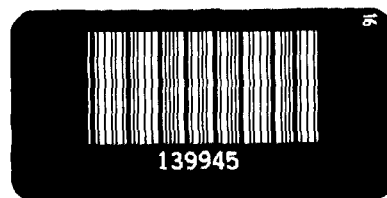


GAO

November 1989

BUREAU OF  
RECLAMATION

Misapplication of the  
Buy American Act





United States  
General Accounting Office  
Washington, D.C. 20548

National Security and  
International Affairs Division

B-233192.1

November 8, 1989

The Honorable Manuel Lujan, Jr.  
Secretary of the Interior

Dear Mr. Secretary:

On August 1, 1988, Representative Vic Fazio requested that we determine whether the Bureau of Reclamation complied with the requirements of the Buy American Act when contracting for an irrigation project in New Mexico. The prime contract for this work was awarded in September 1987 to Mingus Constructors, Inc., of Cottonwood, Arizona. In November 1987, Mingus awarded a subcontract for water control valves to Bermad Irrigation Controls, Inc., of Anaheim, California. The work on the prime and subcontracts was substantially completed in April and May 1989.

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## Results in Brief

There was a general confusion among both the government and private sector officials on what the Buy American Act covers and how to apply its implementing regulations to the awards in question. This confusion resulted in the Bureau misapplying the Act in determining that a supplier's construction materials qualified as being of domestic origin. The requirement that the cost of domestic components account for over half of the total component costs was not met. However, since the prime and subcontracts have been substantially completed, there is no reason to disturb these awards.

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## Buy American Act Requirements

The Buy American Act (41 U.S.C. sec. 10b), as implemented by the Federal Acquisition Regulation (FAR, part 25), requires that only construction materials manufactured in the United States be used on public construction work done in the United States unless (1) the cost would be unreasonable, (2) use of domestic construction material would be impractical, or (3) the construction material is not produced in the United States in sufficient quantities of a satisfactory nature. The Act and the FAR require construction material to pass a two part test to qualify as being of domestic origin: (1) the material must be manufactured in the United States and (2) the cost of its U.S. components must account for more than half the total component cost.

The wording of the Buy American Act prohibits the use of foreign construction materials subject to certain exceptions. These exceptions in

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effect only grant U. S. products a price preference. In general, civilian agencies, including the Department of the Interior, implement the Act by defining the "unreasonable cost" exception to mean bids where the domestic materials cost over 6 percent more than the foreign materials offered. The private sector officials involved were confused by this difference.

The solicitation for the prime contract allowed the use of foreign construction materials under certain conditions: they had to be (1) separately listed and (2) clearly shown to be of lower price (after adding a 6 percent differential) than the available domestic materials. If these conditions were not met, the solicitation required the prime contractor to use domestic materials.

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### Application of the Buy American Act

Ames Company, Inc., of Woodland, California, an unsuccessful bidder on the subcontract for 27 water control valves, wrote a letter in September 1987 to the Bureau of Reclamation questioning the subcontract award to Bermad. Ames believed that Bermad (an importer of valves from its parent company in Israel) had bid foreign valves and should not have qualified for the subcontract award. The Bureau obtained Bermad's February 1988 cost breakdown on its subcontract bid, which showed that over 50 percent of Bermad's total subcontract cost was domestic. The Bureau requested legal advice from Interior's Regional Solicitor in Salt Lake City, Utah, on whether the Bermad cost data did in fact establish these valves as being of domestic origin. The Solicitor replied in March 1988 that because the cost of U.S. materials comprised over 50 percent of the total cost of materials, the valves provided by Bermad should qualify as being of domestic origin under the Buy American Act.<sup>1</sup> Consequently, the Bureau took no further action, and the subcontract was completed in April 1989.

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### Determining Domestic Origin

One of the two separate tests that must be passed to qualify construction materials as being of domestic origin is that the cost of the components produced in the United States be over half of the total component costs. Components are articles, materials, or supplies that are incorporated directly into the construction material. Only the component costs

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<sup>1</sup>The United States and Israel have a Free Trade Agreement which waives the Buy American Act's domestic materials preference for certain procurements. However, the waiver does not apply to (1) construction contracts, and (2) purchases for the Bureau of Reclamation. Therefore, the Agreement does not cover this procurement.

(including the cost of manufacturing any domestically made components) are used to determine whether the materials bid are of domestic origin.<sup>2</sup>

Both the government and private sector officials responsible for evaluating and awarding the prime and subcontracts confused the Buy American Act's requirements for determining if construction materials are of domestic origin. When the Bureau and Interior officials calculated the costs of the valves' domestic components (based on Bermad's cost breakdown), they included the costs of (1) domestic labor to attach parts to the imported valve assemblies and (2) manufacturing overhead and general administrative expense. These costs should not have been included in this calculation. When these two costs are excluded, the amount of domestic component costs falls below 50 percent. Thus, the Bermad valves do not qualify as being of domestic origin. Therefore, if Bermad's subcontract bid had been properly listed as offering foreign valves that apparently cost more than the domestic ones bid by Ames, the Bureau, in accordance with the solicitation's requirements, should have required that Mingus use domestic valves.<sup>3</sup>

The other test that also must be passed to qualify construction materials as being of domestic origin is that they be manufactured in the United States. In this case, Bermad's records show that the valve body, actuators, and pilots were imported while the control valves and strainers, pressure gauges, orifice plates, and control fittings and tubing were added in the United States. If the work done in the United States constituted a substantial manufacturing process, the valves would pass the Buy American Act's manufacturing test. However, we are not addressing this issue because the Bermad valves failed the component cost test.

## Recommendations

To ensure that all future procurements are made properly, we recommend that

- the Bureau of Reclamation's Division of Acquisition and Assistance issue guidance for its contracting personnel and prospective bidders on the proper application of the Buy American Act's requirements for determining (a) whether a bid involves materials of domestic origin and

<sup>2</sup>When determining the proper costs attributable to components, the freight cost from the source to the point of inclusion in the end product and any customs duty on foreign components must be added.

<sup>3</sup>Ames claims that its lower bid for the valve subcontract was included in its bid sheet along with bids for other contract line items. Mingus disputes this claim.

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(b) the correct evaluation differential is applied to bids of foreign materials and

- Interior's Office of Acquisition and Property Management determine whether other Interior organizations need similar guidance.

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## Agency Comments

As requested, we did not obtain written agency comments on this report, but we discussed it with the officials involved who told us that our report was accurate, and our recommendations would be implemented.

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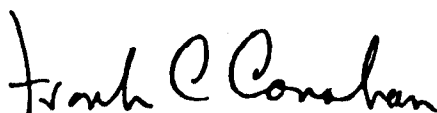
To determine whether all relevant Buy American Act requirements were met for the award of the prime and subcontracts, we reviewed the Buy American Act and related federal and Department of the Interior procurement regulations. We also interviewed Interior Department and private sector officials involved in evaluating the bids and awarding the contracts and reviewed all documentation available concerning these actions. We have not included the proprietary cost data used in our analysis of component costs. Our work was done in Washington D. C., in accordance with generally accepted government auditing standards.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations. This statement must be submitted to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report. A similar statement must be submitted to the Senate and House Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to Representative Vic Fazio and to the Director, Office of Management and Budget, and will be sent to other interested parties on request. The report was prepared under the direction of Allan I. Mendelowitz, Director, Trade, Energy, and Finance Issues. The principal staff members responsible for this review were

John E. Watson and Roy B. Karadbil. They were assisted by William T. Woods and Richard R. Perruso of the Office of General Counsel. If you have any questions, please call Mr. Mendelowitz on (202)-275-4812.

Sincerely yours,



Frank C. Conahan  
Assistant Comptroller General

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