



✓

# *REPORT TO THE CONGRESS*

## Potential Savings In Procurement Of Petroleum Products For Use By Navy Contractors

Department of the Navy

LAW BRANCH  
THE ARMY LIBRARY

*BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES*

770 284/087460 FEB. 6, 1968



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-160334

To the President of the Senate and the  
Speaker of the House of Representatives

The General Accounting Office has reviewed the Department of the Navy practice of permitting contractors to furnish petroleum products used by them in the testing of aircraft and aircraft engines. The accompanying report presents our findings and conclusion and the actions initiated when this matter was brought to the attention of the Department of Defense.

It is Navy policy that petroleum products should be provided to contractors as Government-furnished material where feasible, economical, and otherwise in the best interest of the Government. Our review showed, however, that the Navy has permitted contractors to purchase required petroleum products. It also showed that substantial annual savings could be realized if the petroleum products used in the testing were furnished to the contractors by the Navy.

We found that the Department of the Air Force since 1957 has generally furnished such products to contractors.

Our review was made at three plants where estimated requirements represented about 86 percent of the total petroleum needs of Navy aircraft and aircraft engine contractors. We estimated that during 1964 the Navy paid two of the contractors--Pratt & Whitney Aircraft Division of United Aircraft Corporation and Grumman Aircraft Engineering Corporation--about \$229,000 more for such products than it would have paid if the products had been centrally procured by the Defense Fuel Supply Center and furnished to the contractors. We believe that about \$250,000 and about \$400,000 could have been saved in calendar years 1965 and 1966, respectively, if the Navy had furnished the petroleum products used by the two contractors.

With regard to the third contractor--McDonnell Aircraft Corporation now McDonnell Douglas Corporation--our review showed that the Navy had contractual arrangements in effect different than the arrangements at Pratt & Whitney and Grumman. At McDonnell the Government

B-160334

pays a profit on the administrative costs that the contractor incurs in buying and handling the fuel. Under this method, the resulting profit is considerably less than it would be if the profit rate were applied to the basic cost of the fuel as is done at Pratt & Whitney and Grumman.

The Navy advised us on June 28, 1967, that in the case of Pratt & Whitney it had concluded that substantial savings might be realized if the Government were to furnish the petroleum products or, alternately, if a change in the contractual treatment of these products were negotiated as in the case with McDonnell. By letter dated November 2, 1967, the Navy advised us that negotiations with Pratt & Whitney were taking place and would be completed by about March 31, 1968.

With regard to Grumman, the Navy stated that it is to the overall advantage of the Government for the contractor to continue to furnish petroleum products. The Navy's evaluation indicated that there would be relatively small savings if the Government furnished the fuel.

Our review showed that the potential savings at Grumman are not as substantial as those at Pratt & Whitney. It is our opinion, however, that, if additional expenses involved in furnishing petroleum products to Grumman would reduce the savings to a minimal amount, the Navy should consider negotiating arrangements with Grumman similar to those the Navy is in the process of negotiating with Pratt & Whitney.

Therefore, in the case of Grumman and similar situations involving other contractors, we are recommending that the Navy consider negotiating contractual arrangements similar to those currently in effect with McDonnell. With respect to other aircraft and aircraft engine contractors that furnish fuel, we are recommending that the Navy examine its arrangements to see whether savings might be made by furnishing fuel to these contractors.

We are issuing this report to inform the Congress of the annual savings that can be expected from the actions that the Navy has indicated it will take and to advise the Congress of the possible additional savings attainable through improved management of this function at other contractors producing aircraft and aircraft engines for the Navy,

B-160334

Copies of **this** report are being sent to the Director, **Bureau** of the Budget; **the Secretary of** Defense; the Secretaries of the Army, **Navy**, and Air **Force**; and **the** Director, Defense **Supply Agency**.

A handwritten signature in black ink, reading "James B. Abate". The signature is written in a cursive style with a large initial "J" and a distinct "B".

Comptroller General  
of the United States

## C o n t e n t s

	<u>Page</u>
INTRODUCTION	1
BACKGROUND	2
<b>FINDINGS AND RECOMMENDATIONS</b>	<b>3</b>
Savings available through direct Government procurement of petroleum products for use by Navy contractors	3
Estimated savings attainable	4
Other studies on savings available by converting from contractor- to Government-furnished fuel	6
Considerations other than cost affecting decision to furnish petroleum products to contractors	6
Contractor comments and our evaluation	8
Navy comments	9
Conclusion	11
Recommendations	11
	<u>Appendix</u>
<b>APPENDIXES</b>	
Principal officials of the Department of Defense and the Department of the Navy responsible for administration of activities discussed in this report	I      15
Letter of June 28, 1967, from the Assistant Secretary of the Navy (Financial Management)	If     17
Letter of November 2, 1967, from the Office of the Comptroller, Department of the Navy	III    20
Letter of February 8, 1967, from United Aircraft	IV     21
Letter of February 21, 1967, from Grumman Aircraft Engineering Corporation	V      22

REPORT ON  
POTENTIAL SAVINGS IN PROCUREMENT OF  
PETROLEUM PRODUCTS FOR USE BY  
NAW CONTRACTORS  
DEPARTMENT OF THE NAVY  
INTRODUCTION

The General Accounting Office has reviewed the feasibility of having the Government furnish Department of the Navy contractors with petroleum products for use in testing aircraft and aircraft engines. Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), the Accounting and Auditing Act of 1950 (31 U.S.C. 67), and the authority of the Comptroller General to examine contractors' records, as set forth in contract clauses prescribed by 10 U.S.C. 2313(b).

Our review was undertaken to inquire into the Department of Defense policies and practices pertaining to the furnishing of petroleum products to contractors engaged in producing aircraft and aircraft engines for the Government. We found that the Department of the Air Force was supplying a substantial number of its aircraft contractors and aircraft engine contractors with fuel for use on Government contracts. We were informed by Department of the Army officials that, although its use of such products is relatively limited, it did supply fuel to certain contractors but that decisions on whether or not to furnish fuel were made on a case-by-case basis. The Navy, on the other hand, followed the general practice of permitting the contractors to purchase the aircraft fuel and include the cost in the contract prices.

Our review was conducted at the Defense Fuel Supply Center and the Bureau of Naval Weapons, Washington, D.C.; United Aircraft Corporation, Pratt & Whitney Aircraft Division, East Hartford, Connecticut; McDonnell Aircraft Corporation, now McDonnell Douglas Corporation, St. Louis, Missouri; and Grumman Aircraft Engineering Corporation, Bethpage, Long Island, New York. In performing our review, we examined records of the three selected contractors to determine the volume and cost to the Government of contractor-furnished petroleum products and compared such costs with those that would likely have been incurred if the products had been supplied as Government-furnished material.

## BACKGROUND

The Military Petroleum Supply Agency (MPSA) was established in August 1956 as the operating agency for the Secretary of the Navy, to carry out his responsibilities as single manager for the Department of Defense for petroleum products. Effective January 1, 1962, MPSA was redesignated the Defense Petroleum Supply Center of the Defense Supply Agency under the Secretary of Defense. Subsequently<sup>p</sup> on February 1, 1964, the Defense Petroleum Supply Center was redesignated the Defense Fuel Supply Center (DFSC). DFSC is responsible for world-wide purchasing of petroleum products used by the armed services; the purchases are based upon requirements determined by each military department,

At the time of our review, the Bureau of Naval Weapons was responsible for determining whether petroleum products needed by Navy aircraft and aircraft engine contractors would be furnished by the Government. In a reorganization effective May 1, 1966, the functions of the Bureau of Naval Weapons were assumed by the Naval Air Systems Command and the Naval Ordnance Systems Command.

The principal management officials of the Department of Defense and the Department of the Navy responsible for the administration of activities discussed in this report are listed in appendix I.

## FINDINGS AM) RECOMMENDATIONS

### SAVINGS AVAILABLE THROUGH DIRECT GOVERNMENT PROCUREMENT OF PETROLEUM PRODUCTS FOR USE BY MAW CONTRACTORS

Our review showed that substantial annual savings could be realized if the **Navy** would furnish petroleum products used in the testing of aircraft and aircraft engines to the contractors instead of permitting the contractors to **supply** these products as a part of their contracts. In commenting on our findings, the Department of the Navy suggested an alternate solution which we feel would be appropriate in certain cases.

Our review was conducted at three Navy contractors' plants. We estimated that during 1964 the Navy paid two of the three contractors about \$229,000 more for such products than it would have paid if the products had been centrally procured by DFSC and furnished to the contractors. We estimate that about \$250,000 and about \$400,000 could have been **saved** in calendar years 1965 and 1956, respectively, if the Navy had furnished the petroleum products used by the two contractors. Our estimate considered (1) the lower prices available to DFSC for packaged lubricating oils, (2) the elimination of the prime contractors' profit on the basic *cost* of the lubricating oils and aircraft fuels, and (3) in the case of one contractor, the elimination of overhead charged to the Government.

Department of Defense policy with regard to the Government's furnishing materials and supplies to its contractors is set forth in section 13 of the Armed Services Procurement Regulation. The pertinent provision of the regulation states that material should be Government-furnished when by reason of economy, standardization, and certain other considerations, it appears to serve the interest of the Government.

With specific reference to petroleum products required for the development, production, or testing of aircraft and aircraft engines, the Navy reiterated this policy in Navy Procurement Directive 13-250. In further implementation of this policy, the Bureau of Naval Weapons issued BuWeps Instruction 4341.1 which required that the Bureau (1) collect consumption data on aircraft contractors using substantial quantities of petroleum products and (2) make a determination on whether such products were to be furnished by the Government or the contractor. Such determinations were to be made for each contractor and reviewed every 18 months.

We found that the Navy had accumulated pertinent statistical data **and** contractors' views on the matter, but we **were** informed by Navy officials at the close of our review that no detailed studies had been made which were recent enough to be of value.

During our review **we** noted that the Air Force started furnishing petroleum products to its contractors as early as 1957 and that, as of March 31, 1965, at least 21 Air Force contractors were receiving Government-furnished petroleum purchased by DFSC. We also noted that the **Army made** its decisions to furnish petroleum after a case-by-case evaluation.

#### Estimated savings attainable

In making our evaluation of the savings attainable through furnishing petroleum products to Navy aircraft contractors and aircraft engine contractors, we obtained data collected **by** the Bureau of Naval Weapons for calendar year 1964. These data, consisting of information submitted by 13 contractors, showed that the contractors had a total estimated consumption of about 55 million gallons; this included requirements for commercial customers as **well** as for **the Government**. From this group of contractors, we selected for review three whose combined estimated consumption requirements represented 86 percent **of the** total requirements of the 13 contractors.

The three contractors selected for review were Pratt & Whitney Aircraft, Grumman Aircraft Engineering Corporation, **and** McDonnell Aircraft Corporation. Our review at these contractors' plants showed that about **48** percent of the products consumed in 1964 were charged to Government contracts. This **included** jet fuels, aviation gasoline, and lubricating oils. On the basis of cost data obtained from the contractors' records, we estimated that the cost of these products to the Government could have been reduced by **about** \$229,000 if the products had been furnished by the Government to two of these three contractors, as shown in the table **on page 5**. We found that there would have been no appreciable savings at the third **contractor**, McDonnell Aircraft, largely because of contractual arrangements whereby only relatively minor amounts of **profit** to McDonnell **were** charged to the Government in connection with petroleum products used.

The remaining 10 Navy contractors, whose plants we did not visit, consumed about 7.9 million gallons of petroleum products in 1964. On the basis of our findings at two of the three contractors' plants it appears that additional

savings may be attained by supplying petroleum products to these 10 contractors as Government-furnished material, or, alternatively, by negotiating changes in these contracts to include arrangements similar to those in effect at McDonnell.

Computation of Potential Savings

	<u>Contractor</u>		
	<u>Bratt &amp; Whitney</u>	<u>Grumman</u>	<u>Total</u>
Estimated savings attributable to:			
Lower prices available to DFSC for packaged lubricating oils	\$ 33,000	\$ (a)	\$ 33,000
Profit applicable to cost of packaged and bulk fuel charged to Government contracts by prime contractors	62,000 <sup>b</sup>	33,000	95,000
Overhead applicable to cost of packaged and <b>bulk</b> fuel charged to Government contracts	<u>101,000</u>	<u>(c)</u>	<u>101,000</u>
Total	<u>\$196,000</u>	<u>\$33,000</u>	<u>\$229,000</u>

<sup>a</sup>Consumption of oil at Grumman was insignificant (under \$5,000).

<sup>b</sup>Excludes certain nonprofit contracts between Pratt & Whitney and the Navy.

<sup>c</sup>Production at Grumman is almost entirely on Government contracts; therefore, overhead **costs would** in all likelihood be borne by the Government regardless of whether such costs were allocated to these products. Pratt & Whitney has substantial commercial work and the amount shown is the amount **we** estimate would be allocated to commercial work if petroleum products were supplied as Government-furnished material.

Our computations of potential savings include price differential savings applicable only to packaged lubricating oils. We did not compute possible savings that might be realized from lower unit prices available to the Government on bulk fuel but **used** the prices the contractors had paid. We believe, however, that additional savings might be realized in some cases through lower prices that would

be available to the Government through bulk purchasing of products **such** as aviation fuel. We **were** informed by a major oil company that its price to the Government, for fuel delivered to the plant of a particular contractor, which the oil company was then supplying, would have been the same as its price to the contractor, or possibly **lower**.

Not considered, when **we** estimated savings, were possible offsetting administrative and inspection costs which the Government might incur were the Navy to furnish the petroleum products presently procured by the contractors. **DFSC** officials informed us, however, that **DFSC** would incur no additional administrative expenses in procuring the petroleum for the contractors since the volume that would be procured for the contractors **was** insignificant compared with the total volume that would be procured for the services by **DFSC**.

Other studies on savings available by  
converting from contractor- to Government-  
furnished fuel

We found that the Auditor General, Defense Supply Agency, had conducted a study in 1964 as to the possible savings to the Government through direct procurement by the **DFSC** of petroleum products for Navy contractors. The study of six Navy contractors, including the three covered in our review, indicated that substantial savings could be realized by converting from contractor- to Government-furnished fuel.

In February 1964, the Auditor General of the **Navy** issued a report concerning annual savings available to the Government by furnishing petroleum products to a contractor not included in our review. This report stated that the Government could realize annual savings because of two factors: (1) the difference between the prices paid by the Government and the contractor, and (2) the elimination of the contractor's **fee**.

In each case, however, the Navy considered it in the best interest of the Government to continue its existing practice.

Considerations other than cost  
affecting decision to furnish  
petroleum products to contractors

Certain factors other than **cost** could affect a decision on whether or not the Government should furnish materials or equipment to its contractors. This aspect was

discussed with Navy officials and with representatives of the three contractors at whose plants our examination **was** performed.

Contractor officials assumed that Government and commercial petroleum **stocks** would have to be segregated and stated that this requirement could involve costly construction of additional storage facilities and piping at their plants.

The Armed Services Procurement Regulation allows commingling of Government- and contractor-owned property when advantageous to the Government. The Air Force follows the practice of allowing the commingling of contractor- and Government-owned petroleum products in both contractor- and Government-owned storage and handling facilities where necessary. Therefore, no additional storage and handling facilities seem necessary since the total amount of petroleum consumed by the contractor would be the same regardless of whether it is furnished by the contractor or the Government.

Navy and contractor officials also were of the opinion that there would be no significant increases in cost for the fueling and defueling of planes, purging of tanks, and use of special purpose equipment if the Government were to **supply** the aviation fuel.

## Contractor comments and our evaluation

On January 23, 1967, we reported this matter to the Secretary of Defense and the contractors included in our review. Pratt & Whitney Aircraft and the Grumman Aircraft Engineering Corporation submitted their replies on February 8 and February 21, 1967, *respectively*. (See appendixes IV and V.) Comments from McDonnell Aircraft were obtained but are not included because we concur in its view that little would be gained by changing the present system at McDonnell.

Details of the comments furnished by the two contractors together with our evaluation thereof are presented below.

### Pratt & Whitney Aircraft

Pratt & Whitney informed us that it had studied this matter on more than one occasion in the past and had concluded that the furnishing of petroleum products by the Government would not be practicable or more economical. It stated, however, that it would be glad to cooperate in any reexamination that the Navy decided to undertake.

### Grumman Aircraft Engineering Corporation

In commenting on our draft report, Grumman stated that its calculation of profit on petroleum products consumed in 1964 was about \$15,000 less than that computed by the General Accounting Office.

This difference is due mainly to our use of profit factors applicable to major contracts awarded in 1964; however, the contractor contended that these profit factors should not have been used since the contracts were worked on in 1965. The contractor's calculation of profit, based on profit factors applicable to major contracts worked on in 1964, is incorporated in the schedule on page 5.

It stated further that, as it had made known to Navy officials on various occasions, additional facilities costing approximately \$300,000 would be required if the facilities presently furnished by its vendor were to be replaced. Additionally, if aviation fuels were furnished by the Government, some arrangement would be necessary for the contractor to purchase this fuel for the use of its company planes and commercial production to avoid duplication of facilities,

The "additional facilities" referred to by Grumman are mobile refueling trucks, which are furnished on a no-rent basis by the company presently supplying petroleum products to Grumman. All applicable maintenance, both major and minor, is the responsibility of the supplier, which is reimbursed for all "out-of-pocket" expenses as well as for depreciation costs on the vehicles. These costs are reimbursed on a cents-per-gallon basis as a part of the delivered price of the fuel. The trucks are used to deliver fuel from the contractor's central storage point to the area where it is to be consumed.

We realize that, under a Government-furnished petroleum program, some arrangement would have to be made to provide for the mobile refueling trucks required at Grumman. Several alternatives are available. For example, trucks could be purchased or leased by the Government or, through negotiations, the Government could enter into an agreement with the present supplier for the same services that had been provided to Grumman, if such arrangements were considered advantageous. Since about 94 percent of Grumman's total business is with the Government, the Government is, in effect, already paying for the majority of the operating expenses and depreciation associated with the trucks so it appears probable that this problem could be worked out without any significant increase in cost to the Government.

It should be noted that, as a result of a reevaluation at Grumman, the Navy concluded that some savings could be realized under a Government-furnished petroleum program. (See discussion below.) We found that the Navy, in computing these savings, had included an estimated cost of providing the necessary trucks.

#### Navy comments

By letter dated June 28, 1967, the Assistant Secretary of the Navy (Financial Management), furnished comments on behalf of the Department of Defense, (See app, II.) In commenting on our findings, the Navy indicated that it had reexamined the matter of furnishing petroleum products to McDonnell, Grumman, and Pratt & Whitney. As a result of its reevaluation, the Navy had concluded that the arrangements with McDonnell and Grumman should be continued without change.

In the case of Pratt & Whitney, however, the Navy concluded that appreciable and definite savings might be realized if the Government were to furnish the petroleum products or, alternatively, if a change in the contractual treatment of these products were negotiated. By letter

dated November 2, 1967, we were advised that the Navy had established a special team to conduct negotiations with Pratt & Whitney and anticipated that negotiations would be completed about March 31, 1968. (See app. III.)

Details of the Navy comments follow together with our related views.

1. It is the Navy position that it has been examining the feasibility and economic advantages of furnishing petroleum products to its contractors on a case-by-case basis as recommended by GAO.

During our review we found that the Navy had accumulated pertinent statistical data and contractors' views on the matter; however, Navy officials informed us at the close of our review that, because of a shortage of personnel, no detailed studies of this data had been made that were recent enough to be of value.

2. In view of the findings in the draft of this report, the Navy reexamined its review and evaluation of the furnishing of petroleum products to the three contractors specifically covered by the report. In the case of Pratt & Whitney Aircraft Division, the review and evaluation indicated that an appreciable and definite savings might be realized, if the Government were to furnish the petroleum products or, alternatively, a change in the contractual treatment of these products were negotiated. The Navy further informed us that the matter would be negotiated with Pratt & Whitney and that they would advise GAO of the measures taken. In the case of McDonnell Aircraft Corporation and Grumman Aircraft Engineering Corporation, the Navy's review and evaluation indicated that relatively small savings could be realized if the Government furnishes the fuel products and it is believed in the best interest of the Government to allow the contractor to continue to furnish such products.

We have reviewed the basis for the Navy's position and concur in its views not to seek any change in the practices regarding fuel costs at McDonnell.

At McDonnell, a procurement expense factor is applied to the basic cost of petroleum products. A general administrative and handling factor is then applied to the sum of the basic fuel cost plus the previously computed procurement expense. The contractor's profit is then computed by

applying a profit rate to the **sum** of the two factors, Under this method, the resulting profit is considerably **less** than it would be if the profit rate were applied to the basic cost of the petroleum. Because of the method used by McDonnell to compute profit on the **petroleum** products consumed on Government contracts and of the additional **expenses** that the Navy states would be involved in a Government-furnished petroleum program, **it appears** that any savings that might be realized by furnishing these products as Government-furnished material would be relatively minor.

At Grumman, however, the **profit** factor is applied to the **basic cost** of the petroleum products consumed. In its review and evaluation of Grumman, dated May 3, 1967, the Navy computed a profit of **\$86,829** for 1967 on the basis of estimated quantity of petroleum products to be consumed during the year. If the Navy feels that the additional **expenses** involved in furnishing petroleum products to Grumman or other contractors as Government-furnished material would reduce the savings to a minimal amount, consideration could be given to negotiating the contractual treatment of these products on a basis similar to that used at McDonnell. The Navy has **already** indicated that similar negotiations were being conducted with Pratt & Whitney.

### Conclusion

The Navy's findings regarding both Pratt & Whitney and Grumman are essentially parallel with ours. Concerning Pratt & Whitney, the Navy **stated it plans** to take action to obtain the indicated savings. In the case of Grumman, the Navy indicated that **it does** not plan to change the existing arrangements under which the fuel is purchased from Grumman since, in the Navy's judgment, the uncertainties involved are too great in relation to the potential savings.

The Navy's arrangement with McDonnell appears to offer a possible method of dealing with the situation at Grumman or with similar situations involving other contractors, when the Navy considers it not in the best interest of the Government to furnish **fuel**.

### Recommendations

In cases such as that of Grumman, we recommend that the Navy consider contractual arrangements similar to those currently in effect with McDonnell. With respect to other aircraft contractors and aircraft engine contractors that furnish fuel, we recommend that the Navy examine its arrangements to see whether savings might be made by furnishing fuel to these contractors.



**APPENDIXES**

PRINCIPAL OFFICIALS  
OF THE DEPARTMENT OF DEFENSE  
AND THE DEPARTMENT OF THE NAVY  
RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES  
DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
<u>DEPARTMENT OF DEFENSE</u>		
SECRETARY OF DEFENSE:		
Robert S. McNamara	Jan. 1961	Present
DEPUTY SECRETARY OF DEFENSE:		
Paul H. Nitze	July 1967	Present
Cyrus R. Vance	Jan. 1964	June 1967
Roswell L. Gilpatric	Jan, 1961	Jan, 1964
ASSISTANT SECRETARY OF DEFENSE (IN- STALLATIONS AND LOGISTICS) :		
Thomas D. Morris	Sept. 1967	Present
Paul R. Ignatius	Dec. 1964	Aug. 1967
Thomas D. Morris	Jan, 1961	Dec. 1964
DEPUTY ASSISTANT SECRETARY OF DE- FENSE (PROCUREMENT) :		
John M. Malloy	Apr. 1965	Present
Brig. Gen. Robert H. McCutcheon (acting)	Feb. 1965	Apr. 1965
Graeme C. Bannerman	Jan. 1961	Feb. 1965
<u>DEPARTMENT OF THE NAVY</u>		
SECRETARY OF THE NAVY:		
Paul R. Ignatius	Aug. 1967	Present
Vacant	July 1967	Aug. 1967
Paul H. Nitze	Nov. 1963	June 1967
Fred Korth	Jan. 1962	Nov. 1963
UNDER SECRETARY OF THE NAVY:		
Charles F. Baird	July 1967	Present
Robert H. B. Baldwin	July 1965	June 1967
Kenneth E. BeLieu	Feb. 1965	July 1965
Paul B. Fay, Jr.	Feb, 1961	Jan. 1965

PRINCIPAL OFFICIALS  
OF THE DEPARTMENT OF DEFENSE  
AND THE DEPARTMENT OF THE NAVY  
RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES  
DISCUSSED IN THIS REPORT (continued)

Tenure of office  
From To

DEPARTMENT OF THE NAVY (continued)

ASSISTANT SECRETARY OF THE NAVY  
(INSTALLATIONS AND LOGISTICS):

Graeme C. Bannerman  
Kenneth E. Belieu

Feb. 1965 Present  
Feb. 1961 Feb. 1965



DEPARTMENT OF THE NAVY  
OFFICE OF THE SECRETARY  
WASHINGTON, D. C. 20350

28 JUN 1967

Dear Mr. Hammond:

The Secretary of Defense has asked me to reply to your letter of 23 January 1967 which forwarded the draft report on savings offered by direct procurement of petroleum products for use by Department of the Navy aircraft and aircraft engine contractors.

I am enclosing the Navy reply to the report.

Sincerely yours,

A handwritten signature in cursive script that reads "Charles F. Baird".

CHARLES F. BAIRD  
ASSISTANT SECRETARY OF THE NAVY

Mr. James H. Hammond  
Associate Director, Defense Division  
U. S. General Accounting Office  
Washington, D. C. 20548

Enclosure

- (1) Department of the Navy reply on GAO Draft Report of 23 Jan 1967 on Potential Savings Offered by Direct Procurement of Petroleum Products for Use by Department of the Navy Aircraft and Aircraft Engine Contractors (OSD Case #2552)

COPY

Navy Reply

to

GAO Draft Report of 23 January 1967

on

Potential Savings Offered by Direct Procurement of  
Petroleum Products for Use by Department of the Navy

Aircraft and Aircraft Engine Contractors

(OSD Case #2552)

I. SUMMARY

The General Accounting Office feels that the Navy, primarily through the elimination of prime contractors' fees on the petroleum product cost, could realize substantial savings if the Navy were to furnish its contractors with certain petroleum products in the testing of aircraft and aircraft engines rather than permitting the contractors to purchase these products from the suppliers.

GAO conducted a review of petroleum procurement for calendar year 1964 at three Navy contractors' plants. These contractors consumed 86 per cent of the total 1964 requirements. GAO estimated that the Navy could have realized savings approximating \$264,000 in 1964 had the Navy furnished the petroleum products. Estimated consumption of petroleum products was slightly higher in 1965 and substantially higher in 1966. GAO estimates that savings in 1966 could have exceeded \$500,000.

GAO recommends that the Secretary of Defense consider taking action to have the Department of the Navy re-examine the feasibility and economic advantages of furnishing petroleum products to its contractors on a case-by-case basis.

II. STATEMENT

The GAO report recognizes Navy Procurement Directive 13-250. This Directive requires a Contracting Officer determination for each contractor as to whether petroleum products

Enclosure (1)

will be Government or contractor furnished. This determination must include a written summary of supporting information and must be reviewed every two years. The determinations are made by, reviewed by, and are on record in the Naval, Air **Systems** Command. It is the Navy position that it has been examining the feasibility and economic advantages of furnishing petroleum products to its contractors on a case-by-case basis, **as** recommended by GAO.

In view of the findings in the GAO report, the Navy re-examined its review and evaluation of the furnishing of petroleum products to the three contractors specifically covered by the report. In the case of McDonnell Aircraft Corporation and Grumman Aircraft Engineering Corporation, this review and evaluation determined that it is to the overall advantage of the Government for the contractors to continue to furnish the products. Based on actual or estimatable costs of the products, the contractors' profits, and government administrative expenses under the two methods of furnishing the fuel products, there is calculated to be a relatively small savings if the Government furnishes the fuel products. The actuality and amount of these savings are not definite because of the fact that prices of the products to the Government are not firm until contracts for the particular requirements are made and of uncertainties with respect to the cost of administrative operations which would be required, but are not in existence. When the more intangible costs, and those factors other than product cost whose existence is recognized in the GAO report, are taken into consideration, it is believed not in the best interest of the Government for it to furnish the fuel products to McDonnell and Grumman.

In the case of Pratt and Whitney Aircraft Division, the review and evaluation indicated that an appreciable and definite savings might be realized, if the Government were to furnish the petroleum products or, alternatively, a change in the contractual treatment of these products were negotiated. This matter will be negotiated with Pratt and Whitney during negotiations for definitization of the present letter contract. Due to the magnitude of this contract, negotiations are not expected to be completed until 30 September 1967. GAO will be advised of the measures taken.



DEPARTMENT OF THE NAVY  
OFFICE OF THE COMPTROLLER  
WASHINGTON, D. C. 20350

IN REPLY REFER TO

NOV 2 3.967

Dear Mr. Hammond:

Assistant Secretary of the Navy (Financial Management) letter of 28 June 1967 forwarded the Navy reply to the GAO draft report on savings offered by direct procurement of petroleum products for use by Navy aircraft and aircraft engine contractors (OSD Case #2552). The reply stated that a change in the contractual treatment of petroleum products would be negotiated with Pratt and Whitney during negotiations for definitization of the current letter contract and that GAO would be advised of the measures taken. At that time, it was expected that the negotiations would be completed about 30 September 1967.

Subsequent to the Navy reply, the negotiations became more complex and a special team was established to conduct them. It is now anticipated that the negotiations will be completed about the last of March 1968,

Sincerely,

A handwritten signature in cursive script, appearing to read "Eli T. Reich".

ELI T. REICH  
Acting

Mr. James H. Hammond  
Associate Director, Defense Division  
U. S. General Accounting Office  
Washington, D. C. 20548

Office of the President

# United Aircraft

February 8, 1967

United States General Accounting Office  
Defense Accounting and Auditing Division  
Washington, D.C.

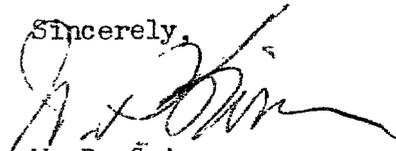
Attention: Mr. James H. Hammond, Associate Director

Gentlemen:

This will acknowledge your letter of January 23, 1967, transmitting to us a preliminary draft of your report on potential savings you believe would be realized by direct procurement of petroleum products for use by Department of the Navy contractors. We note that, you are recommending that the Secretary of Defense consider taking action to have the Department of the Navy re-examine the feasibility and economic advantages of furnishing petroleum products to its contractors on a case-by-case basis.

We have studied this matter on more than one occasion in the past, and have concluded that, in the particular circumstances of our Pratt & Whitney Aircraft division, the furnishing of petroleum products by the Government for use in engine testing would create a number of problems, and would not be practicable. Neither would it produce, in our opinion, any over-all savings to the Government. Our views have not changed. However, of course, we would be glad to cooperate in any re-examination of this matter which the Navy may undertake.

Sincerely,



W. P. Gwinn  
President

ems

EAST HARTFORD, CONNECTICUT 06108

GRUMMAN AIRCRAFT ENGINEERING CORPORATION  
BETHPAGE, LONG ISLAND, NEW YORK 11714

CABLE ADDRESS  
GRUMAIR

EXECUTIVE OFFICES



February 21, 1967

United States General Accounting Office  
Defense Accounting and Auditing Division  
Washington, D. C. 20548

Attention: Mr. James H. Hammond, Associate Director

Reference: United States General Accounting Office  
letter dated January 23, 1967

Dear Mr. Hammond:

We have reviewed the preliminary report of your analysis of potential savings offered by direct procurement of petroleum products **for** use by Department of the Navy aircraft and aircraft engine contractors.

Our review included a discussion with your staff concerning the computation of Grumman's 1964 profit applicable to the cost of products charged to Government contracts of \$48,000 indicated on page 8 of your preliminary report. We find that the profit calculation should have been \$33,000.

Reference is made to your recommendation that the Department of the Navy determine the feasibility of furnishing petroleum products to its contractors on a case-by-case basis, which in the Contractor's considered opinion, is the only reasonable means to make such a determination. In this respect the Contractor wishes **to** advise that he has furnished data to the Naval Plant Representative Office, Bethpage, at various times to aid the Navy in making its determination.

Included in the data furnished, the Contractor has indicated that additional facilities costing approximately \$300,000 will be required if those facilities presently furnished by the Contractor's

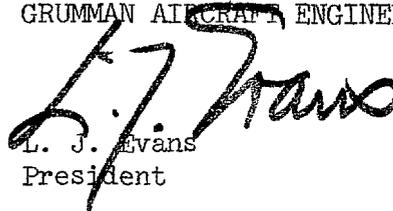
GRUMMAN AIRCRAFT ENGINEERING CORPORATION

vendor (Shell Oil Company) are to be replaced. Additionally, if aviation fuels were government furnished, some arrangement would be necessary for the Contractor to purchase this fuel for the use of its company planes and commercial production to avoid a duplication of facilities.

The Contractor would like to note, however, that in its opinion the present arrangements have proven mutually satisfactory to both the Navy and to Grumman from an operational standpoint,

Very truly yours,

GRUMMAN AIRCRAFT ENGINEERING CORPORATION



L. J. Evans  
President

cc: NAVPLANTREPO