions.

Finally, I would like your opinion as to the effectiveness of the Truth in Negotiation Act and any recommendations for strengthening it.

Sincerely yours,


William Proxmire

Attachments

BEST DOCUMENT AVAILABLE