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

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JUN 14 1972

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91 R Dear Mr. Henderson:

As requested in your letter of February 1, 1972, we have examined the contract award procedures and the financial capability review for a contract awarded by the Air Force to Piston Ring and Parts Company of Georgia, Inc., for operation of an automotive parts store at Seymour Johnson Air Force Base, North Carolina.

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Although we found that the contract had been awarded to the lowest bidder in accordance with normal contract award procedures, we believe there were weaknesses in determining the company's financial capability.

The contract provided for furnishing Seymour Johnson Air Force Base with commercial parts and accessories for motor vehicles and other equipment on an as-required basis. The contract, awarded March 17, 1971, was to have been in effect through February 29, 1972. The Government estimated that purchases would be approximately \$127,500 during the contract period and that the contractor would bill the Government at the end of each month for parts actually delivered.

The contractor was to establish and operate a motor vehicle parts store in Government-provided on-base facilities for exclusive sale to authorized representatives of the Government. Air Force regulations state that contractor-operated motor vehicle parts stores (COPARS) function as part of the overall supply system to provide the majority of repair parts and accessories support required for automotive maintenance.

Piston Ring and Parts Company of Georgia, Inc., Atlanta, Georgia, began business in January 1968. The corporation was formed by three individuals: James T. Ferguson, William A. Shope, and E. C. Howell. The corporation purchased certain assets from Piston Ring and Parts Company and continued the business at the same location. The corporation's opening balance sheet showed \$20,000 in cash, \$70,000 in inventory, \$50,000 in equipment, \$110,000 in notes payable, and \$30,000 in capital stock.

Piston Ring was awarded COPARS contracts at 11 Air Force bases throughout the United States during 1971. The contractor estimated that first-year sales under these contracts would be in excess of \$1.3 million. For the 9 months the contract at Seymour Johnson was in effect, the contractor received \$91,570. Payments were made to the factoring department of a bank, to which the contractor's Government accounts receivable had been assigned.

Piston Ring abandoned the COPARS operation at Seymour Johnson on December 17, 1971. The base contracting officer terminated the contract for default 4 days later. On January 13, 1972, an involuntary petition in bankruptcy was filed against Piston Ring in the U.S. District Court of

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B-175141

Atlanta, and on January 25 a receiver was appointed. At that time Piston Ring owed creditors about \$512,000 and had assets of about \$132,000.

The Financial Services Division of the Defense Contract Administration Services Region (DCASR), Atlanta, is responsible for reviewing the financial capability of prospective contractors and for making appropriate recommendations as part of the preaward survey process. DCASR financial analysts attempt to determine whether a prospective contractor has the financial resources to satisfactorily perform under a proposed contract. In evaluating a contractor's financial resources, the analysts generally rely on financial data submitted by the contractor, such as its cash position, working capital, and net worth. Separate financial preaward surveys were performed in February and March 1971 for six of the COPARS contracts, including one for Seymour Johnson, for total contract amounts of about \$700,000. Approval was recommended for all.

PROCUREMENT PRACTICES AT
SEYMOUR JOHNSON AIR FORCE BASE

Records at Seymour Johnson showed that normal procurement practices had been followed in awarding the COPARS contract to Piston Ring. On January 15, 1971, invitations for bids were mailed to 14 potential bidders. Notice of the invitation was previously published in the Commerce Business Daily. At the bid opening, on February 12, 1971, Piston Ring's bid was the lowest of four bids received.

FINANCIAL CAPABILITY REVIEW AT DCASR

On February 16, 1971, the procurement office at Seymour Johnson requested that DCASR perform a preaward survey concerning the prospective contractor's financial capability, labor resources, and performance record.

On February 25, 1971, DCASR received Piston Ring's unaudited financial statements, including a balance sheet as of December 31, 1970, certified by the president of the firm. The financial statements showed (1) an increase in retained earnings of \$128,730 over the amount included in a balance sheet dated June 30, 1970, although the company had realized a profit of only \$3,243 during the 6-month period, and (2) a cash balance of \$29,786, instead of a bank overdraft of \$21,701. DCASR requested a revised balance sheet as of December 31, 1970.

The revised balance sheet, submitted on March 3, 1971, and certified by the president of the firm, showed a bank overdraft of \$21,701 and a deficit of \$34,353. The statement included \$5,375 in trade accounts payable and a note payable of \$80,000, which was allegedly long-term and non-interest-bearing. DCASR's analyst did not verify the statement.

Although unknown to DCASR, the \$80,000 note was actually a trade account payable to a major supplier; therefore, the trade accounts payable should have been stated as \$85,375. This improper classification had the effect of overstating working capital, an important measure of financial capability.

Piston Ring also provided DCASR with individual cash flow estimates for each proposed COPARS contract. For the first six awards, the company anticipated a negative cash flow through the first 8 months of operations and a peak deficit of \$11,466 during August 1971.

An entry on the preaward survey report stated that the contractor expected to purchase, with liberal credit terms from an American auto manufacturer, at least 90 percent of all required parts and materials for seven COPARS contracts. But, on March 3, 1971, the president of Piston Ring informed the DCASR financial analyst that this auto manufacturer would not be providing parts support at Seymour Johnson. However, a document dated March 4, 1971, from Piston Ring showed that this auto manufacturer would be providing parts at Seymour Johnson. We found no indication that DCASR had questioned this contradiction. Piston Ring purchased most of the parts from local suppliers under more stringent credit terms.

The preaward survey report stated that \$35,000 had been deposited in Piston Ring's bank account as a loan secured by existing commercial accounts receivable. This statement, relating to arrangements made by the firm for working capital, was attributed to a bank official. The report stated also that the official had said that the bank was willing to lend Piston Ring additional funds, as needed to complete the contract, to be secured by accounts receivable. DCASR officials were unable to produce any documentation to support the statements attributed to the bank official.

The bank official informed us that there was not a loan for \$35,000, as described in the survey report, but a bank note for \$34,055. He stated that on March 10, 1971, the bank note was prepared and signed by the firm. This new note represented the renewal of a \$20,000 bank note, which had been due and payable since December 28, 1970, and \$14,055 to cover an overdraft in the firm's checking account. The \$34,055 was due and payable in full on June 3, 1971. He stated also that funds subsequently advanced to the firm were for establishing operations at the air bases. These funds were recouped from the first month's billings to the bases.

We discussed the preaward survey report with DCASR officials who stated that they believed Piston Ring had reasonably demonstrated that it had the financial capacity or credit to perform the contract and that capital requirements and Government risk were minimal. They also pointed

B-175141

out that one of the largest and most successful banks in the southeast shared that opinion when it concluded that Piston Ring warranted additional bank financing.

CONCLUSIONS

Records at Seymour Johnson showed that normally acceptable contract award procedures had been followed in awarding the COPARS contract. However, we believe that there were weaknesses related to DCASR's finding that Piston Ring was financially responsible. One weakness was the acceptance and use of questionable financial data without verification, and another was the failure to recognize the significance of unfavorable financial data.

We believe DCASR exercised questionable judgment in recommending the award of six COPARS contracts within 1 month, totaling about \$700,000 a year, to a firm which had not demonstrated its ability to operate a profitable business and which had a financial deficit at the time the contract award for Seymour Johnson was recommended.

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We interviewed knowledgeable individuals and examined pertinent records of Piston Ring, Seymour Johnson, and DCASR. In addition, we held discussions with the president of Piston Ring, its major supplier, the firm's banker, and the receiver in the bankruptcy action.

No further distribution of this report is being made at this time. With your concurrence, however, we will send copies of this report to the Secretary of Defense and to the Defense Contract Administration Services for information and necessary corrective action. If we can be of further assistance, please let us know.

Sincerely yours,



Comptroller General
of the United States

The Honorable David N. Henderson
House of Representatives