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UNITED STATES GENERAL ACCOUNTING OFFICE
INTERNATIONAL OPERATIONS DIVISION

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OFFICE OF THE DIRECTOR

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Dear General Lampert:

We have reviewed selected policies, procedures, and practices of the United States Civil Administration of the Ryukyu Islands (USCAR). Our review included an examination into certain expenses allowed under contracts 64-N-1 and 68-N-1, awarded to Caltex (Asia) Limited and covering periods May 1964 to April 1968 and May 1968 to April 1971, respectively, for the supply, terminal operation and distribution of bulk petroleum products. Additionally, we examined into the use of funds derived from the administration of the former state and prefectural properties.

The results of our review are discussed below.

Questionable Expenses Allowed
Under Petroleum Contracts

Our limited review of expenses incurred and charged by the contractor as applicable to the services required by the contracts revealed some costs which we believe should not have been claimed by Caltex nor allowed in computing the profit margin.

The contracts provided that an annual review would be made by USCAR of the expenses incurred by Caltex in performing the distribution services under the contracts. If such a review showed that Caltex had received payments (negotiated service allowances) totaling more than its actual expenses, plus 12.5 percent of these expenses, the contractor would refund the excess to USCAR. No adjustments were to be made if the contractor made a profit of less than 12.5 percent. The contracts also provided that in determining all items of expense, Caltex's regular accounting practices would be followed. Contract 68-N-1 further provided that only expenses directly related to the performance of the required services would be considered proper charges to the contract.

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We found that the contractor's statements of expenses along with the Certified Public Accountant audit reports have been generally accepted by USCAR without question. The USCAR contracting officer advised us that since Caltex had been refunding substantial amounts to USCAR (through contract year 1969 net refunds totaled about \$845,000) as a result of the year-end comparisons of expenses incurred with service allowances received, he had not been very concerned with the nature of the various expenses.

The contracting officer further stated that responsibility for reviewing Caltex's reported expenses rested with another official of the Comptroller Department and that this official had been provided with copies of Caltex's Statements of Expenses, and the related audit reports, for performing such a review. However, this other official stated that he was not responsible for reviewing Caltex's expenses and that the contracting officer had been mistaken.

Regardless of who was responsible, the USCAR Comptroller agreed that there had been inadequate review of Caltex's expenses in the past. Further, he stated that, in his opinion, this lack of review had been interpreted by Caltex as approval of the reported expenses, and therefore, made it difficult for USCAR to take exception now to expenses which had been allowed in previous years.

Examples of expenses claimed by Caltex during contract years 1968 and 1969 which we believe were neither allowable under the terms of, nor necessary in the performance of the contracts are presented below.

Entertainment expenses

During the year ending April 30, 1968 and the last 6 months of the year ending April 30, 1969, USCAR personnel and/or their wives had participated in 112 entertainment functions for which Caltex charged over \$4400 to the contracts. These functions included luncheons, dinners, golf outings, cocktail parties and entertainment at hotels, bars, and a cabaret. Charges also included costs of Caltex personnel attending USCAR functions.

In April 1967, Caltex paid \$134.97 for expenses incurred by a USCAR official and his wife during their visit to Bangkok, Thailand, from April 12 through April 15, 1967. These expenses were originally paid by the Caltex office in Bangkok and were then transferred to the Naha, Okinawa, office of Caltex where the costs were charged to the petroleum contract. We were unable to determine in Okinawa, the exact nature of these expenses.

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USCAR and Department of Army officials advised us that about half of the entertainment expenses were for large public receptions to which most United States and Ryukyuan leaders of the community were invited and that some entertainment of such individuals is appropriate and in accord with normal business practices since USCAR is in the business of selling petroleum products to the public.

Officials noted the possibility that some of the affairs attended by USCAR personnel were not authorized by applicable government regulations, but emphasized that there was no evidence to indicate that improper influence was exerted. Nevertheless, we were advised that steps had been taken to bring the required standards of conduct to the attention of all USCAR personnel and to require adherence thereto.

Travel and personal expense

According to Caltex policy, the receiving office pays the moving expenses of an employee transferring from one location to another. However, we noted that when a Caltex employee was transferred from Okinawa to Saigon, Vietnam, a cost of \$421.63 for shipment of his household goods to Saigon was charged to contract 68-N-1. It was explained that the expenses had been absorbed by Caltex's office in Okinawa because the Saigon office could not transfer the funds out of Vietnam.

Interest expense

For contract years ending April 30, 1968 and April 30, 1969, Caltex reported interest expense of \$42,076.26 and \$97,383.53, respectively.

With respect to these finance charges, the Request for Proposal stated, in pertinent part, that the selected offeror must demonstrate the financial ability to finance incoming deliveries and reasonable inventories of all products and the operations of the terminal.

These costs were for interest incurred by Caltex on bank overdrafts. This type of credit was established by Caltex with two banks having branch offices in Okinawa. Caltex first utilized this credit in July 1967 to finance the sale of fuel to commercial airlines at the relatively low interest rates available in Okinawa.

On December 5, 1969, Caltex requested that it be granted 60 days' credit in connection with the remittance of monies owed to USCAR under contract 68-N-1. This procedure, if implemented, would have eliminated the charging of interest costs to the contract; however, it still would have resulted in USCAR's financing the Caltex inventories.

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Subsequent to our review, we were advised that USCAR had denied the request from Caltex for a 60-day line of credit. In addition, we were advised that Caltex had been requested to eliminate the interest expense for contract years 1968 and 1969 that we had questioned during our review. Also, Caltex was requested to recompute the profit or loss for those years and to make appropriate refunds to USCAR.

Membership expense

For contract years ending April 30, 1968 and April 30, 1969, Caltex reported membership expenses of \$1,242 and \$1,084, respectively.

These costs included payments for dues and memberships of Caltex or its employees in local golf and yacht clubs, Naha Officers' Open Mess and Naha Officers' Club.

Public relations expense

In each year, this category of expense included a \$600 donation to the University of the Ryukyus Foundation to provide for university scholarships. In the year ended April 30, 1969, these expenses also included the cost, \$687.08, for films of the United States Open and Masters Golf Tournaments. The majority of the other public relations expenses incurred in each year represented the cost of congratulatory messages in local magazines and newspapers on such occasions as Armed Forces Day, anniversaries of the founding of various military organizations, and holidays.

Sales promotion expenses

For contract years ending April 30, 1968 and April 30, 1969, Caltex reported sales promotion expenses of \$4,695.32 and \$5,691.86, respectively.

These expenses included costs of various parties and luncheons for service station operators. In this connection, the sales promotion budgets for 1968 and 1969 submitted by Caltex to its New York office stated that two annual meetings with members of the Service Station and Dealer Associations were being proposed in the interest of Caltex's future possible business activities in the Ryukyus aside from the USCAR contract.

This category of expenses also included the purchase of 420 golf umbrellas, costing \$1,041.60 and bearing the Caltex and Ryukyu Oil Company trademarks. The Ryukyu Oil Company is the sole distributor of bulk petroleum products in the Ryukyu Islands.

Department of Army officials stated that the contractor, in addition to providing stipulated terminal services and products distribution, is further charged with developing a comprehensive and efficient petroleum distribution system in the Ryukyus. Further, they stated that expenses for public relation, membership, sales promotion and advertising are consistent with customary business procedures for enhancing a normal petroleum industry.

We were advised by the Caltex Chief Accountant that all of its business on Okinawa was performed as a result of the USCAR contract and therefore all expenses incurred were chargeable to the contract. This official stated that these expenses were of the type that would be incurred by any Caltex office and that, in his opinion, USCAR should not be concerned with them. He further expressed the opinion that USCAR should only be concerned as to whether Caltex incurred a loss or realized more than 12.5 percent profit in connection with the services required by the contract.

Conclusions and recommendation

We believe that Caltex was reimbursed for costs which were neither allowable under the terms of, nor necessary in the performance of the contracts and which should not have been used to compute its 12.5 percent profit margin. Reimbursement to Caltex of these costs and their inclusion in prices established by USCAR resulted in Government agencies and contractors incurring additional costs for substantial quantities of petroleum products provided by USCAR.

In our opinion, the contract provisions allowing the contractor to retain profits from the performance of the required services up to a certain percentage of costs are of such a nature to have required a thorough review by USCAR of the costs incurred. In view of the general acceptance by USCAR of the contractor's expenses and the results of our limited review of those expenses, we recommend that USCAR request the Defense Contract Audit Agency to review the costs allowed as applicable to the services required by contracts 64-N-1 and 68-N-1.

Funds derived from the administration of former State properties

Since 1948, the USCAR Office of the Ryukyuan Property Custodian has administered in trust former Japanese State and Okinawa Prefectural properties acquired by the United States at the conclusion of World War II. While most of the properties do not earn revenue, USCAR is earning an average of about \$132,000 per year of which about \$120,000 represents rental income on 1500 acres of land and one building, and about \$12,000 represents interest earned on deposits of rental income.

The Custodian's budgets are not presented to the Department of Defense, the Office of Management and Budget or the Congress for review and approval. We were advised by USCAR and Department of the Army officials that review by higher authority is not required because these funds are not subject to the provisions of the Act of July 12, 1960 (74 Stat. 461), as amended, which was enacted for the purpose of providing statutory authorization for the promotion of economic and social development in the Ryukyu Islands.

That law provides, under Section 3, that revenues derived by USCAR from certain sources shall be deposited in separate funds which are authorized to be established by the High Commissioner of the Ryukyu Islands and shall be available for obligation and expenditures in accordance with annual budget programs approved by the President. These sources of revenue are:

- (1) Public-benefit trusts, business-type operations, funds and enterprises established by USCAR or its predecessor agencies.
- (2) Corporations wholly or partly owned by the civil administration of the Ryukyu Islands.
- (3) Fines, fees and forfeitures received by USCAR.

Congressional committee reports relating to the law noted that this legislation would give precise legal authority to the activities previously conducted by the United States under the authority of Executive Order 10713, dated June 5, 1957 and the Treaty of Peace with Japan. The reports also indicate that, although the new legislation would permit the continued use of these revenues, statutory controls would be established over their use. Revenues covered by Section 3 would be used for reinvestment in the activities from which derived or for programs such as typhoon relief and aid to the Government of the Ryukyu Islands and its municipalities.

The separate funds discussed in Section 3 of the above legislation comprise what is referred to as the General Fund of USCAR. Certain assets of the General Fund have been capitalized to form corporate entities completely owned by USCAR while other assets have been used to carry on a separate fund activity of the General Fund.

As a result of the 1960 Act, the Bureau of the Budget, now the Office of Management and Budget, brought the separate fund activity of the General Fund under the apportionment process. General Fund programs are submitted along with the annual appropriation request for review by the Office of Management and Budget and the Congress.

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USCAR and other Department of the Army officials maintain that the Ryukyuan Property Custodian corpus is not a part of the General Fund since neither the language of the law nor its legislative history identifies this revenue as a type of revenue which must be included in the annual budget program approved by the President. They have pointed out that the corpus did not have its genesis in the sale of commodities (provided under the Government and Relief in Occupied Areas appropriations) as did the activities now considered to comprise the USCAR General Fund.

We were advised by USCAR officials that the rental income and interest are generally used to (1) meet operating expenses of the Custodian's office, (2) maintain property in his custody, and (3) support various projects intended to benefit the Ryukyuan people. We were also advised that the Custodian has authority to approve expenditure of such rental and interest income to meet operating expenses of that office and to maintain property under his custody. However, either the High Commissioner or the Civil Administrator must approve the expenditure when the funds are to be used for purposes intended to benefit the Ryukyuan people.

Our review of selected expenditures revealed that rental income collected by the Property Custodian had, in some instances, been used for purposes which did not meet the established criteria for which these funds were available. In fiscal year 1969, for example, about \$3,800 of these funds were used to provide carpets, carpet pads, and office decorations for the offices of the High Commissioner which serve as Headquarters, United States Army, Ryukyu Islands. These offices, which are separate from the offices in the USCAR building, had already been renovated with financing provided from appropriated funds. Also, in fiscal years 1968 and 1969, about \$16,000 of these funds were used to renovate and improve USCAR's office building and to beautify the grounds around the building.

Conclusions and recommendation

We believe that the Office of Management and Budget and the Congress should be fully advised of all resources available to USCAR and of the proposed disposition of those resources. In our opinion, such disclosure would be helpful to the Congress in its consideration of requests for appropriations during the period remaining before reversion of the Ryukyu Islands to the Government of Japan. Accordingly,

we recommend that USCAR include the funds and proposed programs of the Ryukyuan Property Custodian in any future USCAR budget submissions and any presentations of programs or activities.

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We will appreciate being advised of the action taken or contemplated with regard to the matters discussed above.

Sincerely yours,



C. Roman
Director

Lieutenant General James B. Lampert
High Commissioner of the Ryukyu Islands
APO 96331

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