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Defense Department Is Not Doing Enough To Maximize Competition when Awarding Contracts for Foreign Military Sales. PS&D-78-147; B-165731. October 17, 1978. 33 pp. + 2 appendices (6 pp.).

Report to Rep. Jack Brooks, Chairman, House Committee on Government Operations: Legislation and National Security Subcommittee; by Elmer B. Staats, Comptroller General.

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When transacting foreign sales, the Department of Defense (DOD) generally follows the same policies and procedures required by the Armed Services Procurement Regulations (ASPR) whether the contract is awarded for U.S. forces or for foreign military sales (FMS). Foreign countries are, however, allowed to make sole-source designations in their requests for procurement. A statistical sample of DOD contracts was studied to determine the extent of competition in FMS. Findings/Conclusions: Many U.S. firms lose the opportunity to compete for DOD contracts because the DOD is currently placing contracts valued at billions of dollars on a sole-source basis to buy goods and services for other countries. DOD activities often ignored or were unaware that ASPR applies to foreign military sales, requested other countries to make sole-source designations, awarded contracts that could have been handled through normal commercial channels, and fostered and encouraged designation of high-priority requisitions which influence the award of sole-source procurements. The Northrop Corporation was designated as the sole-source supplier for the Peace Hawk program for Saudi Arabia. Designation of Northrop as supplier for certain related efforts was logical, but the Saudi Arabians also designated Northrop as the sole source for phases of the program that would not normally be awarded to an aircraft manufacturer. As a result, many U.S. firms lost the opportunity to compete on hundreds of millions of dollars of contracts in their own areas of expertise. Recommendations: The Secretary of Defense should: encourage other countries and U.S. program managers to avoid setting time schedules that compel sole-source

procurement; determine whether the predominance of high-priority acquisitions is caused by a failure to apply normal DOD priority rules; determine whether greater integration of other country efforts with DOD logistics systems could hold sole-source procurements to a minimum; make procurement personnel aware that disciplinary action will be taken if they request other countries to make sole-source designations; assess the desirability of foreign country designations requiring DOD to use subsequent procurements from the original vendors; take advantage, where possible, of commercial channels to reduce administrative burdens imposed by FMS; and explain to customer countries the potential benefits available through competitive procurement. The Secretary of the Air Force should return sensitive functions, such as monitoring FMS requirements and purchasing plans, to appropriate Air Force commands. (MRS)

8048

REPORT BY THE
Comptroller General
OF THE UNITED STATES

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Defense Department Is Not Doing Enough To Maximize Competition When Awarding Contracts For Foreign Military Sales Programs

The Department of Defense could award more contracts on a competitive basis for foreign governments. This would improve the U.S. industrial base, provide opportunities to U.S. firms not currently bidding on contracts, and enable DOD to better fulfill its role as mediator between foreign buyers and American sellers.



PSAD-78-147
OCTOBER 17, 1978



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

B-165731

The Honorable Jack Brooks
Chairman, Subcommittee on Legislation
and National Security
Committee on Government Operations
House of Representatives

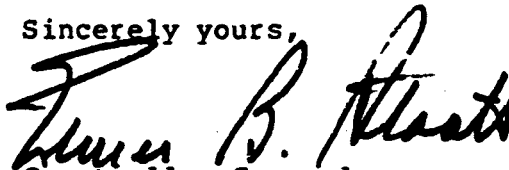
Dear Mr. Chairman:

In response to your Subcommittee's December 7, 1977, request, we examined the extent of competition in foreign military sales and the reasons for award of sole-source (noncompetitive) contracts.

At the Subcommittee's request, we did not take the additional time to obtain written Defense Department or contractor comments. The matters covered in the report were discussed with Department officials and Northrop Corporation personnel, and their comments are incorporated where appropriate.

As arranged with your office, we will provide copies to the Secretary of Defense and make a general distribution of this report 30 days after you receive it.

Sincerely yours,


Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE SUBCOMMITTEE ON
LEGISLATION AND NATIONAL SECURITY
COMMITTEE ON GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

DEFENSE DEPARTMENT IS NOT
DOING ENOUGH TO MAXIMIZE
COMPETITION WHEN AWARDING
CONTRACTS FOR FOREIGN
MILITARY SALES PROGRAMS

D I G E S T

Many U.S. firms lose the opportunity to compete for Department of Defense (DOD) contracts because DOD currently is placing contracts valued at billions of dollars on a sole-source basis to buy goods and services for other countries.

The Armed Services Procurement Regulation, ^{1/} which according to DOD policy applies to foreign military sales, provides that competition be obtained in awarding Government contracts whenever practical and advertised procurement is the preferred method of contracting. However, DOD has a policy of permitting countries that are paying for items ordered to designate the U.S. company that will provide the goods and services desired. In some cases, these designations exist for several years.

The services have not maximized competition when awarding contracts to satisfy foreign requests. GAO found instances where DOD activities had

- ignored or were unaware that the Armed Services Procurement Regulation applies to foreign military sales,
- requested other countries to make sole-source designations,
- awarded contracts that could have been handled through normal commercial channels, and
- fostered and encouraged designation of high-priority requisitions which influence the award of sole-source procurements.

^{1/}The Armed Services Procurement Regulation is now called the Defense Acquisition Regulation.

Result: a high percentage of contracts awarded sole source.

Of course, some factors make the use of competition in foreign military sales difficult, such as the

- short time to meet delivery requirements frequently placed on DOD,
- peculiarity of some weapon systems sold to other countries not common to U.S. systems,
- uncertainty of integrating foreign logistics systems with U.S. logistics systems,
- political factors influencing many foreign programs, and
- funding problems encountered in financing some foreign military sales.

Notwithstanding that some of these factors are outside DOD's control, it is important that procurement authorities do everything, whenever possible, to maximize competition.

RECOMMENDATIONS TO THE SECRETARY OF DEFENSE

GAO recommends that the Secretary of Defense make a strong and continuing commitment to provide greater management attention and emphasis on the desirability of obtaining competition in procurements for foreign military sales by

- encouraging other countries and U.S. program managers to avoid setting time schedules that compel sole-source procurement;
- determining whether the predominance of high-priority requisitions is caused by a failure to apply normal DOD priority rules;
- determining whether greater integration of other country needs with DOD logistics

systems could hold sole-source procurements to the minimum;

- making procurement personnel at all levels aware that disciplinary action will be taken if they request other countries to make sole-source designations;
- assessing the desirability of foreign country designations requiring DOD to make all subsequent procurements from the same vendors that provided the original items;
- taking advantage of available commercial channels, whenever possible, to reduce the administrative burden imposed by foreign military sales; and
- explaining to customer countries the potential savings and other benefits available through competitive procurement and attempting to obtain agreement for procurement on this basis.

The growth of foreign military sales and the attendant growth in the administrative burden associated with such sales have strained DOD manpower resources. This manpower shortage led the Air Force to contract with Northrop Corporation for management functions that Government personnel normally perform. This arrangement creates a potential organizational conflict of interest because Northrop is a major supplier of foreign military sales items. Organizational conflicts of interest in the context of Government contracts deal primarily with situations where a company, by virtue of work performed on one contract, would be in an unfair competitive position to obtain other contracts or would be in a position to influence the work to be performed on other contracts.

**RECOMMENDATION TO THE
SECRETARY OF THE AIR FORCE**

GAO recommends that the Secretary of the Air Force return sensitive functions, such as

monitoring foreign military sales requirements and purchasing plans, to appropriate Air Force Commands. In the event personnel ceiling limitations will not permit returning these functions to Air Force personnel, the Secretary should contract for these services with an organization not involved with production or sale of military goods or services.

RECOMMENDATION TO THE CONGRESS

GAO recommends that the Congress consider the impact of foreign military sales on DOD manpower when establishing personnel ceilings.

As requested by the subcommittee, GAO did not take the additional time to obtain written DOD or contractor comments. The matters covered in the report were discussed with DOD officials and Northrop Corporation personnel, and their comments are incorporated where appropriate. Generally, DOD believes GAO's report over-emphasizes the negative aspects of sole-source procurements and does not sufficiently recognize that there are valid reasons for making such procurements. GAO recognizes that some sole-source procurements are unavoidable. (See p. 7.) The report also points out that there are factors beyond DOD's control which influence or contribute to sole-source procurements. (See p. 14.)

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ABBREVIATIONS

ASPR	Armed Services Procurement Regulation
BOA	basic ordering agreement
DOD	Department of Defense
DSAA	Defense Security Assistance Agency
FMS	foreign military sales
GAO	General Accounting Office
LOA	letter of offer and acceptance
NiSD	Northrop Aircraft Services Division
P&A	price and availability
RAPS	reporting, analysis, and planning system
RFPs	requests for proposals
VAST	versatile avionics shop test

CHAPTER 1

INTRODUCTION

As requested by the Chairman, Subcommittee on Legislation and National Security, House Committee on Government Operations, we have reviewed selected aspects of foreign military sales (FMS). Such sales result from Government-to-Government agreements initiated when a foreign country indicates it wants to buy U.S. military equipment.

When transacting foreign sales, the Department of Defense (DOD) generally follows the same policies and procedures required by the Armed Services Procurement Regulation (ASPR) whether the contract is awarded for FMS or U.S. Forces. Foreign countries, however, are allowed to make sole-source designations (select the U.S. firm by name) in their requests for procurements. This right is an exception to ASPR policy that competition is the preferred way to buy, and it results in procurement officers' awarding sole-source contracts that would be competed for U.S. needs.

The spirit of competition is a primary contributing factor in maintaining a modern industrial base. Further, competitive procurements have been estimated to average 25 percent less in cost than sole-source procurements. We made this review to determine the extent of competition in FMS.

PROCEDURES FOR MAKING FMS

FMS are subject to State Department approval in coordination with DOD. When a foreign country desires to buy fighter airplanes or combat ships, the request must be reviewed and approved by State.

The Congress must be notified 30 days in advance of proposed sales exceeding \$25 million or of sales involving major defense equipment over \$7 million. If the Congress disapproves the proposed sale within 30 days of the notification, the sale cannot be made unless the President declares an emergency.

Once approved, the sales order is sent to the Defense Security Assistance Agency (DSAA). DSAA is responsible for monitoring FMS and generally provides the Congress with yearly summaries on FMS activities. DSAA assigns the sale to the Army, Navy, or Air Force. The military services are

responsible for selling equipment, either directly from their own stocks, or purchasing equipment for subsequent delivery to foreign buyers.

Each service has an International Security Assistance Office that assists foreign countries in deciding what items are best suited to meet its needs. These Offices identify the command within their service that will provide the equipment and request a price and availability (P&A) report.

The P&A report is used by the International Security Assistance Office to prepare a letter of offer and acceptance (LOA). The LOA cites an estimated price and delivery date and sets forth the terms and conditions of the sale. The International Security Assistance Office may negotiate with the country while the LOA is being prepared.

The foreign country can accept the offer by signing the LOA and returning it to the International Security Assistance Office; it can also designate its preference for a specific U.S. firm by naming it on the LOA.

The International Security Assistance Office notifies the command that the LOA has been signed and funds are available. The command then decides whether to (1) fill the order from its stock or (2) award a contract.

If the decision is to award a contract, the command can

--award a new contract,

--modify an existing contract by increasing the quantities already ordered, or

--place an order under a basic ordering agreement (BOA)--an arrangement in which the U.S. firm agrees to sell certain items when DOD has a need for them.

PROCEDURES FOR AWARDING GOVERNMENT CONTRACTS

The Government generally buys the items it needs through either formal advertising or negotiation. Under formal advertising procedures any number of firms may submit sealed bids. When the sealed bids are opened, the lowest responsive and responsible bidder is awarded the contract. The competitive process establishes what is a reasonable price. The ASPR provides that all contracts be formally advertised whenever practical and feasible.

ASPR recognizes that formal competition cannot always be used; therefore, it also provides for competitive negotiation and sole-source (noncompetitive) contracts. Competitive negotiation generally involves issuance of requests for proposals (RFPs) which are subject to discussion or negotiations between the Government and the offerers. Award is made to the offerer submitting the proposal deemed most advantageous to the Government, price and other factors considered.

For example, four firms that produce aircraft may be requested to provide proposals on a new aircraft the Government needs. The Government negotiates the price and other matters with the firm selected. Cost and pricing data are submitted to the Government for analysis and generally are a major consideration in negotiating the contract price.

Sole-source awards are made to a single firm without the benefit of competition. The sole-source method of award is the least preferred method the Government uses because there is no competitive incentive to minimize cost.

Of the types of contract actions previously mentioned, contract modifications and BOAs are sole source. New contracts may be formally advertised, competitively negotiated, or sole source.

SCOPE OF REVIEW

To determine the extent of competition in FMS, we took a statistical sample of 230 contracts from the 1,893 new contracts awarded in fiscal year 1977. We determined how each of the 230 sample contracts was awarded--formally advertised, competitively negotiated, or sole source. We then determined the reasons why some contracts were awarded sole source by selectively sampling 35 from among those awarded on a sole-source basis. We also selected and examined an FMS contract awarded for a major undertaking. This contract was awarded by the Air Force to Northrop Corporation for Saudi Arabia in March 1976 and covers a variety of efforts through 1979 at an estimated cost of \$1.6 billion. (See ch. 3.)

We reviewed contract files and related documents on FMS contracts awarded in fiscal year 1977. We also discussed these contracts, as well as FMS in general, with personnel at DSAA and the three International Security Assistance Offices. We interviewed personnel at various commands responsible for awarding and administering contracts for FMS.

We also visited the following activities during our review:

Army:

International Security Assistance Office
Washington, D.C.

Missile Materiel Readiness Command
Huntsville, Alabama

Corps of Engineers, District Office
Huntsville, Alabama

Navy:

International Security Assistance Office
Sea Systems Command
Air Systems Command
Washington, D.C.

Aviation Supply Office
Philadelphia, Pennsylvania

Ships Parts Control Center
Mechanicsburg, Pennsylvania

Air Force:

International Security Assistance Office
Washington, D.C.

Aeronautical Systems Division
Logistics Command
Dayton, Ohio

San Antonio Air Logistics Center
San Antonio, Texas

Oklahoma City Air Logistics Center
Oklahoma City, Oklahoma

Defense Logistics Center:

Defense Personnel Support Center
Philadelphia, Pennsylvania

Northrop Corporation:

Aircraft Group, Hawthorne, California, Northrop
Worldwide Aircraft Services, Inc., Lawton, Oklahoma

CHAPTER 2

EXTENT OF COMPETITION IN FMS

When awarding contracts to satisfy foreign requests, DOD should give greater management attention and increased emphasis to the desirability of competition. It could then

- increase the number of contracts awarded through the competitive process,
- obtain reduced prices for FMS customers,
- foster improvement in the competitive industrial base by increasing the number of participating firms, and
- better fulfill its role as "agent in trust" to foreign buyers and as mediator between buyers and sellers.

The military departments have not maximized competition in awarding contracts for FMS. About 88 percent of the FMS contracts awarded in 1977 and 90 percent of the dollars committed--\$3.99 billion out of \$4.45 billion--were awarded without the benefit of competition. In some cases, the services have encouraged sole-source designation for FMS orders. A primary reason is that it is much easier to award a contract on a sole-source basis than it is to follow the more difficult and lengthy procedure involved in competitive awards.

The number and types of FMS contracts awarded in 1977 follow.

	<u>Number of contracts</u>			<u>Amount</u>		
	<u>Total</u>	<u>Competitive</u>	<u>Noncompetitive</u>	<u>Total</u>	<u>Competitive</u>	<u>Noncompetitive</u>
				(000 omitted)		
Contract modifications	1,778	-	1,778	\$1,560,347	\$ -	\$1,560,347
Orders under contracts	2,083	-	2,083	188,267	-	388,267
New contracts	<u>1,893</u>	<u>664</u>	<u>a/1,229</u>	<u>2,500,922</u>	<u>463,290</u>	<u>a/2,037,632</u>
	<u>5,754</u>	<u>664</u>	<u>5,090</u>	<u>\$4,449,536</u>	<u>\$463,290</u>	<u>\$3,986,246</u>

a/These figures are based on our statistical projection from a random sample plus contracts for major defense items.

Of the three types of awards shown in the table, only new contracts are subject to the competitive process. Some new contracts are also excluded from competition because they are for specific major defense items, such as a particular ship or aircraft produced by a sole-source contractor.

As a result, of the 5,754 awards made in 1977, only 1,831 were considered candidates for the competitive process. Further details on the 1977 awards for FMS are presented below.

CONTRACT MODIFICATIONS

Contract modifications are changes within the scope of work originally agreed to or increases in the quantity of items to be supplied. For example, the Air Force may award a contract for 1,000 missiles. If a foreign country later requests 200 of the same missile, the Air Force, instead of awarding another contract, may modify the existing contract by negotiating a contract modification for the additional quantity and price.

Modifications can result in significant increases in the number of items being procured and the unit price. This is one reason why competition is essential in awarding the original contract. It may also be appropriate to consider a competitive award instead of a contract modification to preclude continuing sole-source awards. As a part of our review, we looked at a number of items that had been purchased under successive sole-source contracts. The results of this segment of our review are presented on page 31.

ORDERS UNDER CONTRACTS

Orders are awards made under agreements established in an earlier period. Such agreements are known as BOAs and used when specific items, quantities, or prices are not known but where past experience or future plans indicate that many items will be needed from a contractor.

For example, the Army may purchase a number of vehicles to be used at various locations. Since the Army does not know what repair parts will be needed at each location or the quantities of such repair parts, a BOA could be executed between the vehicle manufacturer and the Army. The contractor would agree to supply the needed parts in the quantities ordered. The Army would agree to an arrangement for establishing the prices of the items to be supplied and notify its activities of the agreement. Each order placed under the agreement is a separate contract.

BOAs generally are used for ordering replacement parts needed to support equipment, such as planes, ships, vehicles, or electronics. Foreign countries can also obtain replacement parts under these agreements.

MAJOR DEFENSE ITEMS

There were 59 contracts totaling \$806.9 million awarded in 1977 for such items as ships, planes, and tanks. These contracts were awarded sole source because only one manufacturer produced each of the items. For example, McDonnell Douglas Corporation makes the F-15 aircraft, Chrysler Corporation produces the XM-1 tank, and Ingalls Corporation builds DD-963 class destroyers. If a country wants to purchase any of these items, the contract is awarded to the sole producer.

DSAA officials agreed that there was little, if any, competition for major items sold through FMS. They pointed out, however, that frequently there was competition when the items were originally bought by U.S. Forces. This competition was quite intense for some items, with competing systems being tested in actual conditions before the decision to buy was made.

Secondary items

Since it is frequently impractical to obtain competition on major items, it is important that procurement of support items be on a competitive basis whenever possible so the maximum number of firms can participate. Requirements for support items will undoubtedly increase while the demand for major items may decline as foreign countries reach the limits of their absorptive capacity. Support item costs over the life of a major item can represent a major part of the total cost and sometimes constitute the principal cost. The market, therefore, can be large, and a significant number of U.S. firms should be able to participate and benefit.

In the past, DOD used a rule of thumb that a 25-percent saving would result if a noncompetitive buy were awarded competitively. In view of the size of the FMS program, DOD actions to increase competition could result in significant savings to FMS customers and also benefit the United States through strengthening its industrial base by awarding contracts to the most efficient producers.

From a random sample of new contracts awarded in 1977, we estimate that only 37 percent were awarded competitively. The table below does not include contracts for major defense items.

	<u>Number of contracts</u>	<u>Percent of total</u>
Formally advertised	267	15
Competitively negotiated	<u>397</u>	<u>22</u>
Total competitively awarded	<u>664</u>	<u>37</u>
Sole source (noncompetitive)	<u>1,167</u>	<u>63</u>
Total (note a)	<u>1,831</u>	<u>100</u>

a/Figures rounded to total.

We selected 35 contracts that were awarded sole source to determine the reasons for these awards. We noted two categories of noncompetitive awards--those designated by foreign countries (they select the U.S. firm by name) and those where DOD decided to award a sole-source contract.

SOLE-SOURCE AWARDS BY DOD

We found that DOD was making sole-source awards because:

- There was a lack of emphasis and management attention to the applicability of ASPR when contracts were for FMS.
- Foreign requisitions were assigned high priorities, and the indicated urgency was used as justification to avoid the competitive process.
- Single vendor integrity programs (described on p. 13.) have been established on some programs, requiring purchases to be made from the same firm that made the equipment originally installed in the major defense item.
- The delivery dates specified by foreign countries do not allow time for competitive procurements.
- Design data required to competitively procure items was not purchased.

In addition, nonmilitary commercial items were procured through FMS that could have been purchased by foreign countries in the commercial market.

DOD policy recognizes that in some cases it is advantageous to encourage foreign purchasers to use commercial

channels and prefers that such channels be used as much as possible. Foreign countries, however, often prefer to use DOD as a purchasing agent because it provides procurement expertise and assumes contract administration responsibilities.

Despite DOD policy, in several instances the foreign request could have been satisfied through commercial channels but the desired items were purchased under FMS procedures. For example:

- The Peruvian Navy requested the Defense Logistics Agency to purchase X-ray machines and dental chairs totaling \$1.5 million and designated the desired items sole source.
- Other items purchased for the Peruvian Navy included projection equipment, hospital beds, and radio and recording equipment.
- The Army Corps of Engineers complied with a foreign government's request for household furnishings by taking an official to several New York stores to select desired items. Corps of Engineers personnel were used to make the sole-source purchases of items finally selected.

Using DOD manpower to handle purchases that could be acquired in the commercial marketplace adds to the burden of already strained resources.

Further details and specific examples of conditions limiting competition are presented below.

Lack of emphasis and management attention to ASPR applicability

Some activities failed to follow DOD's policy that procurements for FMS are to be handled the same way they handle their own purchases. For example:

- A major Army command obtained foreign country sole-source designations by using an unauthorized clause in the LOA.
- An Air Force activity obtained sole-source designations from foreign countries by threats of requisition cancellation.
- The Navy Ships Parts Control Center failed to apply ASPR provisions to procurements for FMS.

These actions were the result of a lack of emphasis and management attention to ensure that the competitive process was used whenever possible. As a result competition has been reduced and sole-source awards were improperly made.

Army--use of unauthorized clauses

The Army's Missile Materiel Readiness Command awarded sole-source contracts on the basis that foreign countries designated a particular source. However, some of these sole-source designations were triggered by the Missile Command's use of an unauthorized clause in the LOA. The Missile Command included a clause stating that sole-source procurement was necessary to meet required delivery dates and "signature in the acceptance block of this letter will constitute authority for the U.S. Government to negotiate sole source."

Before July 1976 the Missile Command added the sole-source language as a standard clause in all LOAs. In July 1976 the Army International Logistics Command informed Army activities that using such a clause was unauthorized and that

"* * * sole source procurement is authorized only at the specific request of a foreign government without prompting by U.S. advisors or other U.S. Government personnel."

The Missile Command has discontinued using the unauthorized clauses.

Air Force--requires sole-source designations

To justify sole-source awards, an Air Force activity requested foreign countries to make sole-source designations. In a 3-month period, this Air Force activity sent nine messages to foreign countries specifying four contractors' names and part numbers and requesting that the foreign countries designate the companies sole source. For example, one letter stated:

"In the event cost is acceptable, it is necessary that the Randall part number 1900-3A be specified as the only item that will meet your requirement. This is necessary to comply with competitive procurement policy. * * * Failure to reply by December 24, 1977, will be deemed authority to cancel subject requisitions."

Foreign countries generally have responded by designating the stipulated company and part number sole source. One foreign country, however, failed to send the requested sole-source designation, and the Air Force canceled the country's requisition.

In another instance the Air Force awarded a contract sole-source on the basis of the foreign country's so-called sole-source designation. The item requisitioned, a degreaser, is commercially available in many shapes, sizes, and methods of operation. An Air Force engineer, knowledgeable about this equipment, told us that all degreasers performed essentially the same task and that competition would be feasible if ordered by functional description rather than a particular manufacturer's part number.

There was an obvious lack of management emphasis on the necessity of maximizing competition in FMS procurements. An official in the buying activity stated that he had been doing everything possible to keep from formally advertising procurements because he felt that formal advertising was a "farce." Since our examination of the degreaser procurements, the Air Force has awarded a competitive contract for degreasers at a saving of \$9,000 per unit.

Navy--failure to apply ASPR provisions

The Navy Ships Parts Control Center did not attempt to maximize competition on FMS until September 1977. Although Defense Procurement Circular 76-4, dated September 1976, applies ASPR to FMS, center officials said that they had decided the regulations concerning the use of competition did not apply to FMS because appropriated funds were not involved.

Center officials conceded that failure to follow regulations resulted in a greater number of sole-source awards. For example, in fiscal year 1977, about 75 percent of FMS contracts were awarded sole source, compared to 65 percent for all center purchases.

Foreign requisitions assigned high priority

FMS orders are frequently assigned high-priority designations, and this indicated urgency is used to help justify sole-source awards. For example, we examined a sample of FMS contracts awarded in April 1978 at the San Antonio Air Logistics Center, Texas, and found that 42 percent were negotiated to fill high-priority requisitions. None of the awards examined were formally advertised.

This atmosphere of urgency reflects DOD's policy of treating FMS on a top-priority basis and limits efforts to obtain competition. For example, one Army activity estimated that the use of sole-source awards could result in delivery 12 to 15 months sooner than competitive awards.

DOD's emphasis on promptly fulfilling U.S. commitments to foreign countries has led to entire programs being categorized as high priority, thereby reducing competition. For example, the Oklahoma City Air Logistics Center, Oklahoma, was asked to make an urgent procurement of accelerometer indicators and transmitters for a Saudi Arabian F-5 aircraft program. A letter from the F-5 Systems Project Office in the Air Force Systems Command stated:

"* * * The potential for follow on sales and system support make this program one of the largest in history. Because the financial and political implications of this program are so far reaching, it is imperative that delivery commitments be met.

"Program definition directions, and funding for this program have lagged behind the commitment to a delivery schedule, thereby making the allowance for your normal procurement/production lead-time impossible. * * * Therefore, we ask that you employ whatever resources or contractual methods you deem necessary to assure timely delivery."

The Oklahoma City Air Logistics Center, Oklahoma, went on to award a sole-source contract for the accelerometer indicators and transmitters. The determination and findings supporting the sole-source award stated that formal advertising for the procurement was impractical because the purchase request cited an urgent priority. It stated also that the most immediate contractual coverage could be obtained by negotiated procurement and that public exigency would not permit the delay involved in formal advertising.

Three contracts we reviewed at the Army's Redstone Arsenal related to an agreement to supply Hawk missiles to Jordan. The LOA prepared by the Army included language authorizing sole-source procurement when required to meet delivery dates set by the Jordanians. However, the Army established the delivery dates for initial spare parts needed to support the missiles, thereby providing a basis for designating the requisitions as high priority. The Army then used the "indicated urgency" to justify sole-source awards for the spare parts.

Single vendor integrity requires purchase from the same firm

Single vendor integrity is a designation requiring that all subsequent procurements, including parts and components, be made from the same vendor that provided the original item. Foreign countries can specify that single vendor integrity is to apply to the system they are buying. When the foreign country makes this specification, it is usually done to simplify training, maintenance, and logistics support relating to the weapon system. Nevertheless, this process eliminates competition.

The Iranian Government, for example, requested single vendor integrity on the F-14 aircraft it purchased. As a result all follow-on procurements for Iranian F-14 aircraft parts and components have been and will be sole source. A procurement official at the Navy's Aviation Supply Office stated that about 95 percent of the aircraft sold through FMS include single vendor integrity designations. These designations account for most of the foreign designated, sole-source procurements made by the Aviation Supply Office. In fiscal year 1977 the Aviation Supply Office processed about 6,900 transactions for FMS totaling \$75.9 million. Aviation Supply Office officials estimate that 85 to 95 percent of these purchases were sole source. Single vendor integrity designations were used to justify most of these sole-source purchases.

Single vendor integrity designations require DOD to purchase items sole source even though they would normally be purchased competitively. For example, two sole-source contracts awarded for Iranian F-14 parts would have been, and in one case had been, purchased competitively for U.S. Navy F-14s. In one contract for refueling adapters, the Navy rejected an unsolicited proposal to furnish the items at less than half the sole-source price because of a single vendor integrity program.

We did not find any FMS programs managed by the Army that had been designated as single vendor integrity.

Both the Air Force and the Navy have found that programs designated as single vendor integrity not only limit competition but are also extremely difficult to manage. When the United States has changed vendors or placed subsequent procurement competitively, these designations have required extraordinary effort to track the original vendors and to negotiate new contracts.

Delivery dates specified by foreign countries frequently do not allow time for competition

The process of assembling a specification package, soliciting bids, and evaluating proposals is time consuming but is necessary under competitive procurement procedures. The military services, however, become bound to delivery schedules that are established for political and other reasons; therefore, the time required to make competitive procurements is not provided. These compressed time schedules make it difficult to competitively procure the parts and components that are ultimately installed in the systems to be sold. Officials at the Air Force Aeronautical Systems Division indicated that foreign requests for impossible delivery dates are a major problem contributing to sole-source awards.

For example, when the United States agreed to supply F-5s to Egypt, delivery was promised within 12 to 16 months, despite the fact that a normal delivery for an F-5 is 24 months. To meet the agreed-upon delivery date, DOD requested and received blanket authority from the customer country to procure on a sole-source basis all parts and components installed in the aircraft.

In addition to compressed time schedules on major defense items, many procurements for FMS of smaller items (nuts and bolts) are made on a sole-source basis because of inadequate advance planning by foreign countries. As a result the orders are placed with delivery dates too short to consolidate with planned Air Force buys. Thus foreign requirements are frequently fragmented into a series of orders that are too small and have delivery dates too short to be filled by competitive contracting.

In addition, some foreign countries have not provided funding when the LOA was signed. This delays contract awards and reduces the time available for making competitive awards for related equipment.

As an example of the short delivery dates imposed on DOD, the United States agreed to deliver C-130 transport aircraft to the Sudan on a very short time schedule. Delayed receipt of funding for the Sudanese program reduced the effective leadtime to 2 months, compared to a normal 24-month delivery schedule for the C-130.

Data required to competitively procure
items not purchased

A specification package is a prerequisite for soliciting bids on a proposed buy. Staff at two Air Logistics Centers stated that generally no effort is made to acquire specification packages for purely FMS procurements, since U.S. funds cannot be used to finance the cost of acquiring design data and individual foreign countries do not provide funding. This has resulted in the contractors being "locked in."

When we asked Air Force Logistics Command officials if they had considered this problem, they said that they were drafting procedures for the purchase of reprourement data for FMS.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

ASPR requires the use of formal advertising whenever practical and feasible and emphasizes that competition is the Government's preferred procurement method. These provisions apply equally to purchases for FMS. The services, however, have not maximized competition and in some cases have encouraged sole-source contracting. For example, some DOD activities (1) simply ignored or were unaware that ASPR applied to FMS, (2) demanded that foreign countries make sole-source designations, (3) awarded contracts that could have been handled through commercial channels, and (4) fostered and encouraged high-priority requisitions.

These actions resulted in a high percentage of contracts being awarded sole source and lost opportunities to obtain reduced prices for foreign customers. We believe that significant savings can be achieved through the use of competition in FMS. Examples of these potential savings are shown on pages 35 and 38.

We also believe that using competition to obtain the best price is required because an agent-in-trust position exists between DOD and foreign countries. Use of competition becomes even more critical on common items (items used by U.S. Forces and foreign countries) because sole-source contracting can lead to the U.S. Government's paying higher prices. (For an example, see p. 32.)

Some factors outside of DOD's immediate control make the use of competition difficult and create an atmosphere of urgency. Therefore, it becomes even more important that procurement activities do everything possible to place contracts competitively.

Recommendations to the Secretary of Defense

We recommend that the Secretary of Defense make a strong and continuing commitment to give adequate management attention and emphasis to the desirability of obtaining competition in procurements for FMS by

- encouraging foreign countries and U.S. program managers to avoid setting time schedules that compel sole-source procurements;
- determining whether the predominance of high-priority requisitions is caused by a failure to apply normal DOD priority rules;
- determining whether greater integration of other country needs with DOD logistics systems could hold sole-source procurements to the minimum;
- advising other countries that early delivery and/or use of a single source will usually result in a premium price;
- making procurement personnel at all levels aware that disciplinary action will be taken if they request other countries to make sole-source designations;
- assessing the desirability of the single vendor integrity concept; and
- taking advantage of available commercial channels, whenever possible, to reduce the administrative burden imposed by FMS.

CHAPTER 3

PEACE HAWK PROGRAM

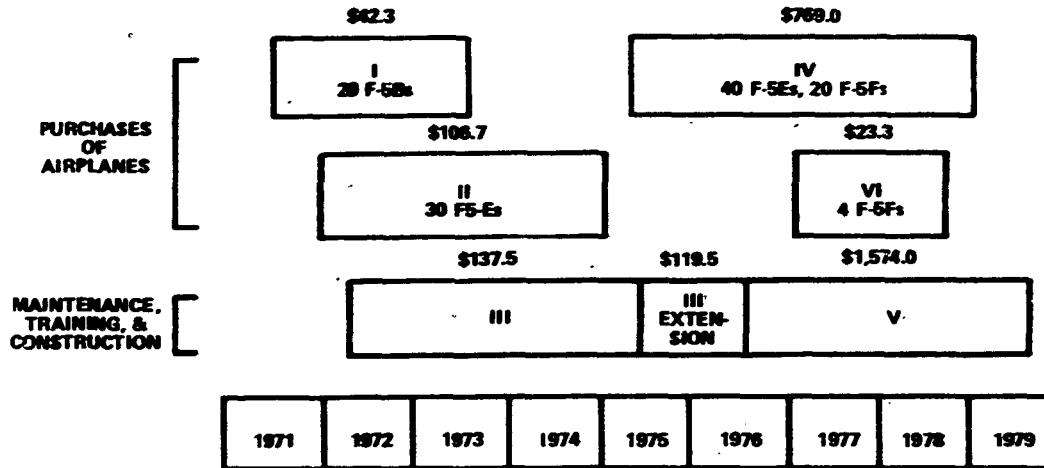
A multibillion dollar FMS program called Peace Hawk was awarded sole-source to the Northrop Aircraft Division, Northrop Corporation. According to Air Force records, the program was awarded to Northrop because the foreign country designated it as the desired source. As a result there was no opportunity to increase competition even though hundreds of millions of dollars in work could have been, and normally would have been, contracted through the competitive process. Many of the segments included in the program were outside Northrop's general area of expertise; therefore, it subcontracted the segments to subsidiaries or unaffiliated companies on a sole-source basis.

PEACE HAWK--A MODERN AIR FORCE IN SAUDI ARABIA

Peace Hawk is a long-range, multibillion dollar FMS program designed to modernize Saudi Arabia's Air Force. Saudi Arabia's objective is to achieve maximum self-sufficiency in all facets of aircraft operations, training, maintenance, and related support.

The Peace Hawk program began in 1971 after the Saudi Arabian Government decided to purchase the Northrop-built F-5 aircraft. Phases I, II, IV, and VI were primarily for buying F-5 aircraft, whereas phases III and V provided maintenance, training, and facility construction. The program is outlined below.

**PEACE HAWK PHASES I TO VI
(DOLLAR AMOUNTS IN MILLIONS)**



As manufacturer of the aircraft, Northrop was the logical source for the planes and certain maintenance and technical training that required experience with the aircraft. In phases III and V, however, Northrop received sole-source awards that

- involved construction and training that could have been performed by companies other than Northrop,
- were outside Northrop's area of general expertise, and
- encompassed contracting for such items as facilities construction that are normally contracted for competitively by the Corps of Engineers.

In Peace Hawk III the Saudi Arabians asked the U.S. Air Force to contract with Northrop for F-5 support. They wanted the contractor to

- construct and modify facilities at two air bases,
- perform required maintenance and supply support for the airplanes, and

--concurrently teach Saudi Arabian personnel to take over these functions through classroom and on-the-job training programs.

By the end of Peace Hawk III, the Saudi Arabians had purchased additional planes, and the major parties involved (Saudi Arabia, the U.S. Air Force, and Northrop) realized that a massive follow-on effort would still be required. Thus began the plans for Peace Hawk V.

As Peace Hawk expanded from the selling of airplanes to building of a self-sufficient air force, the Saudi Arabian Government asked for and received management support from the United States at unparalleled levels. However, the U.S. Air Force found it increasingly difficult to provide adequate manpower for the planning, supervising, and training necessitated by the ever growing Royal Saudi Air Force. According to the Chief of the Saudi Arabian Program Office, the Air Force simply was unable to plan and manage a program as massive as Peace Hawk within existing personnel ceilings.

The Air Force began to rely heavily on Northrop. Northrop began to develop the specifications, program requirements, and time scheduling for achieving the program objectives. For Peace Hawks III and V, Northrop was even instrumental in preparing the program description to identify required contractual work. Northrop, therefore, had become a major participant in the planning process by the time the need for Peace Hawk V was recognized.

Early in Peace Hawk V planning, the Air Force recognized that more than \$600 million of construction would be required. Initially, the Air Force planned that the Corps of Engineers would be responsible for source selection, contracting, and other normal construction management activities. The Saudi Arabian Government, however, wanted the U.S. Air Force to retain overall management responsibility. Recognizing that this program would have direct impact on U.S. and Saudi Arabian relations, the Deputy Secretary of Defense directed the Air Force:

"* * * to act as the single DOD manager of the Peace Hawk V program and, upon Saudi acceptance of the offer, to contract with the Saudi designated sole-source contractor, Northrop, for the services and construction required."

Northrop, being an aircraft manufacturer, was hesitant to tackle such a large construction program and agreed to take the program only if it could award a sole-source subcontract to one of its subsidiaries. The Air Force agreed to this request even though certain ASPR provisions had to be waived.

Peace Hawk V, at a planned cost of \$1.6 billion in the LOA is by far the largest Peace Hawk program. Planned for completion in February 1979, Peace Hawk V provides services similar to Peace Hawk III but on a much larger scale.

The major services planned for Peace Hawk V follow:

Construction of technical facilities	\$523,637,000
Construction of base housing	208,596,000
F-5 support and training	290,973,000
Contractor program management	187,029,000
Technical services of the U.S. Government	31,210,000
Other contractor services, such as:	301,716,000
English language training	
Base management	
Custodial services	
Audio visual center operation	

The entire program was contracted to Northrop even though only a small portion of the work actually required Northrop's technical expertise as the manufacturer of the F-5 aircraft. Northrop officials agreed that the company was not uniquely qualified to perform some major work segments, such as the massive construction requirements. However, they believed that Northrop brought to the program an integrated management team familiar with working in Saudi Arabia. According to Northrop officials, this integrated single-company control was necessary to successfully complete the program.

Northrop Aircraft Services Division, as the sole-source contractor for Peace Hawk V, retained about \$440 ¹/_{million} of the \$1.3 billion definitized contract. The three largest Northrop Aircraft Services Division subcontracts were awarded sole source.

¹/Includes numerous small subcontract awards representing a relatively small portion of program dollars.

<u>Northrop Aircraft Services Division subcontractors</u>	<u>Northrop subsidiary</u>	<u>Amount</u>	<u>Description</u>
		(millions)	
Tumpane Company	No	\$412.3	Housing construction and support services
George A. Fuller Company	Yes	389.2	Technical construction
Page Communications Engineers	Yes	11.5	Maintain and operate communications systems

Tumpane Company and George A. Fuller Company further subcontracted major portions of their work, some of which was competed. George A. Fuller Company, the wholly owned subsidiary, kept about \$50 million for its services as construction manager and contracted the actual construction work to two major subcontractors, as shown below:

<u>George A. Fuller subcontractors</u>	<u>Northrop subsidiary</u>	<u>Awarded sole source</u>	<u>Amount</u>	<u>Description</u>
			(millions)	
Abassi Joint Venture (Pakistan)	No	No	\$235.0	Technical construction
Page Communications Engineers	Yes	Yes	77.2	Communications

Of the \$1.3 billion definitized contract, Northrop kept about \$590 million within the corporate family and subcontracted about \$680 million to nonaffiliates.

Peace Hawk is still expanding. Planning is already underway for Peace Hawk VII, which will involve further training, construction, and other related areas of logistics support. Northrop has again been designated as the sole-source contractor for certain portions of phase VII.

Air Force officials stated that a conscious management decision was made to sole-source award the Peace Hawk

contract to Northrop because the Air Force believed that one contractor should be responsible for total program integration and management to ensure that all program phases were completed on time. They also stated that Northrop was the logical selection because it had an experienced work force in Saudi Arabia. We recognize that selection of an onsite contractor offers significant advantages; however, use of this criteria for contractor selection can result in contractors being locked in for the life of the program.

CONCLUSIONS AND RECOMMENDATION

Conclusions

The Saudi Arabian sole-source designation of Northrop as supplier of the planes and certain related efforts was logical since Northrop was the prime manufacturer of the aircraft. However, the Saudi Arabians also designated Northrop sole source for phases of the program that would not normally be awarded to an aircraft manufacturer.

These sole-source designations were accepted by the Air Force and DOD because it is their policy to permit foreign countries to make sole-source designations. As a result many U.S. firms lost the opportunity to compete on hundreds of millions of dollars of contracts in their own areas of expertise.

We question this DOD policy, particularly

--when it deviates from normal procurement practices,

--when the magnitude of the program could have an adverse impact on the extent of competition in the marketplace, and

--when the designated source is inappropriate for the goods and services being procured.

Recommendation to the Secretary of Defense

We recommend that, where foreign governments request sole-source procurements when competition is available, the Secretary of Defense explain to these governments the potential savings and other benefits available through competitive procurement and attempt to obtain agreement for procurement on this basis.

CHAPTER 4

FMS MANAGEMENT CONTRACTED OUT BY THE AIR FORCE

To supplement its management of FMS programs, the Air Force awarded a sole-source contract for management services to Northrop Worldwide Aircraft Services, Inc. (hereafter referred to as Northrop). The Air Force awarded the contract because of a manpower shortage and a need for additional resources to administer FMS programs. The Air Force chose contracting out as a method of obtaining these resources instead of justifying an increase in its manpower ceiling or performing the functions in-house as the Navy and Army do. In contracting out, the Air Force delegated functions normally performed by the Government to Northrop and gave it access to sensitive information not normally made available to contractors. These actions created a potential for an organizational conflict of interest between Northrop as a private business entity and as an agent of the Government. Generally, organizational conflicts of interest in the context of Government contracts refer to situations in which a company, by virtue of work performed on one contract, would be in an unfair competitive position to obtain other contracts or would be in a position to influence the work to be performed on other contracts.

FMS COMPETE FOR AVAILABLE DOD MANPOWER

The volume of FMS for which the Air Force is responsible has increased significantly. For example, the Air Force was responsible for \$4.3 billion of sales in fiscal year 1976 and \$5.4 billion in 1977, a 28.5-percent increase in 1 year.

DOD tries to recover the full costs of administering FMS programs by charging customer countries an administrative fee. However, this cost recovery does not provide additional manpower. DOD manpower ceilings are set each year by the Congress, and the needs of U.S. Forces and FMS programs compete for the manpower available within the established ceiling.

As pointed out in the previous chapter, Air Force personnel responsible for the Saudi Arabian program indicated that limited manpower forced them to rely on Northrop for many managerial functions. A number of DOD officials have also pointed out that FMS programs consume available manpower resources.

With this environment, Air Force officials responsible for the Saudi Arabian program decided to contract with Northrop for an automated management information system and

a staff of analysts that would accumulate and analyze information on FMS programs. The system known as the reporting, analysis, and planning system (RAPS) was developed and tested on the Saudi Arabian program and is now being applied to other FMS programs. The Iranian Air Force recently agreed to use RAPS. The Saudi Arabian and Iranian programs accounted for about 68 percent of Air Force fiscal year 1977 FMS.

MANAGEMENT FUNCTIONS DELEGATED TO NORTHROP

Northrop is performing management functions normally performed by the Government, and, in the process, it has access to information not normally provided to contractors. Under RAPS, Northrop monitors all Saudi Arabian and Iranian FMS programs. Monitoring begins with the initial request for a sale and continues through the evaluation, approval, and implementation process of State and DOD. In monitoring foreign sales programs, Northrop has

- gathered background information on a proposed purchase of Bell Helicopters by the Saudi Arabians,
- reported on General Dynamic's progress in producing F-16 aircraft for Iran,
- analyzed Saudi Arabian requests for equipment and recommended additional related and supporting equipment, and
- drafted LOAs to be signed by the Saudi Arabian Government after reviewing price and availability data covering the products of another manufacturer.

Northrop likewise monitors day-to-day logistics operations in support of systems operated by Saudi Arabia and Iran. Northrop receives complete information on Saudi Arabian and Iranian requisitions, including items and quantities ordered and the status of action taken to fill the requisitions. Status information identifies those requisitions the Air Force is taking procurement actions to fill. Northrop analyzes this requisition data and identifies problem requisitions which will not be filled within the dates specified by the customer. Northrop develops recommendations for solving the problems caused by untimely delivery and communicates directly with Air Force managers to request information on improved delivery dates obtainable by means of sole-source contract or premium buys. For example, when Northrop was recommending to the Air Force a method to obtain Saudi Arabian "forgot to buy items," it stated that a sole-source requirement and premium

buy must be requested by the Royal Saudi Air Force and approved by the U.S. Air Force. Using U.S. Air Force flying hours and parts usage data, Northrop develops projections of Saudi Arabian spare parts requirements. More significantly, while monitoring foreign sales, Northrop has complete, detailed information on requirements and purchasing plans for a major segment of FMS programs managed by the Air Force. Acting as management's staff, Northrop is in a position to know what systems Saudi Arabia and Iran may be considering for purchase and comments on the product and performance of its competitors.

Air Force officials stated that RAPS is needed to assist FMS customers that lack trained personnel for determining requirements and managing logistics operations. They also stated that management responsibility was not delegated to Northrop because the Air Force retains ultimate decision-making responsibility.

We do not question the need for the services provided by RAPS, however, we do question the Air Force decision to contract for these services with a major defense contractor heavily involved in FMS. Northrop's computerized access to Air Force maintenance and logistics data and FMS case data, together with responsibility for analyzing the data, identifying alternative courses of actions, and making recommendations to Air Force officials, gives Northrop a major input into the decisionmaking process.

Potential for organizational conflicts of interest

Delegating sensitive management functions creates a potential for conflicts between Northrop's interests as a private entity and Northrop as an "agent of the Government." A corporation has a natural and proper desire to improve its sales, profits, and competitive position. The interest of the customer country in FMS transactions is to obtain supplies and services on the most favorable terms and conditions possible. The U.S. Government acts as a mediator in the adversary relationship between buyer and seller. Agreeing to acquire weapons systems at a reasonable price, the Government must properly represent the buyer's interests. On the other hand, the Government assists the seller through requiring the customer to remain committed to the terms and conditions of the sales agreement. The use of Northrop as a "trusted agent of the Government," conflicts with the mediator role the Air Force is required to play between buyers and sellers.

In the case of RAPS, the appearance of an organizational conflict of interest is intensified by

--the directed sole-source award of the RAPS contract for a management information system and

--Northrop's heavy involvement in FMS on its own account.

Aside from the above factors indicating the potential for an organizational conflict of interest, the movement of former Air Force personnel to Northrop raises propriety questions regarding the Air Force's role as an independent mediator between Northrop as a seller and the buying foreign customer.

Directed sole-source award for RAPS

RAPS is based on a computerized management information system that Page Aircraft Maintenance, Inc., developed in 1964 for Army aircraft maintenance. The system design and programs are owned by the Army.

Air Force officials responsible for the Saudi Arabian F-5 Peace Hawk program selected the Army design as a basis for a management information system to be used on their program. The system was modified to manage the logistics of the Saudi Arabian Peace Hawk program. The system was also expanded to provide the Air Force with information on all FMS programs involving Saudi Arabia.

Northrop, the Peace Hawk contractor, acquired the stock of Page Aircraft Maintenance, Inc., in 1972 and redesignated the company as Northrop Worldwide Aircraft Services, Inc. Northrop was operating the existing Army system when Air Force officials contracted for the management information system to be used on the Saudi Arabian-Northrop aircraft program.

The Air Force awarded a 1-year, sole-source contract to Northrop for developing RAPS. The justification cited for the sole-source award was that the Air Force lacked adequate plans and specifications to procure RAPS competitively.

The stated objective was to provide uninterrupted contract coverage while the Air Force attempted to develop a statement of work suitable for competition.

The procurement review board at the San Antonio Air Logistics Center reviewed the proposed contract for RAPS and made the following comments.

"It is apparent on its face that this is the type of contract that could probably be performed by a number of competent firms.

"Detailed reasons as to why we cannot have a break in the present coverage or forgo the requirement until a competitive work statement can be prepared must be addressed."

The chairman of the procurement review board stated that Air Force Logistics Command officials directed a sole-source contract award to Northrop for RAPS. The contract file providing documentation for the contract award did not cite any reasons for uninterrupted coverage.

The initial 1-year, sole-source award has been extended to 2-1/2 years and the Air Force still does not have a statement of work for a competitive award. We believe Air Force efforts to develop such a statement have been feeble. For example:

- The officer initially assigned the task of developing a statement was not directed to prepare one suitable for competition, nor was he informed of the additional details required to make it competitive.
- The effort to develop a statement of work was assumed by higher headquarters and disagreements developed on what features RAPS should include.
- Much of RAPS' software and technical data was developed under the Army-owned system. This data did not require extensive modification but rather adaptations, such as substituting Air Force codes for Army codes. New features and programs not available in the Army system were added to RAPS, but one of these features was based on existing Air Force data systems.

Northrop involvement in FMS

Northrop is heavily involved in FMS on its own account and would be seriously affected if it did not continue to participate in the program. For example, about 1,900 F-5s of all models have been produced by Northrop. Northrop forecasts an additional 250 sales during the next 2 to 3 years. Air Force officials estimate that total F-5F production could reach 1,500 planes by 1985.

Northrop is also heavily involved in support services programs, such as Peace Hawk V. (See p. 17.) This contract represented over half of the total dollar value of new contracts acquired by Northrop in 1976. Performance on Peace Hawk will continue through at least 1979. Northrop, through commercial and FMS channels, also offers maintenance and logistics management services to support the F-5s it has sold and hopes to sell in the future. Using RAPS in these situations would have the Northrop subsidiary providing comments on its parent company's performance to the Air Force. This is the current situation on the Peace Hawk program.

Former DOD personnel work for
Northrop on the RAPS project

Northrop's employment of former Air Force personnel raises propriety questions regarding the Air Force's role as an independent mediator between Northrop as a seller and the buying foreign customer. For example, of the 90 Northrop employees working on the RAPS project, 61 (over two-thirds) have been employed previously by DOD. Not all of these individuals recently held responsible positions in DOD. Some, however, held important positions in Air Force management, as shown by the following examples.

--The Deputy Chief of the International Fighter Weapons Division at the San Antonio Air Logistics Center was employed by Northrop to work on RAPS 5 days after leaving DOD.

--The Air Force official in charge of the Saudi Arabian desk at the Pentagon was hired by Northrop 3 months after leaving DOD. This retired officer is currently assigned to Northrop's Washington, D.C., office and is performing some special research projects for his successor at the Pentagon.

--The Chief of the Data Products Division at the San Antonio Air Logistics Center was hired by Northrop 10 months after leaving DOD.

Another official, the Assistant for International Logistics, Air Force Logistics Command, influenced the contract award and suggested to the Chief of the Saudi Arabian Program Office that the Air Force use RAPS to manage the Saudi Arabian Air Force programs. He also

--directed the contracting office to award a sole-source contract for RAPS to Northrop and

--overrode the protests of the Director of Procurement, San Antonio Air Logistics Center, that there was no proper authority for continuing the project.

This individual is now employed by Northrop as a program manager for logistics services.

ARMY AND NAVY INFORMATION SYSTEMS

The Army and the Navy have established automated management information systems that collect data on many aspects of their FMS. These systems are used for essentially the same purpose as the Air Force system--management of FMS--and collect essentially the same information. Both systems are operated and maintained in-house without contractor assistance.

The Army and the Navy also project requirements (future buys) and monitor the logistics support provided on the systems they have sold. This is done through periodic meetings, sometimes quarterly, with individual foreign countries. Before the meetings current logistics and maintenance status is extracted from the management information systems and provided to the customer countries. At the meetings an assessment is made of how well logistics support is meeting the foreign country's needs and what future needs are anticipated. Navy personnel stated that some countries have complained about the inadequate support they received. In these cases, the meetings may be expanded or upgraded to include representatives of the Chief of Naval Material and, occasionally, the Chief of Naval Operations. These representatives pointed out that a special reporting arrangement is set up to cover items that result in aircraft being inoperable due to lack of spare parts. These items for both the U.S. Navy and the foreign countries are the subject of weekly meetings with the Chief of Naval Material.

Navy personnel stated that the new system was developed because the growth of FMS simply overwhelmed the old system. They also indicated that they did not consider contracting out for the system because they believed it was a function to be done in-house. The Navy did experience some difficulty in obtaining the manpower necessary for developing and operating the system.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The growth of FMS and the attendant growth in the administrative burden associated with such sales created a staffing problem for the Air Force. The Air Force decided to contract out to obtain the additional management resources needed to administer its FMS while remaining within its manpower ceiling.

By delegating to Northrop functions normally performed by the Government and providing access to sensitive information not normally made available to contractors, the Air Force created a potential for conflicts between Northrop's interests as a private business entity and Northrop as an "agent of the Government."

We believe the Air Force should perform these functions in-house as the Navy and Army do, and, if necessary, justify an increase in its manpower ceiling. In the event this is not feasible, the Secretary should contract out for the necessary services.

Recommendation to the Congress

We recommend that the Congress consider the impact of FMS programs on DOD manpower when establishing personnel ceilings.

Recommendation to the Secretary of the Air Force

We recommend that the Secretary of the Air Force return sensitive functions, such as monitoring FMS requirements and purchasing plans, to appropriate Air Force commands. In the event personnel ceiling limitations will not permit returning these functions to Air Force personnel, the Secretary should contract for these services with an organization not involved with production or sale of military goods or services.

CHAPTER 5

INCREASES IN CONTRACT PRICES DUE TO

A LACK OF COMPETITION

The staff of the Legislation and National Security Subcommittee, House Committee on Government Operations, brought to our attention a situation in which the Army's Communications and Electronics Material Readiness Command had modified a competitively awarded contract several times and experienced successive price increases. A subsequent purchase of the same items was competitively procured and a significant decrease in unit price was achieved with a resultant saving of about \$450,000. The Committee staff asked us to determine if similar situations existed.

SIMILAR CONDITIONS DO EXIST

Navy procurement of electronic testing equipment

Between 1965 and 1977, the Navy awarded 15 consecutive sole-source contracts to the Harris Corporation, PRD Electronics Division, for 109 aircraft electronics testing stations. The Navy's investment in these stations totals about \$775 million.

Initially, PRD sole-source subcontracted many testing modules contained in each station. Each series of subcontracts, however, resulted in substantial price increases until the Navy began questioning the reasonableness of the subcontract prices.

In 1973 the Navy raised the possibility that PRD was awarding "sweetheart" contracts to its vendors and asked the subcontractors to make their cost records available for audit. When the subcontractors failed to comply, the Navy directed PRD to obtain competition in awarding the subcontracts. PRD, however, stated it would not subcontract with anyone but the present vendors regardless of the price differential. PRD's resistance prompted the Navy to purchase the modules competitively and furnish them to PRD for assembly in the testing stations. Navy officials estimated that \$12 million was saved by obtaining competition for module purchases in fiscal years 1973 and 1974.

In 1975 the Navy returned subcontracting responsibility to PRD. Systems Command officials explained that their decision was based on PRD's more cooperative attitude toward

awarding competitive subcontracts, smaller quantities to be bought, and a determination that PRD's fees for handling subcontracts were reasonable. Since regaining subcontracting responsibility, however, PRD has awarded sole-source contracts for items previously competed by the Navy and has charged handling fees ranging from 10 to 35 percent of subcontract costs. In addition, PRD has chosen to make a number of modules that were previously purchased competitively. For example, on the 1977 procurement PRD awarded eight sole-source subcontracts totaling \$1,649,180, and received a total of \$281,310 for handling these subcontracts. All but two of these items had been purchased competitively by the Navy. PRD competitively awarded three subcontracts totaling \$1,866,178 and received \$600,168 in handling fees.

Additional details on these procurements are provided in appendix I, page 34.

Air Force procurement of F-5E equipment

Since 1972 the Air Force has awarded successive sole-source contracts for selected items of F-5E equipment and experienced successive price increases. The following table shows the extent of this price increase.

<u>Item</u>	<u>Price in 1973</u>	<u>Latest price sole source</u>	<u>Increase</u>	
			<u>Dollars</u>	<u>Percent</u>
Generator	\$957	\$3,200	2,243	234.4
Wheel	91	a/1,134	1,043	1,146.1
Control unit	677	1,375	698	103.1
Brake	224	2,173	1,949	870.1

a/The wheel was recently purchased competitively, and the winning bid was \$827, a reduction of \$307 per unit.

The price increase was incurred despite indications that some of the initial prices were "buy-ins" that could escalate rapidly on subsequent purchases. Nevertheless, the Air Force did not take steps to preclude future price increases.

During the period the Air Force was buying the items sole source, it had ample evidence that competition could be used to moderate price increases. For example, the Air Force was buying two other items, originally included with the above items, on a competitive basis. Price increases on these items were slight. On another item, an airborne computer, the Air Force obtained competition for the third

buy, and the original vendor reduced his bid price by over \$3,000 from the price it received on the previous contract.

When the Air Force began buying these items, F-5s were not planned for U.S. air fleet use. Today the Air Force is operating 120 F-5s and must provide spare parts support. Thus the Air Force, instead of benefiting from lower prices due to quantity buys, is paying prices established through a series of sole-source contracts awarded exclusively for FMS.

Additional details on these procurements are provided in appendix II, page 37.

CONCLUSIONS AND RECOMMENDATION

Conclusions

The above examples clearly demonstrate that competitive procurements can reduce costs significantly. The examples also illustrate the disadvantages of permitting vendors to become locked in so they can receive successive sole-source awards.

Both the Navy and the Air Force had ample evidence, based on their own experiences in the programs, that competition would result in lower prices without having a detrimental effect on program results. The Navy's experience with the modules and the Air Force's experience on two F-5E items and the computer should have given strong impetus to competitively award the contracts.

These programs are continuing and the items are still being procured, with one exception, sole source despite the availability of competition. Under these circumstances, we believe there was a clear lack of commitment to the DOD procurement principle of obtaining competition when feasible.

Recommendation to the Secretaries of the Navy and Air Force

We recommend that the Secretaries of the Navy and the Air Force see that competitive procurement procedures are used in any future contract awards for the items discussed above. In the event that competition is not feasible, the activities involved should be required to demonstrate the basis for concluding the prices are fair and reasonable. In future programs in which plans call for the same vendor to receive successive sole-source awards, specific safeguards should be established to ensure that unrestrained price increases will not occur.

ADDITIONAL DETAILS ON NAVY'S PROCUREMENT
OF THE VERSATILE AVIONICS SHOP TEST SYSTEM

Versatile avionics shop test (VAST) system is used for testing and identifying faulty electronic equipment installed on F-14, E-2, S-3, and future F-18 aircraft. Each system consists of a general-purpose computer and a set of about 26 individual modules. When a number of modules are grouped together and plugged into the computer, specific equipment installed in the aircraft can be tested. By varying the number and makeup of the modules, the equipment can be subject to a variety of tests.

The Navy has purchased about 109 systems and may buy more. Seven of the systems were purchased for a foreign country. The Navy's total investment in the system is about \$775 million.

NAVY'S EFFORTS TO OBTAIN COMPETITION
STRONGLY RESISTED BY CONTRACTORS

In 1967 the Naval Air Systems Command awarded a contract to the Harris Corporation, PRD Electronics Division, to study aircraft equipment maintenance problems and to develop an electronic testing system. This contract was awarded competitively. Subsequently the Navy made 15 sole-source awards to PRD.

As prime contractor, PRD awarded subcontracts for many of the modules making up the system. When successive module subcontracts showed substantial price increases, the Navy asked the subcontractors to make their cost records available for audit. The subcontractors refused or were unable to comply with the Navy's request. Naval Material officials raised the possibility that the subcontractors were receiving "sweetheart" contracts.

In 1973 the Naval Air Systems Command directed PRD to solicit bids for the subcontracted components. Although PRD complied and sent out bid packages, PRD argued repeatedly that great technical risks would be encountered if a source was selected competitively. When the Navy instructed PRD to solicit "best and final offers" for the item with the highest priority for competition, PRD stated in writing that it would not risk subcontracting the item to anyone but the present supplier. The Navy then advised PRD that it would purchase the item. PRD finally solicited best and final

offers. The low bid represented a saving of \$458,000, or 32 percent, compared to the original supplier's quote.

Subsequently, PRD stated that regardless of the magnitude of the price differential, it would not contract with the low bidders unless directed to do so by the Navy. Therefore, the Systems Command decided to purchase certain modules itself and provide them to PRD for assembly into a system. Since the modules were purchased separately, the cost of PRD's overhead and profit was eliminated.

NAVY DECISIONS TO OBTAIN COMPETITION RESULT IN SUBSTANTIAL SAVINGS

In its 1973 proposal, PRD estimated that it would spend \$10.7 million for subcontracting modules. However, the Systems Command competitively awarded the subcontracts for \$5.9 million, a saving of over 45 percent.

The Systems Command also awarded competitively the subcontracts for modules included in the fiscal year 1974 procurement. The following table shows the costs of modules purchased through PRD in December 1971 and the same modules competitively purchased in September 1973.

<u>Module number</u>	<u>Unit cost PRD purchased</u>	<u>Unit cost Navy purchased competitively</u>	<u>Savings</u>
10	\$21,250	\$10,462	50%
11	33,565	16,857	50
45	33,039	24,250	27
50	33,048	22,465	33
51	19,842	14,410	27
55	44,976	36,989	18
67	33,802	19,977	41

A Systems Command official estimated about \$12 million was saved using competitive procurement methods.

NAVY RETURNS SUBCONTRACT RESPONSIBILITY TO PRD

The Navy decided to return subcontracting responsibility to PRD after the fiscal year 1974 buy despite an estimated savings of \$12 million. Systems Command officials explained that their decision was based on PRD's more cooperative attitude toward awarding competitive subcontracts, smaller quantities to be bought, and the determination that PRD's fees for handling subcontracts were reasonable.

APPENDIX I

APPENDIX I

Navy officials also stated that, since the VAST contract accounts for almost all of PRD's sales, the Navy must pay PRD's overhead costs whether it provides the modules as Government-furnished equipment to PRD or the modules are subcontracted by PRD. We believe it is reasonable to assume there would be reductions in overhead costs and profit paid by the Navy if PRD did not provide such services. Navy officials stated, however, that PRD depends on the subcontracting income to stay in business and that the Navy is dependent on PRD for its VAST services.

ADDITIONAL DETAILS ON AIR FORCE'S

PROCUREMENT OF F-5E EQUIPMENT

Northrop, the F-5E prime contractor, initially furnished most components and equipment installed on the aircraft. The production contract, however, provided for certain equipment to be converted to Government-furnished equipment early in the production contract.

In March 1972 the Air Force began the conversion program when it decided to purchase 10 items directly and furnish them to Northrop as Government-furnished equipment. The decision was based on a desire to eliminate Northrop's overhead charges estimated at 60 percent of cost.

Originally, Northrop purchased 9 of the 10 items competitively. The Air Force, however, negotiated new contracts with the Northrop suppliers, and therefore the initial quantities were procured sole-source. Air Force technicians recommended continuing sole-source procurement for three items; recommended consideration of future competition for five; and were uncertain about the other two. A list of the items and vendors follows.

<u>Item</u>	<u>Vendors</u>
Central air data computer	AiResearch
Horizontal situation indicator	Astronautics Corporation of America
Dual oil pressure indicator	Bendix Corporation, Courter Products
Take-off trim position indicator	Bendix Corporation, Courter Products
Total temperature probe	Rosemont Engineering Company
Generator system:	
Generator	Westinghouse
Generator control unit	Westinghouse
Main wheel	Goodyear
Main brake	Goodyear
Main tire	Goodyear

The Air Force recognized that prices on some items were "buy-in" prices. Although it is Government policy to discourage "buy-ins," they are not illegal. However, contracting officers are advised that steps must be taken to ensure that vendors do not make up losses experienced on buy-ins through price increases on follow-on buys.

The Air Force decision to negotiate with Northrop vendors resulted in sole-source contractors being "locked in." Although significant price increases resulted (see examples below), they may be partially attributable to inflation. They suggest, however, that the sole-source contractors have made up any losses experienced on the initial buy-in prices.

Central air data computer

After taking over direct procurement responsibility, the first contract price the Air Force paid for this item was \$6,495 each for 299 units. The second contract price was \$14,956 each for 266 units, a price increase of 130 percent. For the third buy, the vendor quoted a price of \$22,112 for 29 units. At this time the Air Force decided to compete the item, and requests for proposals were issued. Two bids were received, including one from the original vendor for \$11,648, representing a reduction of almost 50 percent from his initial quote as a sole-source supplier. The new competitive bid was also 21 percent less than the unit price on the last sole-source procurement.

The Air Force awarded this competitive contract to the original vendor as low bidder. Despite this successful venture in competition, the most recent contracts have been awarded to this vendor on a sole-source basis, and the last unit price paid for the item was \$14,220.

Generator system

The generator system consists of two items--a generator and a generator control unit. The vendor's original proposal to Northrop, one of three received, was \$1,496,000. In subsequent negotiations, the vendor reduced his proposal to \$1,059,500, a difference of \$436,500, or about one-third of the initial bid. The Air Force made all subsequent awards to the same vendor on a sole-source basis and experienced successive price increases, as shown in the following table.

APPENDIX II

APPENDIX II

Generator

<u>Fiscal year of contract award</u>	<u>Quantity</u>	<u>Price</u>	<u>Increase of decrease (-)</u> <u>in unit price</u>	
			<u>Amount</u>	<u>Percent</u>
1973	148	\$ 957	\$ -	-
Option	42	957	-	-
1974	13	1,514	557	58.2%
1974	376	1,601	87	5.7
Option	10	1,760	159	9.9
1975	176	2,091	331	18.8
Option	41	2,303	212	10.1
1976	191	2,432	120	5.2
Option	35	2,415	-8	(a)
1976	144	2,415	-	-
1977	263	2,910	495	20.5
1978	55	3,000	90	3.1
1978	28	3,200	200	6.7

Total increase over original price: \$2,243, or 234.4 percent.

a/Less than 1 percent.

Generator Control Unit

<u>Fiscal year of contract award</u>	<u>Quantity</u>	<u>Price</u>	<u>Increase or decrease (-)</u> <u>in unit price</u>	
			<u>Amount</u>	<u>Percent</u>
1973	148	\$ 677	\$ -	-
Option	42	677	-	-
1974	14	972	295	43.6%
1974	378	1,013	41	4.2
Option	33	1,122	109	10.8
1975	341	1,051	-70	-6.2
Option	36	1,162	110	10.5
1976	176	1,130	-32	-2.8
Option	35	1,130	-	-
1976	144	1,130	-	-
1977	213	1,265	135	11.9
Option	58	1,275	10	(a)
1978	28	1,388	113	8.9
1978	108	1,375	-13	(a)

Total increase over original price: \$698, or 103.1 percent.

a/Less than 1 percent.

Main brake

This was another item where buy-in prices were used. The vendor bid \$206,173 on the initial Northrop contract, in comparison to the next low bid of \$628,949. Nevertheless, the Project Office decided to keep the services of the vendor and award all subsequent contracts on a sole-source basis. The price increase on this item is shown below.

<u>Fiscal year of contract award</u>	<u>Quantity</u>	<u>Price</u>	<u>Increase or decrease (-) in unit price</u>	
			<u>Amount</u>	<u>Percent</u>
1973	148	\$ 224	\$ -	-
Option	178	224	-	-
Option	113	224	-	-
1974	450	975	751	335.3%
1975	351	1,110	135	13.8
1976	38	1,446	336	30.3
1977	48	1,446	-	-
Option	42	1,958	512	35.4
Option	14	2,712	754	38.5
1977	28	2,039	-619	-22.8
1978	32	2,050	-43	-2.1
1978	24	2,173	123	6.0

Total increase over original price: \$1,949, or 870.1 percent.

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