

GAO

Report to the Honorable
Tom DeLay, House of Representatives

July 1989

EL SALVADOR

Limited Use of U.S. Firms in Military Aid Construction



**National Security and
International Affairs Division**

B-236752

July 12, 1989

The Honorable Thomas DeLay
House of Representatives

Dear Mr. DeLay:

In response to your request, we (1) reviewed the Army Corps of Engineers' decisions on four Salvadoran construction contracts funded by the Military Assistance Program (MAP) and (2) reviewed the circumstances surrounding the legality and propriety of the offshore procurement waivers¹ approved for these four and similar contracts, particularly those that could have affected firms from labor surplus areas.² A key concern was whether the waivers, which opened competition to Salvadoran firms, unfairly affected U.S. firms' ability to compete for the contracts.

Background

U.S. security assistance dollars are primarily intended for expenditure within the United States and can be used to purchase foreign goods and services only on an exception basis. However, since 1986, offshore procurement waivers have been approved for MAP-funded construction in El Salvador, including the four construction contracts we reviewed.

Although MAP funds are provided under the Foreign Assistance Act, these funds have been merged since fiscal year 1982 with another component of the security assistance program called Foreign Military Sales, which is governed by the Arms Export Control Act. Thus, under Defense Department regulations, "merged MAP funds" are subject to the security assistance procedures specified in the Arms Export Control Act. Under section 42(c) of the act, these funds may be used for procurement outside the United States only if the President determines that such procurement will not result in adverse effects upon the U.S. economy, with special reference to areas of labor surplus, that outweigh the economic or other advantages of less costly procurement outside the United States.

¹These waivers allow the procurement of goods and services outside the United States only if such procurement will not result in adverse effects on the U.S. economy that outweigh the economic or other advantages of less costly procurement outside the United States.

²The U.S. Department of Labor classifies an area in the United States as labor surplus if the unemployment rate is at least 20 percent higher than the average unemployment rate for all states during the previous 2 years. As of April 1988, 1,678 areas in 46 states and Puerto Rico were classified as labor surplus areas.

The Defense Security Assistance Agency (DSAA) has been delegated the authority to make offshore procurement determinations, with the concurrence of the Departments of State and the Treasury. In addition to DSAA's review of offshore procurement requests, which are submitted by the Army Corps of Engineers, these Departments generally analyze the economic impact and policy implications of these procurements before the waivers are approved.

Results in Brief

Since 1986,³ no U.S. firms have been awarded contracts for construction projects in El Salvador under the U.S. security assistance program. However, 13 construction contracts, valued at \$19 million, were awarded to Salvadoran or joint venture firms that had generally submitted lower prices.

Some of the U.S. firms that submitted proposals on these projects are located in labor surplus areas. However, it is most likely that their labor forces would largely be comprised of Salvadorans plus a few Americans to provide technical supervision.

DSAA does not have any written procedures for reviewing or approving offshore procurement determination decisions or for considering labor surplus areas in these decisions. We could find no evidence that DSAA took specific action to consider the impact on labor surplus areas. DSAA said it does consider various general factors in awarding offshore procurement waivers and pointed out that the law does not require that an assessment of the impact on labor surplus areas be documented. Although significant changes can occur in scope or costs after the Treasury and State Departments concur in an offshore procurement waiver, the Department of Defense has no mechanism to inform these Departments of modifications.

The Army Corps of Engineers awarded the construction contracts in accordance with the solicitation requirements and the Federal Acquisition Regulation. However, the Defense Contract Audit Agency (DCAA) has had difficulty in obtaining relevant documentation for Salvadoran contractors and has not conducted any in-country audits of these contracts.

³This report covers construction contracts awarded for work in El Salvador between 1985 and August 1988.

Construction Performed by Salvadoran or Joint Venture Firms

Since Salvadoran and/or joint venture (U.S.-Salvadoran) firms generally provide the same services as U.S. firms at lower cost, they have consistently been awarded construction contracts since July 1986. Between fiscal year 1985 and May 1988, \$37 million of security assistance funds was authorized for 18 current and completed construction contracts for El Salvador. Of these projects, 5 were awarded to U.S. firms before off-shore procurement was authorized in 1986. Since then, the other 13 contracts, including the 4 construction contracts we reviewed, have been awarded to Salvadoran or joint venture firms that had generally submitted lower prices than U.S. firms.

Seventeen U.S. firms submitted 27 proposals, 14 Salvadoran firms submitted 45 proposals, and 1 joint venture firm submitted 2 proposals on the 18 construction contracts funded by MAP since fiscal year 1985. It appears that many U.S. firms bid only once and did not pursue other contracts after an unsuccessful try, whereas many of the same Salvadoran firms repeatedly bid for the contracts.

Of the 17 U.S. firms that submitted proposals, 7 were located in labor surplus areas, as classified by the U.S. Department of Labor's Areas in Employment and Unemployment, October 1987 and April 1988. However, most of the U.S. firms we contacted stated that the labor force for construction work in El Salvador would largely be comprised of Salvadorans plus a few Americans to provide technical supervision. Thus, whether or not a waiver is approved to permit local competition, most of the construction work is performed by the local labor force.

U.S. firms have offered reasonably competitive prices. For example, on 6 of the 18 contracts, 9 U.S. firms⁴ submitted offers that were less than the U.S. government estimate⁵ (7 firms) or exceeded the government estimate (2 firms) by only 3 and 6 percent. Even so, Salvadoran firms often bid lower than the government estimate, and as a result, the awards on the 13 construction contracts to Salvadoran or joint venture firms were \$2 million less than the total U.S. government estimate of \$20 million. Thus, the use of Salvadoran firms has resulted in lower construction costs and has saved security assistance funds.

⁴Offers from five of the nine U.S. firms were deemed unacceptable for failure to submit technical proposals or required bid bonds with their proposals.

⁵The government estimate provides a basis for comparison to determine the reasonableness of proposed prices.

Since military aid funding for El Salvador declined from \$121 million in fiscal year 1986 to \$85 million in fiscal year 1988, it has become increasingly important that these funds be used as effectively as possible. Awarding contracts to Salvadoran firms in lieu of direct funding may be viewed as an additional form of aid to a war-torn country.

Limitations on U.S. Firms

U.S. firms encounter difficulty in competing for projects because they generally incur more costs than their Salvadoran counterparts for such items as overhead and mobilization. These higher costs result in higher-priced offers that are not competitive. It is also difficult for U.S. firms to secure performance and payment bonds.⁶ We were told that some U.S. firms could not secure the required bonding because the U.S. insurance companies generally will not provide bonding for work in countries where there is civil unrest.

The Army Corps of Engineers, however, has waived certain bond requirements for all firms because the Corps contracting officer determined that it would be impracticable for Salvadoran and joint venture firms to use Treasury-listed sureties for bonding purposes. Waiving this requirement made it possible for these firms to perform Corps construction contracts using Salvadoran bonding. However, the Department of Defense (DOD) noted that both U.S. and Salvadoran firms had the option of using Salvadoran banks to execute the performance and payment bonds. Thus, Salvadoran firms would have had no advantage over U.S. firms if U.S. firms had chosen this option.

Even though some U.S. officials said that it was somewhat questionable whether the U.S. government would be reimbursed if an Salvadoran contractor defaulted using Salvadoran bonds, permitting these bonds was the practice on 10 of 13 contracts awarded to Salvadoran and joint venture firms. On the other three contracts, other non-Treasury listed sureties were permitted by the Corps.

The Corps has followed its procedures and regulations in awarding contracts to Salvadoran and joint venture firms. However, on one contract awarded to a Salvadoran firm, two U.S. firms were excluded from evaluation in the contract selection process solely because of price and not on

⁶Performance and payment bonds can be executed by corporations, but only by those on the Treasury Department's list of approved sureties. The list contains U.S. insurance companies that are acceptable sureties for federal bonds.

technical merit. As a result, a U.S. firm was excluded from further consideration.

DSAA approved offshore procurement waivers because U.S. participation was limited and greater competition was needed to ensure competent engineering services at fair and reasonable prices in the contractor selection process. We agree that it may be more expensive for U.S. firms than local firms to perform the construction in El Salvador. However, U.S. firms, including some from labor surplus areas, are both willing and technically capable to perform the work and have submitted reasonably competitive prices. Since U.S. firms are competitive, the question is whether priority should be given to reducing program costs and conserving assistance funds over the possibility that the U.S. economy may be adversely affected by an offshore procurement.

Procedural Guidance and Criteria Lacking

Although the purpose of security assistance funds is to support U.S. commitments to our allies, these funds are intended to be spent in the United States. Section 42(c) of the Arms Export Control Act permits exceptions to this policy when DSAA determines, with concurrences from the Departments of State and the Treasury, that there will not be adverse affects upon the U.S. economy, with special reference to labor surplus areas, that outweigh the economic or other advantages of less costly procurement outside the United States. However, DSAA has not documented any specific action to consider labor surplus areas in these decisions. In addition, it has not established any guidance or criteria for reviewing or approving offshore procurement determination decisions (waivers) or procedures for considering labor surplus areas.

As justification for continuing its approvals of offshore procurement waivers for construction in El Salvador, DSAA stated that Salvadorans comprise most of the on-site labor force on the contracts. Thus, DSAA determined, after waivers had been approved, that the impact on U.S. labor would not be significant. DSAA's General Counsel concurred that DSAA must consider labor surpluses in various U.S. locales but stated that section 42(c) does not specifically require that an assessment be documented. In addition, DSAA's General Counsel stated that it is difficult to define the adverse impact in any quantifiable sense, since one cannot anticipate months in advance whether firms from a labor surplus area will submit offers on construction contracts.

We recognize that implementation of the act does not require documentation and that the adverse impact need not be defined. Although we

agree that it may be difficult to anticipate that firms from labor surplus areas will bid on these construction contracts, the requirement to consider labor surplus areas in offshore procurement decisions is mandatory under section 42(c) of the Arms Export Control Act.

We are also concerned about the content of DSAA's determinations. They contain little specificity, with no references to time frames or monetary ceilings, and have resulted in some confusion within DSAA and the Corps over the limitations of each determination. These vague determinations can give the impression, for example, that they are blanket offshore procurement waivers. Technically, a blanket offshore procurement waiver was not approved for construction in El Salvador. However, some Corps officials believed that a blanket offshore procurement waiver had been approved. In two cases, Corps officials even solicited requests for proposals on two separate contracts from Salvadoran and joint venture firms before a waiver was authorized. DSAA officials do not believe this procedure was improper, since the contract was not awarded until after an offshore procurement determination had been approved.

DSAA believes that the determination language should be in general terms to provide flexibility in the process. This would avoid the need to constantly revise determinations. We were told that DSAA usually issues a new determination for a related program if the initial proposal is changed significantly. We do not believe, however, that DSAA's flexibility would be impeded by requiring determinations to contain limitations on scope and value. Only significant changes would require a separate determination.

Waiver Concurrences by the Departments of State and the Treasury

The State and the Treasury Departments provide initial concurrences on offshore procurement determinations on a particular project or a group of projects. When making these decisions, the Departments rely on DOD for information about the planned scope and nature of projects. DOD has no mechanism for reporting changes made to scope or costs during implementation.

Significant changes can occur; for example, in our review of offshore procurement determinations for Salvadoran construction, we noted that one waiver was used to cover 10 contracts over a 16-month period for construction work in El Salvador. However, not all of these projects were included in the initial offshore procurement request that was proposed to the Departments of State and the Treasury, and the costs had exceeded the proposed estimate by about 22 percent as of May 1988. It

is possible that the changes in scope from the initial proposal would have affected their decisions. The number of waivers approved by DSAA has increased in the last few years. We believe that DSAA should periodically provide to the Departments of State and the Treasury information on the actual scope and costs of each project authorized by a determination. This information could then be used to analyze subsequent offshore procurement determination decisions.

Recent DSAA Actions

Subsequent to our review, DOD initiated action to provide more detailed guidance to the Corps and other implementing agencies on offshore procurement actions. We believe that DSAA can take further actions to improve its offshore procurement decisions, such as developing criteria and procedures for granting waivers in consultation with the other Departments involved and setting scope and dollar limitations to ensure that the limits of offshore procurement authority are understood and adhered to.

During the course of our review, DSAA took actions to (1) limit its approvals for offshore procurement on two construction projects to the scope and estimated costs as initially requested and (2) limit the proposals on a third construction project to U.S. firms by denying the request for an offshore procurement waiver. Subsequent to our review, DSAA stated that the decision to seek offshore procurement determinations for five of eight construction projects in El Salvador that are currently being considered will depend on whether the Corps identifies adequate interest by U.S. firms.

Contracts Not Fully Audited

DCAA, which is responsible for defense contract audits, has not conducted any in-country audits and has not been able to obtain relevant documentation from Salvadoran contractors when it has attempted to audit contracts. The Corps, in practice, has normally audited letter contracts, while certain other contracts, including those awarded for construction in El Salvador, are not generally audited.

We are concerned that because of the lack of relevant documentation, Salvadoran subcontractors have not been fully audited. We believe that the Corps should work with DCAA to ensure that contracts awarded for construction in El Salvador are fully audited in accordance with the pertinent DOD regulations.

Conclusions

Since military aid to El Salvador has been significantly reduced over the past 3 years, spending these limited resources in the most economical way has taken on even greater importance. Military aid funds used for construction in El Salvador can be stretched further by permitting local competition. In addition, construction contracts awarded to Salvadoran and joint venture firms may be viewed as an indirect form of military aid to a war-torn country.

However, because DSAA has not documented its assessment of the impact on U.S. labor surplus areas before granting waivers, it is not clear that the Arms Export Control Act is being implemented as required. We believe that DSAA cannot be certain that the benefits of offshore procurement outweigh possible adverse effects on the U.S. economy unless it makes it a practice to document assessments of the impact on U.S. areas of labor surplus.

DSAA has recently limited competition to U.S. firms on several proposed Salvadoran construction projects until the Army Corps of Engineers sufficiently determines that U.S. firms cannot provide the services and that an offshore procurement waiver should be granted. However, written procedures are needed to ensure that DSAA's decision to approve offshore procurement has been made with due consideration of the impact on labor surplus areas.

Recommendations

We recommend that the Secretary of Defense direct the Director, DSAA, to

- establish guidance and criteria for reviewing and approving offshore procurement determinations, including documenting its assessment of the impact on labor surplus areas before making offshore procurement determination decisions;
- provide more specificity in each offshore procurement determination, including, at a minimum, the scope of work, monetary ceilings, and approximate time frames to provide clear limitations on the extent that a determination can be used; and
- establish a mechanism to periodically inform the Departments of State and Treasury of significant changes in the scope of work and modifications to previously approved offshore procurement determinations.

We recommend that the Commanding General of the Army Corps of Engineers work with DCAA to ensure that contracts awarded for construction in El Salvador are fully audited in accordance with pertinent DOD regulations.

Agency Comments

The Departments of State, Treasury, and Defense provided written comments on a draft of this report. (See app. V, VI, and VII.)

Although DOD had several major concerns about our conclusions regarding the offshore procurement determination process, it agreed with our recommendation regarding the need for guidance. DOD stated that it will (1) develop internal guidance for reviewing offshore procurement requests and for considering the impact on labor surplus areas and (2) initiate action to provide detailed guidance to the implementing agencies to ensure that the limits of the offshore procurement authority are understood and adhered to. DOD also plans to coordinate with DCAA to ensure that negotiated contracts awarded to Salvadoran firms will be audited in accordance with DOD regulations.

DOD did not agree to include more specificity in offshore procurement determinations. DOD contends that the offshore procurement determination should be used to signify approved policy decisions and that estimated costs, time frames, and milestones need not be specifically addressed in the determination. The wording of the offshore procurement determination, according to DOD, permits reasonable delays or increases in cost to be authorized without the need to process an additional determination.

We recognize that the offshore procurement determination reflects a policy decision, but to ensure that the policy is applied as DSAA intended, the limitations should be clearly stated in the determination. We do not believe that requiring determinations to contain limitations on scope and value would severely limit the flexibility that DSAA desires. We agree that it could be counterproductive to include overly restrictive requirements in the determinations and are not suggesting that new determinations be executed for minor changes. However, significant changes in scope and value should be consistently communicated to the cognizant departments. The current wording in the determinations is so vague that confusion within DSAA and one implementing agency (the Corps) has resulted.

The determination reflects the concurrence of the Departments of Treasury and State on the proposed use of military aid funds. In addition, the determination is recognized as the authorizing document for off-shore procurement; the supporting documentation, such as the coordination document submitted to the Departments of Treasury and State, which provides specificity as to the determination's scope, would not carry similar weight. Therefore, we believe that stating the broad outlines of the projects to be included under each determination would ensure that the policy is not being misunderstood or misapplied.

The State and Treasury Departments concurred with our recommendation that they be informed when significant changes in scope are made to previously approved offshore procurement determinations. DOD did not agree with this recommendation because it believes that sufficient coordination already takes place. DOD added, however, that the new internal guidance it is preparing will address the development of a consistent mechanism to provide information to the Departments. In addition to being routinely informed by DSAA of significant changes, the State Department would want to have the right to object to a change in an offshore procurement determination should policy issues be created by an increase in scope.

The Department of the Treasury agreed that criteria and guidelines should be devised to regulate offshore procurement of construction services in El Salvador and other countries. Treasury believes that such guidance should encourage participation by U.S. firms yet not preclude the use of foreign firms if they can do the job at substantially lower cost or if U.S. firms are not interested in competing. The Treasury Department added that the guidance should give preference to U.S. firms who actively participate in the work rather than subcontracting it to a local firm. Also, the Treasury Department would like more specificity in the determinations as well as notification of significant changes in scope that occur during implementation.

We have made revisions to the report, where appropriate, to reflect the comments made by State, Treasury, and DOD. The revisions included (1) the deletion of a suggestion that the Congress require the Department of State to present the costs and details of the construction program in El Salvador in the Congressional Presentation Document because such information was included in the most recent submission to Congress during the course of the review and (2) the elimination of a proposal that public accounting firms could be used to audit construction contracts awarded to Salvadoran firms, which was replaced by a

recommendation that DSAA work with DCAA to ensure that the contracts are fully audited in accordance with Defense Department regulations.

In addition, the report was clarified to reflect (1) DSAA's consideration of labor surplus areas in its review of offshore procurement requests, (2) the Regional Military Training Center and yearly program costs, (3) the role of the Salvadoran military in the identification of desired projects, and (4) recent DSAA actions implemented subsequent to our review.

We performed our review in accordance with generally accepted government auditing standards. Our objectives, scope, and methodology are discussed in appendix IV.

We are sending copies of this report to interested Committees and Members of Congress; the Defense, State, and Treasury Departments; and the Army Corps of Engineers. Copies will be sent to other interested parties on request.

The report was prepared under the direction of Joseph E. Kelley, Director, Security and International Relations Issues. Other major contributors to this report are listed in appendix VIII.

Sincerely yours,



Frank C. Conahan
Assistant Comptroller General

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Abbreviations

CPD	Congressional Presentation Document
DCAA	Defense Contract Audit Agency
DOD	Department of Defense
DSAA	Defense Security Assistance Agency
FMS	Foreign Military Sales
LOA	Letter of Offer and Acceptance
MAP	Military Assistance Program

A Growing Construction Program in El Salvador

Between fiscal year 1985 and May 1988, \$37 million of the U.S. Military Assistance Program (MAP) fund was approved for 18 construction projects in El Salvador. About \$13 million of that amount was originally allocated for the construction and operation of a Regional Military Training Center¹ but was reprogrammed in fiscal year 1985. The balance of the \$37 million was for various construction projects for military purposes throughout El Salvador.

Background

In August 1984, the Army Corps of Engineers headquarters tasked the Mobile District Office of the Corps of Engineers to handle all MAP-funded construction in El Salvador, beginning with a heliport complex at San Miguel. Other projects since then have included pier and range improvements; security upgrades; and construction of aircraft hangars, barracks complexes, an aircraft dispersal facility, and a country-wide unit training facility.

The construction projects in El Salvador are not highly technical or sophisticated from an engineering perspective. Overall, the cost of each project is relatively low, ranging from \$300,000 to \$3.4 million per project. During fiscal year 1985, three projects totaled \$5.4 million; in fiscal year 1986, four projects totaled \$9 million; in fiscal year 1987, six projects totaled \$8 million; in fiscal year 1988, five projects totaled \$6.5 million; and another four planned projects were estimated to cost \$4.6 million as of May 1988.²

After an October 1986 earthquake in San Salvador destroyed military infrastructure, the Corps assessed the costs of reconstructing damaged and destroyed buildings. In May 1988, the Corps completed construction of 84 of 89 temporary facilities, the first phase of the earthquake reconstruction program.

¹The Regional Military Training Center was to be located in Honduras for the purpose of training military forces from El Salvador, Honduras, and Costa Rica. When negotiations with the government of Honduras failed to resolve outstanding issues, the funds were split among these three countries. The funds for El Salvador were to be used for training, training equipment and ammunition, and training infrastructure. The total reprogrammed fund for El Salvador for fiscal years 1984-85 was \$22 million, of which \$13 million was allocated for construction and \$9 million for other training support.

²The amounts represent the actual costs of current and completed construction projects as of May 1988; the actual costs are less than the amount authorized in the Letters of Offer and Acceptance for this construction. The amounts reflect the year in which contracts were awarded and not the year in which the Letter of Offer and Acceptance was funded.

Construction Program to Continue

The Military Group Commander in El Salvador identified a requirement for a sustained level of funding at \$8 million a year to continue the construction program. Proposed projects in fiscal years 1988 and 1989 include the construction of a medical warehouse and utility upgrades at various locations. Construction of other permanent facilities to replace those damaged or destroyed in the earthquake is estimated to cost \$60.4 million but is not currently budgeted. According to a Defense Security Assistance Agency (DSAA) official, when possible, funding for future construction projects will be obtained by reviewing every open Salvadoran MAP case and determining how much can be deobligated from these cases to make funds available for other construction projects.

No Congressional Reporting Requirement

DSAA is not specifically required to report the construction of military facilities in El Salvador in the Congressional Presentation Document (CPD), which explains and supports annual security assistance budget requests to Congress. According to the CPD program objectives for fiscal years 1985 to 1988, the procurement and repair of equipment are described as the purposes for MAP funding in El Salvador. During these fiscal years, construction projects were not mentioned because they were considered a minor element of the security assistance program, according to a DSAA official, and only major programs were discussed in the CPD.

According to the Military Group Commander, emphasis has recently been placed on MAP-funded construction in El Salvador. In addition, the fiscal year 1989 CPD includes a requirement to reconstruct military facilities that were destroyed or damaged in the 1986 earthquake. He added that this reconstruction will provide a lasting improvement to the military infrastructure, thereby helping to sustain a viable military force in El Salvador. Although additional funding will be required to reconstruct these facilities, these costs were not included in the fiscal year 1989 CPD. However, this information is now included in a classified annex to the fiscal year 1990 CPD.

Although DOD is not specifically required to include information about the construction program in El Salvador in the CPD, the total construction activity could, over time, represent a significant buildup of the Salvadoran infrastructure.

Initiation of Salvadoran Construction Projects

The Military Group at the U.S. Embassy, El Salvador, receives from the Salvadoran military the construction requirements of their country and identifies those that can be met with the use of security assistance funding. The Military Group translates these requirements into requests to the Army Corps of Engineers to prepare the Foreign Military Sales (FMS) casework for design and construction of these projects. At that time, the Corps decides whether the project deviates from the normal FMS procedures and will require special authorization. For example, due to the anticipated limited interest of U.S. firms for work in El Salvador, the Corps has requested offshore procurement authorization from DSAA to broaden the FMS vendor participation to include Salvadoran firms. These requests, together with the case information regarding price and project description, are submitted to DSAA. Upon receipt of offshore procurement authorization, the FMS case is submitted to the Salvadoran government for approval. If accepted, the work is contracted to independent or joint venture firms through the Corps, as was the case for construction work in El Salvador. Once the contracts are awarded, the Corps Area Office in El Salvador is responsible for contract administration and quality assurance.

The Contract Process

The Corps follows the Federal Acquisition Regulation, plus implementing regulations and supplements, in selecting contractors whose offers are most advantageous to the U.S. government. This regulation contains the policies and procedures relating to acquisition of supplies and services.

Overseas construction projects customarily involve solicitations and competitive negotiations that result in negotiated procurement contracts. When construction work needs to start immediately, a letter contract is negotiated (see p. 18).

Before a request for proposals is issued to solicit offers, a formal Source Selection Plan is prepared. The plan describes evaluation criteria and the relative importance of the criteria. The proposals are first evaluated for responsiveness³ in the Corps Contracting Division. A responsive proposal for a construction contract often includes, among other things, an

³The concept of responsiveness applies only when sealed bidding procedures are used and does not apply in negotiated procurements. However, the Corps uses the term "responsive" to mean that proposals comply with all of the requirements of the request for proposals.

adequate bid bond; a bidding schedule; and a complete technical proposal, which typically includes appropriate material describing the contractor's prior and current experience, financial capability, and management structure. The Division rejects a proposal as being nonresponsive if it does not conform to a material provision of a request for proposals.

The proposals that are determined to be responsive are then evaluated by the Source Selection Evaluation Board members. The Board is normally composed of members of Engineering, Construction, and Resource Management Divisions. Each Board member ranks each proposal based on the criteria in the Source Selection Plan and the request for proposals. The criteria and weight applied to each factor in the plan depend on the circumstances of the particular work to be done. Standard evaluation factors include specialized experience, scheduling, quality control management, previous experience, and experience of supervisory personnel. Technical competence is usually given more weight than management/administrative factors, and price is normally considered after the technical evaluation.

After each technical evaluator independently evaluates each responsive proposal, a price analysis is performed by comparing the submitted prices with each other and with independent government estimates, using a rough mathematical pricing formula. The pricing formula consists of dividing the total proposed price by the number of technical evaluation points. According to Corps officials, the highest ranking proposal based on the price-per-point analysis is always considered the most favorable proposal.⁴

Generally, the competitive range is determined by the contracting officer and discussions are conducted with all offerors within the range. However, awards may be made on the basis of initial offers without discussions if the contracting officer determines that the most favorable proposal would result in the lowest overall cost.

The successful contractors are selected based on technical and management evaluation factors as well as price. If the contracting officer determines that a proposed price is significantly lower than the government estimate, he must make sure that both the offeror and the government

⁴In April 1988, the Army Federal Acquisition Regulation Supplement was amended to discontinue the price-per-point analysis, according to Corps officials.

estimator completely understand the scope of work. This has been done by requesting a price verification from the offeror.

Prior to making an award, the contracting officer must determine that the proposed awardee is financially and technically responsible, can manage the contract properly during performance, and can complete the work on time. This process results in a determination of the contractor's ability to meet contractual obligations. The contracting officer may determine that a pre-award survey will be used in determining contractor responsibility, if appropriate to the circumstances.

Letter Contracts Expedite the Award Process

The letter contract is a quick means of negotiating and awarding contracts when the Corps determines that (1) the government's interests demand that the contractor be given a binding commitment to start work immediately and (2) it is not possible to negotiate a definitive contract in sufficient time to meet the requirement. The ongoing insurgency in El Salvador required that some projects be completed as expeditiously as possible. In this regard, two projects were requested immediately following a 1985 guerilla attack on an unprotected base, which resulted in damage to the base and the deaths of about 60 Salvadoran soldiers.

In awarding letter contracts, Corps officials told us that, because of the unusual and compelling urgency, they generally limit competition to several firms that they believe can satisfy the requirement. Corps officials generally request the firms to develop proposals and present them orally to Corps officials. The price, Corps officials told us, is negotiated and is not a major factor affecting the award decision. Later, the contract is modified to include a firm fixed price.

Rationale for Approving Offshore Procurement Authority

According to DSAA, some of the general considerations that are applied but not documented when considering whether to approve an offshore procurement are as follows:

- Does the procurement fit within the context of the country program and mutual U.S. and host country interests?
- Can the item or service, as required for the program, be obtained from U.S. sources or would it be cost prohibitive?
- Must the item or service be obtained from an offshore source in order to meet specific requirements of the program?

- Is the U.S. mobilization base or U.S. industry, with reference to areas of surplus labor, affected by offshore procurement of this particular item or service?
- Are U.S. trade patterns or trends affected?

Although these factors are provided by DSAA as considerations in the offshore procurement decision process, as stated previously, there is no documentary evidence that such factors are considered. The Defense Department added that none of these considerations is decisive in every case in granting offshore procurement determinations, but they do establish the basis for the request for such action.

In the case of construction in El Salvador, the Corps requested and used offshore procurement authority three times as of May 1988: in July 1986 and in May and July 1987. Although the authority involves construction services in El Salvador, the number of projects covered varies considerably. For example, the July 1986 authority covered 10 projects, the May 1987 authority covered 2 projects, and the July 1987 authority covered 1 project. As a result, 13 solicitations between July 1986 and May 1988 authorized U.S. firms, Salvadoran firms, or joint (U.S.-Salvadoran) firms to submit offers on projects as prime contractors.

According to DSAA, its decision to approve the requests for offshore procurement was based on the fact that U.S. participation was limited in the past and greater competition was needed to ensure competent engineering services at fair and reasonable prices. U.S. government officials who provided input in the initial decision to authorize offshore procurement included the U.S. Ambassador and Military Group Commander in El Salvador, the Corps of Engineers, and the U.S. Southern Command.

In April 1986, the U.S. Ambassador to El Salvador requested offshore procurement authorization for construction of military facilities and infrastructure, citing the high initial cost of construction and significant cost overruns experienced with U.S. firms. The Corps informally reported to DSAA that few U.S. companies submitted proposals and that offers solicited from U.S. firms for contracts frequently exceeded the Corps' estimated costs for the planned projects.

The Military Group Commander recommended that this authority be obtained to ensure the maximum use of security assistance funds through savings that would result from greater competition. He stated that one of the frustrations with the existing competitive system was that the U.S. firms were winning the contracts, taking administrative

fees and profits, and then subcontracting the actual work to Salvadoran firms. This practice, he said, did not result in the best price for the U.S. government with respect to construction projects.

Furthermore, the Commander in Chief, U.S. Southern Command, stated in a message to the Chief of Station, U.S. Embassy, El Salvador, that he supported offshore procurement on the basis that

“there are a number of highly qualified, underemployed [Salvadoran] firms available which could complete designs faster than U.S. counterparts and which are better able to specify local construction standards, materials, and methods.”

He also stated that

“we recently overcame the ‘Buy U.S.’ prime contractor restriction in ‘Costa Rica’ and would work with the staff to ‘get this same relief on future projects in El Salvador.’ ”

Corps officials and the Military Group Commander pointed out that the Corps Area Office in El Salvador also fulfills a training or educational mission. The Office (1) assists the Salvadoran contractors and subcontractors who are awarded construction contracts in constructing to U.S. specifications and (2) trains local engineers, who are employed by the Corps Area Office, how to supervise the contractors.

Not all of the negative conditions that were cited by these officials as resulting from the use of U.S. firms were fully substantiated by our analysis. Before offshore procurement authority was first granted in July 1986, five construction contracts were awarded to U.S. firms, and a number of U.S. firms submitted offers or expressed interest in performing the work on these contracts. Three of the five contracts awarded to U.S. firms were negotiated using a letter contract in which price was not the major factor affecting the award decision.⁵ We noted that the prices submitted on the other two contracts by some U.S. firms appeared reasonably competitive, since they did not exceed the government estimate or exceeded it by a small percent.

Regarding the statements on cost overruns, we noted that the Corps repeatedly added to or deleted from the scope of construction work in El Salvador, often at the request of the Salvadoran government. These

⁵On these three contracts, no formal proposals were submitted to the Corps prior to the time the contract was awarded, as stated previously. The contracts were “definitized” during construction.

changes in scope resulted in price changes on the two negotiated contracts. On these contracts, the actual cost exceeded the initial award by 16 and 45 percent. On the three letter contract awards to U.S. firms, the actual costs of each contract did not exceed the "definitized" cost by more than one percent. Changes in scope also resulted in increases to some Salvadoran firms' costs on other Corps contracts. Overall, however, permitting competition from Salvadoran firms has resulted in lower construction costs.

We were also informed by Corps officials that U.S. firms might not be interested in working in El Salvador partly due to the relatively small size of the construction projects. According to Corps officials, larger projects are more attractive to U.S. firms because they are more likely to achieve economies of scale by spreading overhead and mobilization costs over a larger base. Thus, U.S. firms can bid more competitively on larger projects, whereas we were told by Corps officials that local firms, which often have cash flow difficulties, can more easily finance projects that are broken down into smaller ones.

In one instance, however, the Corps separated construction work of the same type into a number of small contracts. The project, estimated to cost \$4.8 million for the construction of obstacle courses and open-air classrooms throughout El Salvador, was broken down into three different contract proposals by regional area. A Corps official stated that the projects were not solicited under one proposal because of an urgent need to initiate and complete work simultaneously at several locations. Even so, two of the three contracts were awarded to the same Salvadoran firm, and the third was awarded to another Salvadoran firm. One U.S. firm, which bid on the three proposals separately, said that it could have submitted a more competitive offer and achieved economies of scale if the work had been covered under one proposal.

U.S. Contractors' Ability to Compete Against Salvadoran and Joint Venture Firms for Construction in El Salvador Is Limited

We contacted 10 U.S. firms and a U.S. partner in a joint venture firm that submitted offers on 21 separate contracts, executed between 1985 and 1987, to gain an understanding of the factors that might have affected their competitiveness for construction in El Salvador. Many of them had encountered similar difficulties in attempting to win construction contracts after Salvadoran firms were authorized to compete. Several firms cited their inability to compete in bidding against local firms and described the problems associated with obtaining performance and payment bonds. Some firms said that to compete effectively they would need to bid on solicitations restricted to U.S. firms or enter into a joint venture with a Salvadoran firm on solicitations permitting local competition. In a joint venture, U.S. firms could cut overhead costs and use Salvadoran bonds, which were perceived by several U.S. firms as being easier for Salvadoran firms to obtain.

Analysis of Selected Construction Contracts

Three of the four construction contracts that we focused on in our review involve the construction and/or erection of pre-engineered metal buildings. The fourth contract involves the construction of obstacle courses, ranges, and open-air classrooms at various locations. The contracts were awarded to Salvadoran firms, except one that was awarded to a joint venture firm. In each case, the offeror with the lowest proposed price won the contract.

Offerors submitted 30 proposals for the 4 contracts: 17 from El Salvador, 11 from the United States, and 2 from a joint venture firm. Of the 30 proposals submitted, 12 were deemed nonresponsive or not competitive by the Corps Contracting Division. All 11 of the U.S. firms' offers and one Salvadoran firm's offer were deemed nonresponsive or not competitive. Table II.1 shows the reasons that the U.S. firms were not considered for award on the contracts.

Table II.1 Offers From U.S. Firms Regarded as Nonresponsive or Not Competitive

Reason	Frequency
Failed to submit a technical proposal	4
Not priced within competitive range or excessively priced	3
Failed to submit a bid bond	2
Failed to submit a financial statement	1
Submitted a bidding schedule via facsimile telegraph	1

The Salvadoran firm was nonresponsive for failure to submit a bid bond and a technical proposal. The offerors that were considered nonresponsive had not conformed to a material provision of the request for proposals.

U.S. Firms Incur More Costs to Perform the Same Work

U.S. firms often cannot compete with the prices of local competitors. Officials of several U.S. firms told us that they generally incur more costs than Salvadoran firms because of the extra costs associated with start-up, mobilization in-country, and use of American supervisors. Representatives of a majority of the firms we contacted said that they planned to subcontract much of the work to Salvadorans and use American employees to supervise. In addition, one U.S. firm noted that the Salvadoran firm it planned to use as a subcontractor also submitted a proposal as prime contractor for the construction work.

A U.S. contractor, who had performed work in El Salvador before off-shore procurement was authorized, explained the difference between working in El Salvador and Panama. He said that in Panama, where he has successfully competed against local firms for Corps construction contracts, he was able to hire his own work force at a reasonable cost. However, Americans will not work in El Salvador unless they are well compensated. This contractor explained that Americans expect a base pay plus a premium, or "danger," pay. Thus, the U.S. firms hire only a few Americans and then subcontract to local nationals, who comprise virtually all of the on-site labor force. However, several U.S. firms said that Salvadoran subcontractor prices for doing the site work may be high for the amount of work required. Thus, the prices submitted by U.S. firms would also be high.

Difficulties in Obtaining Performance and Payment Bonds

Performance and payment bonds are generally required from the contractor that is selected as the successful offeror for any construction contract exceeding \$25,000. These bonds basically guarantee that the contractor will complete the work (performance) and pay the laborers, material suppliers, and subcontractors (payment). Performance and payment bonds may be secured through a corporate surety that is approved by the U.S. Treasury or by two or more individual sureties. However, the contracting officer may determine that, for work performed in a foreign country, it is impracticable for the contractor to furnish such bonds or use Treasury-listed sureties. Thus, the contracting officer may waive either requirement.

**Appendix II
U.S. Contractors' Ability to Compete Against
Salvadoran and Joint Venture Firms for
Construction in El Salvador Is Limited**

**Salvadoran and Joint Venture
Firms Obtain Bonding**

According to the contracting officer for the construction contracts, when the Corps began soliciting proposals for construction in Central America, it found that local firms had difficulty obtaining the performance and payment bonds as required by the solicitation. Therefore, the Corps allowed the successful offeror the option of using a letter of credit from a local bank to secure the performance and payment bonds. As a result, on the 13 construction contracts awarded to Salvadoran and joint venture firms between fiscal year 1986 and May 1988, all were permitted to use non-Treasury listed sureties, 10 of which used local Salvadoran financial institutions.

**U.S. Firms Have Difficulties
Obtaining Performance and
Payment Bonds**

Several U.S. firms we talked to cited difficulties in obtaining performance and payment bonds due to the civil unrest in El Salvador. They said that U.S. insurance companies considered the venture too risky and would not issue a bond. A bond specialist of a U.S. insurance company agreed that it would be difficult for U.S. companies to obtain bonds for work in El Salvador.

In one case involving a U.S. firm that submitted a proposal on a Salvadoran construction project, a U.S. insurance company verbally approved the performance and payment bond but withdrew its commitment a few days before bid submission in 1987 due to a news report of a bombing incident in El Salvador.

Several U.S. firms believe that bonds are easier to obtain from a Salvadoran bank but may be worthless if they are not backed by hard currency. According to an official of a U.S. firm, one reason his firm agreed to submit an offer on a project as a joint venture was that he could use a Salvadoran bank to obtain bonding. Otherwise, he said, his firm would not have been able to obtain bonding for the contract. However, DSAA noted that U.S. and Salvadoran firms had the option of using Salvadoran banks to execute the performance and payment bonds. Thus, Salvadoran firms would have had no advantage over U.S. firms, if U.S. firms had chosen this option.

According to a Corps official and a bond specialist of a U.S. insurance company that specializes in international bonds, if a Salvadoran contractor defaulted, it would be questionable whether the U.S. government could be reimbursed. They also noted that the government of El Salvador imposes severe restrictions on foreign exchange.

Price Criteria Used for Determining the Competitive Range

Corps officials have broad discretion in determining the competitive range. Competitive range encompasses both price and technical considerations.

We noted that proposals from two U.S. firms were determined not to be in the competitive range by Corps officials. This determination was based solely on price and not on technical merit. The offers from these two U.S. firms were \$3.7 million and \$2.35 million. Of the remaining four proposals, all from Salvadoran firms, the offers ranged from \$1.7 million to \$2.1 million. Since one U.S. firm's offer was only \$250,000 from the next higher-priced proposal that was evaluated, the breakpoint could easily have been between \$3.7 million and \$2.35 million rather than between \$2.35 million and \$2.1 million. Thus, at least one U.S. firm could have been given consideration. The Contracting Officer of the Mobile District Office stated that, in retrospect, this U.S. firm should not have been eliminated from consideration.

Two Salvadoran Firms Were Not Fully Audited Due to Civil Unrest

The Corps has normally audited letter contracts, while certain other contracts, including those awarded for construction in El Salvador are generally not audited.

In 1986, the Corps requested the Defense Contract Audit Agency (DCAA) to audit two letter contracts that involved a U.S. prime contractor and a Salvadoran subcontractor. DCAA is responsible for performing contract audits of Defense Department contractors and subcontractors.

In both instances, DCAA decided not to send an auditor to El Salvador due to the political and civil violence occurring there. DCAA stated that the risks associated with travel in El Salvador were too high and the personal safety of the auditor could not be ensured. DCAA requested that two Salvadoran subcontractors submit relevant documentation to be audited at its stateside office, but the firms did not fully cooperate with this request. Thus, DCAA could not reach definitive conclusions on the subcontractors' costs. On one case, involving the audit of a million-dollar Salvadoran subcontract, DCAA requested information, orally and in writing, from the Salvadoran firm. Although DCAA made repeated attempts to obtain the necessary information, its requests were ignored. Thus, DCAA could not reach a definitive conclusion on its evaluation of the subcontractor's costs and treated the entire \$1 million Salvadoran subcontract as unresolved. On the second contract, DCAA validated roughly 80 percent of the proposed price based on relevant documentation. The

**Appendix II
U.S. Contractors' Ability to Compete Against
Salvadoran and Joint Venture Firms for
Construction in El Salvador Is Limited**

contracting officer in both cases believed that sufficient data were available to negotiate a price.

Defense Department Needs to Revise Its Process for Approving Offshore Procurement Determinations

MAP provides grant funds to friendly and allied countries to finance procurement of defense articles and services that help strengthen their defense capabilities. All of the Salvadoran construction was funded with "merged MAP funds," that is, MAP funds transferred to the Salvadoran FMS program under section 503 of the Foreign Assistance Act. Although MAP funds are provided under the Foreign Assistance Act, under Defense Department regulations, merged MAP funds are subject to FMS procedures under the Arms Export Control Act once they are transferred to an FMS account.

Section 42(c) of the Arms Export Control Act states that

"funds made available under this Act may be used for procurement outside the United States only if the President determines that such procurement will not result in adverse effects upon the economy of the United States or the industrial mobilization base, with special reference to any areas of labor surplus or to the net position of the United States in its balance of payments with the rest of the world, which outweigh the economic or other advantages to the United States of less costly procurement outside the United States."

The President delegated to DSAA the responsibility for making offshore procurement determinations, with concurrences from the Departments of State and Treasury for each proposal. Since 1976, DSAA has approved 64 offshore procurement determinations valued at \$4.7 billion. The value of most of these determinations is related to programs in Israel. About two-thirds, or 41, of the determinations, valued at about \$950 million, were made in the last 3 years (from 1986 to July 1988); of those, 20, valued at \$31 million, involved construction in Central America, Africa, Grenada, and the Philippines.

In recent years, the number of waivers for the purpose of overseas construction has increased, partly to stretch limited security assistance funds, according to a DSAA official. Another reason for the increase is a recently created civic action program for several African countries. This program and others authorized for offshore procurement encompass a number of small-scope construction projects, most of which are less than \$400,000 per project. Separate determinations were approved for each project.

Regarding construction in El Salvador, limited security assistance funds can go further with this authority because, typically, it will be less expensive for local national firms to do the work.

No Evidence That Labor Surplus Areas Were Considered

Section 42(c) does not indicate what procedures should be followed with special reference to areas of labor surplus when deciding whether to procure foreign goods and services under the FMS/MAP program. However, the legislative history of section 42(c) does make clear that responsible officials are to give careful consideration to the possibility and desirability of placing orders in areas of labor surplus in the United States before placing them in foreign countries.

In justification for continuing its approvals of offshore procurement waivers for construction in El Salvador, DSAA stated that Salvadorans were comprising most of the on-site labor force. Thus, DSAA determined, after the waivers had been approved, that U.S. labor would not have been significantly affected.

We found no documentary evidence, however, that DSAA took specific action to consider labor surplus areas before making offshore procurement decisions. DSAA's General Counsel concurred that DSAA must consider labor surpluses in various U.S. locales but pointed out that section 42(c) does not specifically require that an assessment be documented. In addition, DSAA's General Counsel stated that it is difficult to define the adverse impact in any quantifiable sense, since one cannot precisely anticipate months in advance whether firms from a labor surplus area will submit offers on construction contracts.

We recognize that implementation of the act does not require documentation and that the adverse impact need not be defined. Although we agree that it may be difficult to anticipate with precision that firms from labor surplus areas will submit offers on these construction contracts, the requirement to consider labor surplus areas in offshore procurement decisions is mandatory under section 42(c) of the Arms Export Control Act. Without documentation, we believe that it would be difficult for DSAA to ensure that a decision to approve offshore procurement has been made with due consideration of the impact on areas of labor surplus.

Determination Decisions Lack Implementing Guidance and Procedures

Section 42(c) describes the factors that should be considered in approving offshore procurement determinations, but the act does not specify how this authority will be implemented or what weight these factors should be given. DSAA has no written guidance for approving or reviewing these determination decisions.

Early in 1988, both the Deputy Assistant Secretary of Defense for Inter-American Affairs and the Director, DSAA, stated in correspondence to several congressmen that offshore procurement waivers for Salvadoran construction could be authorized only on a case-by-case basis. However, in some cases, the offshore procurement determination did not specify all projects ultimately covered.

The act does not specifically require DSAA to issue separate determinations by country or project, but as a matter of practice, DSAA has made the determinations by country with a generalized scope so that minor extensions in time or scope could be permitted. Each approved offshore procurement determination is normally identified by separate Letters of Offer and Acceptance (LOA). Also, the wording in the offshore procurement determination states that the construction will be authorized "under a LOA." A May 1987 waiver approved for earthquake construction in El Salvador involves two contracts to date; both were covered under one LOA. However, a July 1986 waiver involved 10 contracts for construction throughout El Salvador for pier and base improvements, a joint operations center, unit training facilities, a barracks complex, and aircraft hangers. The construction under this waiver was covered by seven LOAs.

A DSAA official stated that too many projects were included under the authorization of one waiver and that the projects could not be clearly identified as one program. We believe that DSAA should take action to establish written procedures or guidance to ensure that each waiver clearly states limitations in scope and costs.

In addition, a greater number of U.S. firms submitted proposals on certain types of construction projects. For example, a project to erect metal buildings in El Salvador generated 8 proposals, 4 of which were from U.S. firms, and at least one U.S. firm submitted a proposal on 15 of the 18 construction contracts. When making offshore procurement determination decisions, DSAA should take into consideration that a greater number of U.S. firms may submit proposals on certain types of construction projects.

DSAA argues that offshore procurement determinations are policy documents and should not be used for implementation purposes. We recognize that the offshore procurement determination reflects a policy decision, but we believe that to ensure the policy is applied as DSAA intended, the limitations should be clearly stated in the determination. We believe that stating the broad outlines of the projects to be included under each determination would ensure that the policy is not misunderstood or misapplied.

Determinations Do Not Adequately Reflect Scope and Costs

The determinations generally authorize offshore procurement of materials, equipment, and services on a country-by-country basis and contain varying degrees of specificity. Determinations that approve offshore procurement of equipment usually specify the type of equipment and quantity but not the cost of the procurement or the time frames for accomplishment. Determinations involving construction are even less specific and contain no references to time limitations or monetary ceilings. Most determinations involving construction projects cite a broad, generalized scope and state that the procurement is for construction materials, equipment, and/or services. As a result, the determinations have been misinterpreted as blanket waivers.

The three determinations for offshore procurement for construction in El Salvador, for example, are worded basically the same, as follows:

"I [Director, Defense Security Assistance Agency] hereby determine that procurement for the Government of the Republic of El Salvador under a Letter of Offer and Acceptance of construction material and services of Salvadoran contractors will not result in adverse effects upon the economy of the United States or on the industrial mobilization base, and I therefore authorize the use of MAP funds made available for the Government of the Republic of El Salvador for such procurement."

Only a cover memorandum, or a coordination document, which is attached to the proposed determination and reviewed by the Departments of State and the Treasury, provides specificity as to the scope of a determination. But the program is not necessarily implemented as stated in this memorandum because changes can be made in the scope to meet program requirements without further justification or concurrence from the Departments of State and the Treasury. In addition, the Departments do not receive information on the final scope and costs of each determination. Complete information might affect their decisions to concur or nonconcur on subsequent determination reviews.

DSAA officials stated that they require flexibility in the determination language so that they can make changes without submitting a new determination for every minor change. However, (1) there are no criteria defining minor and significant changes and (2) if DSAA does not notify the State and Treasury Departments of proposed changes to a determination, the value of their concurrences is lessened. In addition, the waiver can be misconstrued as a blanket waiver. For example, Corps officials believed that a blanket offshore procurement waiver had been issued for construction in El Salvador. In fact, in two cases, Corps officials solicited requests for proposals before a waiver was authorized.

We do not believe that DSAA's flexibility would be seriously impaired by requiring determinations to contain limitations on scope and value. We agree that it could be counterproductive to include overly restrictive requirements in the determinations and are not suggesting that new determinations be executed for minor changes.

DSAA Changes Projects' Scope and Costs Without State and the Treasury Departments' Concurrence

Officials in the Treasury and State Departments recommend concurrence or nonconcurrence of waivers based on a review of the documents provided to them by DSAA. The process is totally self-determined by these officials because there are no established procedures or guidance for this review. The review process is strongly dependent on the facts given to them by DSAA. Generally, officials in the Treasury Department consider financial and economic factors. Although the State Department considers the same factors as the Treasury Department, it also evaluates the proposal to ensure consistency with U.S. policy. Treasury routinely contacts the Defense Department for information about the planned scope and nature of the project. In some cases, the Treasury Department contacts other government officials and businesses to obtain further information about the changes. There is no mechanism for reporting to the Treasury and State Departments any changes in scope or costs that emerge during implementation.

DSAA provides State and Treasury information regarding each proposed determination that reflects the scope of a program only as known at the time it is initiated. The justification for the July 1986 waiver for construction in El Salvador, for example, estimated that four projects would cost \$11.6 million, and the State and Treasury Departments concurred. However, as of May 1988, this waiver covered 10 separate projects and contract awards of \$14.1 million. The July 1986 waiver was also used for solicitations that had closing dates as late as September 1987. The

award amounts exceeded the waiver estimate by \$2.5 million (22 percent), and the number of projects was increased.

Treasury and State Department officials used the original estimates in scope and costs as the basis for their approval, but as of May 1988, they had no knowledge of the total scope of the program or its costs. DSAA could continue to increase the value of this waiver, since it has no finite dollar ceilings or time limitations. In effect, 10 projects were contracted for under one waiver without explicit DSAA approval to extend the waiver authority beyond the Corps' initial request.

DSAA justified this situation as an example of the flexibility that it needs to exercise waiver authority. However, DSAA's flexibility diminishes the function of the State and Treasury Departments. State and Treasury officials who work on these issues believe that the determination language is more vague than necessary for flexibility and that criteria should be devised for deciding when changes in project scope are substantial enough to require a new determination. As stated previously, we believe the limitations should be clearly stated in the determination to ensure that the policy is applied as DSAA intended. The current wording in the determinations is so vague that confusion within DSAA and one implementing agency (the Corps) has resulted. Stating the broad outlines of the projects to be included under each determination would ensure that the policy is not misunderstood or misapplied.

Since the determination is signed by the Departments of the Treasury and State and reflects concurrence with the proposed use of military aid funds, we believe that the determination is the document that should reflect the limitations of its use. Furthermore, the determination is recognized as the authorizing document for offshore procurement; the supporting documentation, such as the coordination document submitted to the Departments of Treasury and State, which provides specificity as to the determination's scope, would not carry similar weight.

Recent DSAA Actions

After our review was completed, the Defense Department initiated action to provide more detailed guidance to the Corps and other implementing agencies on offshore procurement actions, including specific dollar limitations and a clear statement that the offshore procurement authorization is not a blanket authorization.

During the course of our review, DSAA also took action to limit its approval of the Corps' requests for offshore procurement. In an August

**Appendix III
Defense Department Needs to Revise Its
Process for Approving Offshore
Procurement Determinations**

1988 message to the Corps, DSAA stated that its approval of offshore procurement under one waiver was specifically limited to the scope of construction as initially requested for two construction projects and to the projects' estimated costs. Any additional offshore procurement, whether part of the cited cases or other existing FMS cases, was to be coordinated with DSAA on a project-by-project basis.

Furthermore, DSAA recently directed the Corps not to consider requesting offshore procurement on a third project until it was absolutely certain that no American contractors were interested in it, thereby limiting bidding on the construction proposal to U.S. firms only. After our review, DSAA stated that the decision to seek offshore procurement determinations for 5 of 8 projects currently being considered will depend on whether the Corps identifies adequate interest by U.S. firms.

Objectives, Scope, and Methodology

Our objectives were to review the construction program in El Salvador, with emphasis on selected construction contracts and firms from labor surplus areas who had bid on these contracts, and to evaluate DSAA's process for authorizing offshore procurement waivers with respect to its legality and propriety for construction in El Salvador.

We conducted our review from January to August 1988 and obtained information from the Departments of Defense, Treasury, State, and Labor about the offshore procurement process. We interviewed officials of the Office of the Chief of Engineers and the Mobile District Office of the Army Corps of Engineers and the Area Engineer and the former and current Military Group Commanders, San Salvador, El Salvador, to determine how the contract process worked, the rationale for requesting offshore procurements, and the extent to which U.S. and Salvadoran firms have provided construction services in El Salvador.

Our review did not include an in-depth analysis of all of the construction contracts awarded to both U.S. and Salvadoran firms. However, we reviewed the files on four construction contracts that we were requested to review and obtained and analyzed information about all MAP-funded construction projects in El Salvador between 1985 and August 1988 to provide a basis for comparison and a context for evaluation. We also interviewed officials of 10 U.S. firms and the U.S. partner of a joint venture firm, representing a mix of successful and unsuccessful U.S. firms that had submitted offers on one or more construction contracts in El Salvador since 1985 to determine the factors that might have affected their competitiveness.

We performed our work in accordance with generally accepted government auditing standards.

Comments From the Department of State



United States Department of State

Comptroller

Washington, D.C. 20520

February 2, 1989

Dear Mr. Conahan:

I am replying to your letter of January 6, 1989 to the Secretary which forwarded copies of the draft report entitled "El Salvador: Limited Use of U.S. Firms in Military Aid Construction" (GAO Code 463766) for review and comment.

The enclosed comments were coordinated within the Department and prepared by the Bureau of Politico-Military Affairs (PM).

We appreciate the opportunity to review and comment on the draft report.

Sincerely,

A handwritten signature in cursive script that reads "Roger B. Feldman".

Roger B. Feldman

Enclosure:
As stated.

Mr. Frank C. Conahan
Assistant Comptroller General,
National Security and
International Affairs Division,
U.S. General Accounting Office,
Washington, D.C.

GAO DRAFT REPORT COMMENTS: EL SALVADOR: LIMITED USE OF U.S.
FIRMS IN MILITARY AID CONSTRUCTION (GAO CODE 463766)

See p. 10.

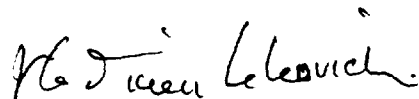
PM would like to point out that basic information on foreign military sales construction agreements is already routinely included in the Congressional Presentation Document (CPD). For example, dollar figures for El Salvador appear on pages 44 and 138 of the FY 1990 CPD and in the classified annex to the CPD. Therefore, there is reason to believe that GAO's recommendation to include details of El Salvador construction projects in future CPD's may be duplicative.

We concur that DSAA should advise State whenever a previously approved offshore procurement case has increased in scope. This could take the form of a simple notification, not a request for re-approval (although we would reserve the right to object if we believed policy issues were created by the increase in scope).

Now on p. 31.

For the sake of accuracy, we would like to make two textual comments. With regard to page 52 of the draft report, State Department officials do take economic and financial factors into account in evaluating proposed offshore procurement waivers. With regard to page 53, we do not recall specific statements in the last paragraph attributed to Department of State officers.

Current limitations on security assistance funding are having a serious effect on America's ability to achieve its foreign policy goals. PM therefore strongly concurs with GAO that cost-saving alternatives, such as appropriate use of offshore procurement in foreign military sales construction projects, are a useful means of conserving scarce security assistance funds.



Vladimir Lehovich
Deputy Assistant Secretary
Bureau of Politico-Military Affairs

Comments From the Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON

February 27, 1989

Dear Mr. Kelly:

Thank you for the opportunity to comment on the draft GAO report, "El Salvador: Limited Use of U.S. Firms in Military Aid Construction." We have no serious disagreements with the draft. We do, however, have several substantive observations which may be of interest to you.

In general, we agree that criteria and guidelines should be devised to regulate procurement of construction services in El Salvador and other countries. Such guidance should encourage participation by U.S. firms yet not preclude use of foreign firms where they can do the job at substantially lower cost or where U.S. firms are not interested in bidding. The guidance should give preference to U.S. bidders who actively participate in the work rather than subcontracting it to a local firm.

The feasibility of procuring U.S. construction materials for offshore projects (see page 5) also is an issue that might be addressed in the guidelines. DSAA often takes the position that materials such as bulk commodities and fixtures made to non-U.S. standards can be procured abroad rather than in the United States. We agree, especially for smaller projects in remote locations. However, higher value-added manufactured items such as generators should continue to be procured in the United States where possible.

We would welcome more specificity in the Determinations as well as advice of significant changes in scope that occur during implementation of a project. Indeed, as a result of this GAO study DOD already has been in contact with us to discuss some of their thoughts on the latter issue.

In addition to these points, we suggest the following specific changes in your draft:

Now on p. 6.

-- On page 11, change the last sentence to read, "When making these decisions, the Departments rely on DOD for information about the planned scope and nature of the project. There is no mechanism for notifying changes in scope or costs that emerge during implementation."

Now on p. 7.

-- Top of page 13, add at the end of the sentence, "... for granting waivers in consultation with the other Departments involved."

Now on p. 31.

-- Middle paragraph on page 52, insert the following sentence just before the present last sentence: "Treasury routinely contacts DOD by telephone to obtain supplementary information on proposed projects and to request clarification on points

Appendix VI
Comments From the Department of
the Treasury

-2-

raised by the DSAA documentation."


Now on p. 32.

-- On page 53, the last sentence should read, "State and Treasury officials who work on these issues believe that the Determination language is more vague than necessary for flexibility, and that criteria should be devised for deciding when changes in project scope are so substantial as to require a new Determination."

Now on p. 27.

Finally, it probably would be useful to introduce early in the report the precise language of Section 42(c) that now appears only in Appendix III, page 44.

Sincerely,


William E. Barreda
Deputy Assistant Secretary
Trade and Investment Policy

Mr. Joseph E. Kelly
Senior Associate Director
NSAID/SIR, Room 5148
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEFENSE SECURITY ASSISTANCE AGENCY

WASHINGTON, DC 20301-2800

22 MAR 1989

In reply refer to:
I-51696/89

Mr. Frank C. Conahan
Assistant Comptroller General
United States General Accounting Office
Washington D.C. 20548-0001

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Draft Report "EL SALVADOR: Limited use of U.S. Firms in Military Aid Construction," dated January 6, 1989 (GAO Code 463766), OSD Case 7873. Although partially concurring with a portion of the report, the DoD has major concerns with several issues, particularly the Offshore Procurement Determination.

The DoD has treated offshore procurement as an exception to policy since Section 42(c) of the Arms Export Control Act (AECA) indicates the intent of Congress is that U.S. military assistance funds should primarily be used for procurement of goods and services from U.S. sources. Since 1970, worldwide U.S. military assistance has totaled \$65.94 billion. Of this amount, only \$4.715 billion has been approved by the DoD for offshore procurement. When Offshore Procurement Determinations for Israel (\$4.509 billion) are deducted, the worldwide non-Israel offshore procurement authority has totaled approximately \$206 million. Accordingly, with the exception of special programs for Israel, since 1970, offshore procurement under the Foreign Military Sales system has been held to less than 1/3 of one percent of U.S. military assistance which is in line with the intent of Congress. As a result, there has been a reluctance to develop detailed guidance on the mechanism by which offshore procurements might be approved. The publication of detailed guidance on a procedure which, due to policy and legal considerations (Section 42(c)), was being discouraged may be perceived as providing additional legitimacy and encouragement of offshore procurement.

The development of Military Assistance Program (MAP) Merger and the expansion of the FMS Forgiven Credit programs has increased the areas in which the DoD has, for policy reasons, supported an increased number of offshore procurement actions. This, notably, has not resulted in a significant increase in the overall dollar value of offshore procurement waivers. However, the DoD agrees with the GAO that the increase in the number of Offshore Procurement Determinations warrants the development of additional guidance in this area, even though the overall value has remained fairly constant.

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A major DoD consideration in the review of the GAO report has been the role of the Offshore Procurement Determination. The Offshore Procurement Determination itself is a policy document. As a policy document, it should be supported by more specific implementation documents. Accordingly, the DoD disagrees with GAO findings that would convert the Offshore Procurement Determination into an implementing document. The DoD does, however, agree with the GAO that additional guidance is necessary to ensure that Offshore Procurement Determinations are supported by appropriate implementing instructions. This guidance will, however, be developed in such a manner so as not to encourage the use of offshore procurement.

The DoD detailed comments on the report findings and recommendations are provided in the attachment. The Department appreciates the opportunity to comment on the draft report.

Sincerely,



CHARLES W. BROWN
LIEUTENANT GENERAL, USA
DIRECTOR

Attachment
As Stated

GAO DRAFT REPORT - DATED JANUARY 6, 1989
(GAO CODE 463766) - OSD CASE 7873

"EL SALVADOR: THE LIMITED USE OF U.S. FIRMS IN MILITARY
AID CONSTRUCTION"

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

FINDINGS

FINDING A: Military Assistance Program (MAP) funded Construction in El Salvador- Background. The GAO noted that, in August 1984, the Army Corps of Engineers tasked the Mobile District Office of the Office of the Corps of Engineers to handle Military Assistance (MAP)-funded construction in El Salvador. The GAO explained that the construction projects in El Salvador are not highly technical or sophisticated from an engineering perspective, and overall, the cost of each construction project is relatively low ranging from \$300,000 to \$3.4 million per project. The GAO reported that, during FY1985, three projects totaled \$5.4 million; in FY1986, four projects totaled \$9 million; in FY87, six projects totaled \$8 million; and, as of May 1988, another 4 planned projects are estimated to cost \$4.6 million. The GAO further reported that, after an October 1986 earthquake in El Salvador which destroyed military infrastructure, the Corps assessed the cost of reconstructing damaged and destroyed buildings and in May 1988, completed reconstruction of 84 of 89 temporary facilities, using MAP funds. The GAO also indicated that \$13.0 million reprogrammed from the Regional Military Training Center (RMTC) were used for general military construction throughout El Salvador. (pp. 2-3, pp. 19-20 GAO Draft Report)

Now on pp. 1-2, 14.

See comment 1.

DOD RESPONSE:

Concur. Some clarification is needed, however, in reference to the discussion of the Regional Military Training Center and yearly program costs.

Regional Military Training Center (RMTC). A total of \$23.0M was re-programmed to El Salvador from FY84 and FY85 funds due to the termination of the RMTC program. The GAO discussion of the overall construction program is not totally clear on the distinction between RMTC construction and general military construction. As a matter of record, the RMTC funds were not used for general construction. These funds were used, as briefed to the Congress, to develop the Salvadoran infrastructure and training capability.

Yearly Construction Summary. A review of Defense Security Assistance Agency (DSAA) records indicates confirms that Letters of Offer and Acceptance (LOAs) for Foreign Military Sales (FMS) construction were issued and implemented from fiscal years 1985 up to May 1988 in the amount of \$37.0 million. The GAO report indicates that a total of \$28.9 million for construction contracts was actually awarded during this period. It should be noted that the balance of construction projects under the indicated FMS cases were in process during this period and many are under contract or solicitation at this time.

FINDING B: El Salvador Construction Program to Continue. The GAO reported that the Military Group Commander in El Salvador identified a requirement for a sustained level of funding of \$8 million a year to continue the construction program. The GAO observed that proposed projects in FY1988 and beyond include the construction of a medical warehouse, utility upgrades at various locations and construction of other permanent facilities valued at \$60.4 million, to replace those damaged or destroyed in the earthquake. The GAO commented that, according to a Defense Security Assistance Agency (DSAA) official, first year funding for the permanent military facilities will be obtained by scrutinizing open El Salvadoran MAP cases for unneeded funds, which will be made available for other construction projects. (p. 21/GAO Draft Report)

Now on p. 15.

See comment 2.

DOD RESPONSE: Partially concur. The DoD agrees that the FMS construction will continue in the immediate future, but disagrees with the projected level of future construction. Additional

Annual Level of Construction. Although the U. S. Military Group (USMILGP) Commander has indicated an estimated annual level of \$6-\$8 million, actual construction levels will be assessed yearly based on actual funds available. As with any MAP recipient, the assessment of valid military requirements for El Salvador for infrastructure improvements, support of current equipment, equipment replacement, modernization, etc., generally far exceeds the funds available. The USMILGP and the U.S. Southern Command (SOUTHCOM) have assessed that an annual MAP allocation of \$125.0 million would be required to meet their assessment of El Salvador's valid military requirements. This level includes the desired level of construction of \$8.0 million.

The FY1988 and FY1989 MAP allocations for El Salvador were \$80 million and \$85 million respectively. If funding levels remain at the current levels, an annual construction program of \$8.0 million will not be possible.

Programmed Construction. The GAO noted the fact that the Corps of Engineers assessed the impact on military facilities of the October 1986 earthquake. The Corps indicated that approximately \$70.0 million would be required to provide both temporary facilities and to replace damaged permanent structures. The GAO report indicates that \$60.0 million of this construction is currently programmed for completion through the FMS system. This is not the case. There can be no firm construction plan due to the nonavailability of funds. The Corps of Engineers report is being used by the Salvadoran military as a planning document in assessing their overall program requirements for the use of both national funds, US assistance funds, and third party assistance funds.

FINDING C: No Congressional Reporting Requirement. The GAO found that DSAA is not required to report the construction of military facilities in El Salvador in the Congressional Presentation Document (CPD). According to the GAO, the CPD program objectives for FY1985 to FY1988, described procurement and repair of equipment as the purposes for MAP funding in El Salvador. The GAO noted that the construction projects were not mentioned because the projects were considered a minor element of the security assistance program. The GAO explained that, according to the Military Group Commander, emphasis has recently been placed on MAP-funded construction in El Salvador and that the FY1989 CPD contains a requirement to construct military facilities that were destroyed or damaged in the 1986 earthquake. The GAO observed that this type of construction will provide a lasting improvement to the military infrastructure, thereby helping to sustain a viable military force in El Salvador. The GAO found, however, that although additional funding will be required to construct these facilities, the costs are not set forth in the CPD. The GAO concluded that, although each project is relatively small in size and cost, the total construction activity could over time, represent a significant buildup of the Salvadoran infrastructure. The GAO noted that, while the authorizing committees on security and foreign affairs received briefings around 1984-85 on the Regional Military Training Center (RMTC), they were not made aware of the other construction activities. (pp. 13-14, pp. 21-23/GAO Draft Report)

DOD RESPONSE: Nonconcur. The current information provided in the CPD and the Classified Annex to the CPD ensures that the Congress is informed of both the continued existence of the FMS construction program in El Salvador and its estimated cost.

Congressional Reporting. Under the existing procedure for developing the CPD, in two separate areas the Congress is already informed that construction is a component of the El Salvador MAP program.

Now on p. 15.

See comment 3.

-FY1988, FY1989, FY1990 CPD Text. In all three of the most recent CPDs, the following paragraph was included in the description of the El Salvador program:

"Approximately two thirds of past military assistance programs have been used for sustainment, including ammunition, spares, fuel, and logistical support. The remaining one-third has been used for the purchase of medical supplies, training, infrastructure improvements, mobility, fire support and command, control and communications."

-Classified Annex to the CPD. The FY1990 Classified Annex to the CPD contains a projected MAP expenditure plan which identifies, as an individual line item, the estimated value of the construction program for El Salvador.

The information provided in the CPD, as it is currently prepared, provides the Congress information on the Salvadoran construction program and its projected value.

RMTC Reprogramming. In FY 1984 and FY1985, special MAP allocations totaling \$38.5 million were made for the development of an RMTC in Honduras for the joint use of military forces from the Central American democracies. When this project was terminated due to political issues, the Congress was notified of its dissolution and planned reprogramming for the previously allocated funds under existing reprogramming rules. At that time; funds were reprogrammed to El Salvador, Honduras, and Costa Rica.

Detailed briefings were conducted at that time because of reprogramming rules and the sensitive regional political issues involved on the establishment of the original facility and its termination. While El Salvador was a focal point of discussion in terms of funds, the nature of the program was the central issue, not El Salvador.

FINDING D: Initiation of El Salvadoran Construction Projects. The GAO explained that the Military Group at the U.S.Embassy, El Salvador, discusses with the El Salvadoran military the construction requirements of their country and identifies those that can be met with the use of security assistance funding. According to the GAO, these requirements are then translated by the Military Group into requests to the Corps of Engineers to prepare the FMS case for design and construction of the projects. The GAO found, that at that time, the Corps decides whether the project deviates from the normal FMS procedure and will, therefore, require special authorization. The GAO noted that the request, together with the case information regarding price and project description is then forwarded to DSAA and, upon its

Now on p. 16.

See comment 4.

approval, the work is contracted to independent or joint venture firms through the Corps. The GAO further reported that, once the contracts are awarded, the Corps Area Office in El Salvador is responsible for contract administration and quality assurance. (pp. 23-24/GAO Draft Report)

DOD RESPONSE: Partially Concur. The GAO does not adequately stress the role of the Salvadoran military in the identification of desired projects, nor does it address FMS case preparation and implementation in its description of the project initiation. The GAO description would lead the reader to believe that FMS construction in El Salvador is U.S. initiated and implemented. All FMS procurements are at the request of the host country with the U.S. personnel assisting the Host Country in defining the requirements and working with the FMS system.

The initiation of FMS construction projects is at the specific request, through a Letter of Request (LOR), for an FMS case by the Salvadoran Ministry of Defense (MOD). Where offshore procurement is contemplated, the FMS case is not offered to the Salvadoran government for acceptance until appropriate offshore procurement authority is obtained. Implementation and contracting does not take place until the Salvadoran MOD accepts the FMS case.

FINDING E. The El Salvador Construction Award Process. The GAO reported that, before the Request For Proposal (RFP) is issued to solicit offers, a formal Source Selection Plan is prepared designating appropriate evaluation criteria. According to the GAO, the proposals are first evaluated in the Corps Contracting Division for responsiveness (i.e., an adequate bid bond, a bidding schedule, a complete technical proposal, which typically includes appropriate material describing the contractor's prior and current experience and financial capability and management structure). The GAO explained that the Division rejects proposals as being nonresponsive when the proposals do not conform to a material provision of a request for proposal. The GAO noted that the proposals are next evaluated by the Source Selection Evaluation Board composed of members of Engineering, Construction, and Resource Management Divisions, which ranks each responsive proposal based on the criteria in the Source Selection Plan and the Request for Proposal. The GAO reported that the criteria and weight applied to each factor in the plan depend on the circumstances of the particular work to be done: however, standard evaluation factors include specialized experience, scheduling, quality control management, previous, and the experience of supervisory personnel. The GAO noted that technical expertise is usually given more weight than management/administrative factors, with price normally considered after the technical evaluation. The GAO further explained that, after each

technical evaluator independently evaluates each responsive proposal, a price analysis is performed by comparing the submitted prices and independent Government estimates, using a mathematical pricing formula that consists of dividing the total proposed price by the number of technical evaluation points. The GAO noted that, according to Corps officials, the highest ranking proposal based on price per point is always considered the most favorable proposal. The GAO reported that, when the contracting officer determines that a proposed price is significantly lower than the Government estimate, a Determination is made to make sure both the offerer and the Government estimator completely understand the scope of work to be done, including requesting price verification from the offerer. The GAO further explained that, prior to making an award, the contracting officer makes a pre-award survey to determine that the proposed awardee is responsible both financially and technically, has the capability to manage the contract properly during performance and the capability to complete the work on time. The GAO explained that the letter contract is a quick means to negotiate and award contracts when the Corps determines that (1) the Government's interests demand that the contractor be given a binding commitment so work can start immediately and (2) negotiation of a definitive contract is not possible in sufficient time to meet the requirement. The GAO observed the ongoing insurgency in El Salvador requires that some projects be completed as expeditiously as possible. The GAO found that, in awarding letter contracts, because of the unusual and compelling urgency, the Corps officials generally limit competition to several firms that can satisfy the requirement. (pp. 24-28/GAO Draft Report)

Now on pp. 16-18.

See comment 5.

DOD RESPONSE. Partially concur.

The award process described by the GAO does not indicate the degree of discussion and analysis that is involved in the evaluation of bids received or the dialogue between the Corps and the bidders.

The highest ranking proposal under the price-per-point analysis is the lowest price to the Government, price and other factors considered, not the lowest price. The GAO emphasizes the role of price but not the role of other factors, such as management and experience, in the award process. In addition, the Army Federal Acquisition Regulation Supplement (AFARS) was amended in April 1988 to stipulate that cost or price shall not be scored or otherwise combined with other aspects of the proposal evaluation. Accordingly, Price-per-Point analysis (as described in the GAO report) is no longer in use.

The GAO also does not give adequate weight to the extensive discussion within the Corps Area Office on the technical merits, prices, bidder experience, etc., that are intimately involved in the ultimate award decision. At each stage of the process, there

are detailed discussions within the Corps offices and discussions with offerers on specific aspects of the submitted bids to ensure that the contracting officer and members of appropriate review section take all relevant information into consideration.

FINDING F: Rationale for Approving Offshore Procurement

Authority The GAO reported that, as of May 1988, the Corps, requested and used offshore procurement authority three times: in July 1986, and in May and July 1987. The GAO noted that the July 1986 authority covered ten projects, the May 1987 authority covered two projects, and the July 1987 authority covered one project; as a result, between July 1986 and May 1988, 13 solicitations authorized U.S. firms, El Salvadoran firms, or joint (U.S.-Salvadoran) firms to submit offers on projects as prime contractors. According to the GAO, the DSAA decision to approve the requests for offshore procurement was based on the fact that, in the past, U.S. participation was limited and greater competition was needed to obtain fair and reasonable prices. The GAO observed that the Corps reported informally to DSAA that (1) offers solicited from U.S. firms for the contracts frequently exceeded the Corps estimated costs for the planned projects and (2) there was low participation among U.S. firms. The GAO explained that the Military Group Commander recommended this authority be obtained to ensure the maximum use of security assistance funds through savings (which would result from greater competition). The GAO indicated that, according to the Military Group Commander, one of the frustrations with the existing competitive system was that the U.S. firms were winning, taking an administrative and profit fee on the contract, and then subcontracting the actual work to Salvadoran firms, which did not result in the best price for the U.S. Government. The GAO noted that before the offshore procurement authority first was granted in July 1986, five construction projects were awarded to U.S. firms, and a number of U.S. firms submitted offers and expressed interest in performing the work on these contracts. According to the GAO, three of the five contracts awarded to U.S. firms were negotiated using a letter contract. where price was not the major factor affecting the award decision, while the prices submitted on the other two contracts appeared reasonably competitive. The GAO further noted that the Corps reportedly added or deleted from the scope of the construction work in El Salvador, which resulted in price changes to the two negotiated contracts. The GAO added that, on the three letter contracts awarded to U.S. firms, the actual costs of each contract did not exceed the "definitized" cost by more than one percent and that changes in scope resulted in increases to the costs for some El Salvadoran firms on other Corps contracts. The GAO concluded, however, that overall competition has resulted in lower construction costs. The GAO also concluded that U.S. firms might not be interested in working in El Salvador because of the relatively small size of the construction projects, since larger projects are more generally

attractive to U.S. firms and are more likely to result in economies of scale by spreading overhead and mobilization costs over a larger base. The GAO noted that U.S. firms generally bid more competitively on larger projects, whereas local firms (which often have cash flow difficulties) can more easily finance projects that are broken down into smaller units. The GAO found, however, that, in one instance, the Corps separated construction work of the same type into a number of small projects. The project, which was to cost \$4.8 million for the construction obstacle courses and open air classrooms throughout El Salvador, was broken down into three different contract proposals by regional area and was solicited under one proposal because of the urgent need to initiate and complete work simultaneously at several locations. The GAO found that two of the three contracts were awarded to the same Salvadoran firm and the third was awarded to another Salvadoran firm, while a U.S. firm (which bid separately on the three proposals) claimed it could have submitted a more competitive offer and achieved economies of scale if the work had been covered under one proposal. (pp.4-6, pp. 28-33/GAO Draft Report)

Now on pp. 3-4, 18-21.

See comment 6.

DOD RESPONSE. Nonconcur. The GAO implies that the primary criteria for a decision by the DSAA to support offshore procurement, whether in El Salvador or elsewhere, is based on price. This is not the case.

The GAO generally confuses approval of offshore procurement authority with the award of specific contracts. Once offshore procurement authority has been granted for a specific program, the awarding of the actual procurement contract will, like all U.S. Government procurements, be heavily influenced by price considerations. These are two totally separate actions.

In general, price is, at best, a minor consideration in the decision to procure an item or service offshore. In considering whether any given procurement (equipment or construction) will be approved for offshore procurement, the following general considerations are applied:

-Does the procurement fit within the context of the country program and mutual U.S. and Host Country interests? (At this level, offshore procurement need has not been determined)

-Can the item or service, as required for the program, be obtained from U.S. sources?

-Can U.S. source items be modified to meet the requirement?

-Must the item or service be obtained from an offshore source in order to meet specific requirements of the program?

-What percentage of the program cost would have to be purchased offshore to meet the program requirements?

-Is it cost prohibitive to procure the item or service in the United States (e.g. special production run, shipping gravel to a foreign country)?

-Is there any impact on the U.S. mobilization base or U.S. industry, with reference to areas of surplus labor, by offshore procurement of this item or service?

-Is there any impact on U.S. trade patterns or trends?

None of these considerations are decisive in every case in granting an Offshore Procurement Determination, but they establish the basis for the request for such action.

Many organizations in the field may request offshore procurement for the perceived economic benefits to the host country (employment, etc) and program savings. However, DSAA reviews the request based on the availability of the service or item from U.S. sources, its impact on the U.S. industrial/mobilization base, and reasonable cost availability.

The bulk of Non-Israel offshore procurements have been for equipment, spare parts, and ammunition which are not produced in the United States such as aircraft parts, communications equipment/parts, 106mm ammunition/90mm ammunition. In such cases, the host country has generally already possessed non-U.S. origin equipment in its inventory. Such offshore procurements are approved because it is frequently more effective to assist the host country in maintaining equipment that it already has than to try to replace it with U.S. origin equipment at many times the cost of the equipment. This reflects the reality that neither the U.S. nor host country budgets can support wholesale replacement of otherwise operational equipment.

In the area of construction, it not logical to ship some items like sand, gravel, and stone to foreign countries in support of construction projects even if the items are available from U.S. sources.

Each country program is unique in many ways and the ultimate decision to support offshore procurement is a policy decision that considers the proposed purchase in the context of the general criteria above and the mutual benefit to the U.S. and host country program.

The GAO indicates that the U.S. Commander-in-Chief, Southern Command; the U.S. Embassy; and the USMILGP have all strongly supported offshore procurement since 1986. The U.S. Embassy and the USMILGP have most often cited local economic conditions and

the desire for program savings as the basis for their request. However strong the pressure for offshore procurement authority, DSAA has permitted offshore procurement authority primarily on the basis of needing to fulfill host country program requirements, of ensuring appropriate engineering technical capability through adequate competition, and obtaining a reasonable price through competition.

The GAO indicates that only 5 of 18 contracts had been awarded to U.S. firms as of the date of the GAO review. It should be emphasized that these projects totaled \$20.9 M or 42 percent of the construction program in El Salvador. The average value of these projects was over \$5.0M. Two of the projects were actually in excess of \$6.0M. As such, these contracts were more attractive to U.S. firms since they were large enough to allow competitive pricing by U.S. firms. Conversely, the remaining 13 contracts rarely exceeded \$1.5 million.

The high dollar U.S. projects were in the FY84-FY1985 time period, when there was a major effort to develop the Salvadoran training infrastructure due to the termination of the RMTC program in Honduras. The GAO report correctly indicates that time was a major consideration and letter contracts were issued for that reason. With the general completion of the RMTC program, the thrust of the Salvadoran construction program shifted to low value projects. In mid-1986 and 1987, a number of smaller scope projects were requested by the Salvadoran Armed Forces (less than \$2.0 million).

The Corps of Engineers reported to DSAA that, due to the small size of the projects and concern by some firms for personal safety, it was experiencing difficulty in getting U.S. firms to bid on the small projects. While the USMILGP and U.S. Embassy emphasized the economic benefits of offshore procurement, the DSAA's primary reason for support was to ensure that there was adequate competition (2 or more firms), that capable construction firms could be identified, and that a reasonable price could be obtained through competition.

Data provided by the Corps of Engineers indicated that, until mid-1987, there had been minimum response from U.S. firms for small-scope El Salvador construction. The Corps reported a moderate increase in U.S. firm interest in selected types of construction above the \$1.5 million price range in 1987. Accordingly, DSAA has directed the Corps to solicit two FY1988 projects (\$1.5 million and \$2.3 million) from U.S. firms only. Evaluation of three smaller projects (average \$.5 million or less) is being conducted to determine if offshore procurement authorization is warranted.

The results of the Corps's ability to obtain U.S. bids on the current projects will determine if future projects in excess of \$1.5 million will be considered for offshore procurement approval. The DSAA has made it very clear on numerous occasions to the USMILGP and to the Corps of Engineers from 1986 to 1989, that it would continue to support offshore construction in El Salvador only in those instances where it was impractical or impossible to obtain the services of U.S. firms. As the situation has changed in the last 18 months, DSAA authorization for offshore construction has decreased.

FINDING G: Analysis of Selected Construction Contracts. The GAO reviewed four construction projects -- three that had been awarded to El Salvadoran firms and one that had been awarded to a joint venture firm. The GAO reported that the offerers submitted thirty proposals for the four contracts: 17 from El Salvador, 11 from the United States, and 2 from joint ventures. The GAO found that, of the proposals submitted, 12 were deemed unresponsive or not competitive by the Corps Contracting Division, including all 11 of the U.S. firms and 1 Salvadoran firm. The GAO observed that U.S. firms often cannot match the prices of local national competitors because U.S. firms generally incur more costs than El Salvadoran firms as a result of the extra costs associated with start-up, mobilization in-country, and use of American supervisors. The GAO explained that performance and payment bonds are generally required from the selected contractor for any construction contract exceeding \$25,000. The GAO reported that local El Salvadoran firms had difficulty obtaining performance and payment bonds, as required by the solicitation. Therefore the Corps allowed the successful bidder the option of using a letter of credit and permitted El Salvadoran firms to use local banks to execute the performance and payment bonds. The GAO found that the U.S. firms also had difficulties in obtaining performance and payment bonds, due to the civil unrest in El Salvador, because U.S. insurance companies considered the ventures too risky. The GAO also found that several U.S. firms perceived the waiver accorded to the El Salvadoran and joint venture firms as unfair because sureties are easier to obtain from an El Salvadoran bank but are worthless because they are not backed by hard currency. The GAO noted that proposals from the U.S. firms were determined not to be in the competitive range based on price and not on technical merit. (pp. 7-8, pp. 35-41/GAO Draft Report)

Now on pp. 4-5, 22-25.

See comment 7.

DOD RESPONSE: Partially concur. The DoD agrees with the bidding statistics provided by the GAO, but does not agree with the analysis of the bidding statistics, particularly with reference to the discussion of performance and payment bonds.

The GAO reports indicates that there was a distinction made between U.S. firms and Non-U.S./joint venture firms concerning the use of no-U.S. sureties for bid bonds and performance and

payment bonds. The Corps of Engineers reports that, effective with the solicitation for construction at Pomerola AB, Honduras in 1984, the option to use non-U.S. bank sureties was extended to all bid participants. This information was communicated to all participants through the use of the Request for Proposal (RFP) and through discussions between the offerers and the contracting officer. The RFP states the following in reference to bid bonds and performance and payment bonds:

Bid Bonds. "Each offerer shall submit a Bid Bond (Standard Form 24), copy attached, in English, The bid bond penalty may be expressed in terms of a percentage of the bid price or may be expressed in U.S. dollars or cents or El Salvadoran colones (Colones notation added to FMS solicitations for El Salvador in late 1987).

Performance and Payment Bonds. "Within 10 days after the prescribed forms are presented to the offerer to whom award has been made for signature, a written contract... shall be executed and two bonds, each with good and sufficient surety or sureties acceptable to the Government, furnished... Bonds will be in English and the penal sums will be in U.S. dollars and cents...."

As indicated, the Corps of Engineers was prepared to accept bonds based on Salvadoran banks from all bidders, not just from Salvadoran or joint venture firms. Nowhere in the RFP is there a distinction between U.S. and Non-U.S. firms on the requirements for appropriate bonds. The Corps confirms that as long as the surety instrument was acceptable to the Government (i.e., contracting officer), its national origin was not an issue. The specification that the bonds be in English recognizes that the source of the surety might not a U.S. institution.

The GAO discussion also indicates that U.S. firms rejected the use of payment and performance bonds that were not backed by "hard" currency (i.e. Salvadoran bonds) as inadequate surety. This is an irrelevant point as it was the U.S. Government that was "at risk" for non-payment of such bonds, not the U.S. firms. Accordingly, if the U.S. Government was willing to accept that risk, the U.S. firms were not financially endangered.

The DoD concedes that, on one occasion, the competitive range might have been expanded to include at least one of the U.S. firms. However, this was a judgement call based on the contracting officer's review of the contract under consideration at that time.

The Corps notes that, based on the overall review of the bids, price is a major consideration for establishing the competitive range after bids have been evaluated for technical completeness and competence. The technical review ensures that

all technical requirements have been met so the U.S. Government can expect proper completion of the services under procurement. The U.S. Government contracting system is based on obtaining the lowest possible price, consistent with specified performance, for the goods and services that it procures.

FINDING H: El Salvadoran Firms Are Not Fully Audited Due to Civil Unrest. The GAO reported that, in 1986, the Corps requested the Defense Contract Audit Agency (DCAA) to audit two construction contracts awarded by letter contract to a U.S. prime contractor and an El Salvadoran subcontractor. According to the GAO, in both cases, the DCAA decided not send an auditor to El Salvador due to the political and civil violence occurring there, since the risks were too high and the personal safety of the auditor could not be ensured. The GAO explained that the DCAA requested the two El Salvadoran subcontractors to submit relevant documentation to be audited, but the firms have not cooperated fully with this request; as a result, the DCAA could not reach definitive conclusions on the subcontractor costs. According to the GAO, the Corps has not made any further requests of the DCAA to audit these firms. (p. 13, pp. 41-43/GAO Draft Report)

DOD RESPONSE: Partially Concur. The DoD agrees that, in two attempts by the DCAA to audit Salvadoran bid proposals, no documentation was submitted in one case. However, 80 percent of the bid proposal was substantiated by the DCAA in the other case. The DoD disagrees with the implication that FMS construction has routinely not been audited or conducted in conformance with the Federal Acquisition Regulation (FAR).

The FAR, section 15.805-5(a)(1), states "When cost or pricing data are required, contracting officers shall request a field pricing report (which may include an audit review by the cognizant contract audit activity) before negotiating any contract or modification resulting in a proposal in excess of \$500,000, except as otherwise authorized under agency procedures, unless information available to the contracting officer is considered adequate to determine the reasonableness of the proposed price...".

In practice, under this section, letter contracts are normally considered as potential candidates for pre-award audit, as deemed necessary by the contracting officer, while contracts awarded under the competitive procedures are not generally pre-award audited.

The GAO indicates that no audits have been conducted on the Salvadoran FMS construction contracts. This is not the case. Of the five letter contracts, the one contract awarded to the Salvadoran firm was less than \$500,000 and not subject to audit. Four were awarded to U.S. firms and involved Salvadoran

Now on pp. 7, 25-26.

See comment 8.

subcontractors. A total of six proposals were provided by the Salvadoran subcontractors in values ranging from \$69,970 to \$1,861,330. Of the six Salvadoran subcontractor bids, only three were in excess of \$500,000 and subject to pre-award audit. As noted by the GAO report, the DCAA was requested to audit two of these bids.

Under contract DACA01-86-C-0023, subcontractor Rene Cuenca, S.A., brought his records to the Mobile District Office. Based on his information, the DCAA audited the records and issued its Audit Report #1251-6L210204-6-768, dated June 25, 1986. This report validated \$1,465,930 of the \$1,861,330 proposal. The balance was unsupported by the DCAA audit.

Under contract DACA01-86-C-0024, the DCAA was not successful in obtaining relevant documentation from the Salvadoran subcontractor ARCO Ingeniero, S.A., and treated the total amount proposed of \$1,520,241.42 as unsupported. Under provision of the FAR (section 15-805(a)(1)), the Mobile District "through other means" (i.e., Government estimate) determined the market value of the subcontract work to be \$1,500,000 which became the negotiated price.

It should be noted that out of 19 contracts (a Corps Number, not a GAO number) valued at \$30.08 million awarded for the El Salvadoran FMS program in the period under discussion, only 5 letter contracts (valued at \$11.8 million) were subject to pre-award audits. All U.S. firm bid information, valued at \$7.1 million of this amount was pre-award audited by the DCAA. Of the remaining \$4.7 million in Salvadoran subcontractor proposals, only two proposals, valued at \$2.0 million, were subject to pre-award audit but not audited. The subcontractor proposals were subsequently validated by the contracting officer sufficiently to permit negotiations.

Since the remaining 14 contracts were awarded by competitive process, they were not subject to pre-award audit. Thus, of 19 contracts valued at \$30.1 million, \$28.0 million was either audited as appropriate or was not subject to audit.

As noted by the GAO, no additional request was made to the DCAA for pre-award audits in the period from 1986-1988. However, this was because all contracts were awarded through competitive process and pre-award audit was not required under the FAR, not due to oversight as the GAO report implies. The Corps of Engineers has initiated coordination with the DCAA to ensure that negotiated contracts awarded to El Salvadoran firms will be audited, when and if required, in accordance with DoD regulations.

FINDING I: Lack of Consideration of Labor Surplus Areas. The GAO reported that since, 1976, DSAA has approved 64 offshore procurement Determinations, valued at \$4.7 billion, and two-thirds of the Determinations, with a value of about \$950 million, were made in the last 3 years (1986 to July 1988). The GAO found that, of these determinations, 20 contracts, valued at \$31 million, involved construction in Central America, Africa, Grenada, and the Phillipines. The GAO noted, that between 1976 and 1986, only four determinations were approved for construction in Israel, El Salvador, and Liberia. The GAO explained that the primary reason for the recent increase in the number of waivers is to stretch limited security assistance funds. (The GAO further explained that at least part of the increase resulted from a recently created civic action program for several African countries which authorized a number of small-scope construction projects for offshore procurement, most of which were less than \$400,000 per project.) The GAO also noted that, in El Salvador, the limited security assistance fund can go further with this authority because, typically, it is less expensive for local national firms to do the work. The GAO found that DSAA did not give any consideration to labor surplus areas in making offshore procurement decisions, since DSAA contends that it is impossible to define the adverse impact on the U.S. economy. The GAO explained that, in addition, DSAA does not know, in advance, which firms plan to bid on specific construction projects. The GAO noted that the Act does not require that the adverse impact be defined, but does require that consideration be given to the impact on labor surplus areas. The GAO agreed that it may be difficult to anticipate with precision if firms from labor surplus areas will bid on these construction contracts. The GAO concluded that, nevertheless, the requirement to consider labor surplus areas in offshore procurement decisions is mandatory under Section 42(c) of the Arms Export Control Act. (pp. 9-10, pp. 45-47/GAO Draft Report)

Now on pp. 5-6, 28.

See comment 9.

DOD RESPONSE: Partially concur. The DoD agrees that labor surplus areas should be considered in the approval of offshore procurement, but does not agree with the GAO conclusion that the DSAA does not consider labor surplus areas in its review of offshore procurement authorities or the discussion of the increase in Offshore Procurement Determinations presented by the GAO.

Impact of Offshore Procurement on Labor Surplus. The DSAA does consider the impact on labor in the consideration of offshore procurement decisions and specifically reviewed this issue in the context of construction in El Salvador.

The subject of labor surplus areas is a difficult area to address, but it must be considered in the review of offshore

procurement. Contrary to the position attributed to the DSAA Legal Counsel, the DSAA General Counsel concurs that consideration of labor surpluses in various U.S. locales must be given by the official delegated the authority to make the Offshore Procurement Determination, but the statute does not require that such consideration be documented. He notes that it is difficult but not "impossible" to define the adverse impact in a quantifiable sense and that the draft report concurs that the statute does not require such definition. This position is amplified in a legal position which has been provided separately to the GAO by the DSAA Counsel.

The GAO also notes that the DSAA does not have written criteria for consideration of labor surplus areas. This is an area in which the DSAA plans to provide additional internal guidance within this year.

The GAO report does not address non-construction offshore procurements and particularly the high-value offshore procurements. Review of specific offshore procurement requests from FMS customers has frequently resulted in proposals not being supported for offshore procurement due to the existence of under-utilized labor or market capacity for that product within the US system. Two fairly recent examples in FY1986 and FY1987 were the rejection by the DSAA and the DoD of El Salvadoran and Somali requests to purchase uniform cloth overseas. The host countries had justified the requests due to program savings. In both cases the procurements involved would have exceeded \$5.0 million each. Due to the current U.S. textile labor/industry situation, these requests were denied. In both cases, there were substantial increases in the cost of the purchased materials because the requested style of cloth was not then being manufactured in the United States and special purchases had to be made.

Where the DSAA has been able to adequately assess U.S. market and labor impact, this has been a significant consideration in offshore procurement approval. However, the impact of DSAA consideration on labor surplus and market availability has most often been on the rejection of proposed projects. Where no obvious impact has been discernable, and other offshore procurement considerations have been met, offshore procurement action has generally been supported.

The GAO also indicates that the DSAA did not consider labor surplus in the approval of construction projects for El Salvador. This is not correct.

The USMILGP Commander noted that U.S. firms that won El Salvador construction contracts (whether FMS or Agency for International Development) generally provided a limited number of U.S. supervisors and procured the majority of the labor force within El Salvador. This information had been substantiated by

the Corps of Engineers. In accordance with this information, the DSAA assessment of labor impact was that there was no significant labor impact whether the construction projects were bid to U.S. or Salvadoran firms. The DSAA decision to support offshore procurement centered on reasonable availability of appropriate competition to ensure technically capable competitors and reasonable market prices rather than labor impact. The GAO, draft report also confirms this assessment of the use of Salvadoran labor, based on discussions with U.S. construction firms, who stated that if they had won the El Salvadoran FMS contracts, they would have used Salvadoran, not U.S. labor. The evaluation of potential labor impact was a central point in the review of the Salvadoran construction Offshore Procurement Determinations.

Increased Number of Offshore Procurement Determinations for Construction. While discussing the increased number of offshore procurement since 1986, the GAO did not relate this information to the overall military assistance program. U.S. military assistance from FY1970 to FY1988, excluding the International Military Education and Training Program (IMET) totalled \$65.94 billion. Of this amount, only \$ 4.715 billion or 7.15 percent has been approved by the DSAA for offshore procurement. When offshore procurement approvals for Israel (\$4.509 billion) are deducted, the worldwide non-Israel offshore procurement authority in the FY1970-FY1988 period was approximately \$206 Million or one-third of 1 percent of U.S. military assistance.

The GAO report notes that approximately 41 OSP actions for a total value of \$950 million were approved from 1986 to 1988. Of this amount, \$860 million was for two Offshore Procurement Determinations for Israeli programs. Non-Israel offshore procurements in this period were only \$90.0 million. Of the 20 construction offshore procurements cited by the GAO in this period for a value of \$31 million, 15 were for the Africa Civic Action program, with an average value of \$400,000 or less. The four construction projects cited by the GAO prior to 1986 had a total value of \$3.203 billion (\$3.2 billion for Israel and \$ 3.2 million for El Salvador and Liberia.)

In summary, while there has been an increase in the number of offshore procurements since 1986 (41), the dollar value of Non-Israel offshore procurements in that period (\$90.0 million) is only one-half of one percent of the FY86-FY1988 military assistance program. It is clear that, except for the special programs for Israel, the congressional intent that U.S. assistance funds should be spent in the United States has been complied with both prior to and after 1986.

FINDING J: Determination Decisions Lack Implementing Guidance and Procedures.

The GAO reported the factors that should be considered for approving offshore procurement are provided in Section 42(c) of the Arms Export Control Act, but the legislation does not specify how this authority is implemented or what weight these factors should be given. The GAO reported, that in 1988, both the Deputy Assistant Secretary for Defense for Inter-American Affairs and the Director, DSAA, stated (in correspondence to several congressman) offshore procurement waivers for El Salvadoran construction could only be authorized on a case-by-case basis. The GAO found, that in some cases, the offshore procurement Determination did not specify all projects ultimately covered. According to the GAO, the Act does not require DSAA to issue separate Determinations by country or project, but as a matter of DSAA practice, the Determinations have been made by country with a generalized scope so that extensions in time or scope could be avoided. The GAO explained that each approved offshore procurement is normally identified by separate Letters of Offer and Acceptance (LOAs). The GAO found that a May 1987 Offshore Procurement Determination approved for earthquake construction in El Salvador, for example, involved two contracts, and both were covered under one LOA. The GAO noted, however, that a July 1986 waiver for construction in El Salvador involved ten contracts for construction of various facilities throughout El Salvador, with construction under this waiver covered by seven LOAs. (pp. 9-10, pp. 48-49/GAO Draft Report)

Now on pp. 5-6, 28-29.

See comment 10.

DOD RESPONSE: Partially concur. The DoD agrees that Offshore Procurement Determinations do not currently contain specific implementing instructions, but the DoD does not, however, agree that Offshore Procurement Determinations should contain implementing instructions or be considered implementing documents. The DoD considers the Offshore Procurement Determination a policy document, not an implementing document.

Offshore Procurement as a Policy. An offshore procurement decision is a statement of policy based on appropriate review of relevant information. As such, it is not intended to provide implementing guidance any more than other Executive Orders or Findings. As a statement of a policy, it needs to be supported by specific implementing instructions or guidance. The DoD concurs that additional guidance is needed to ensure proper implementation of Offshore Procurement Determinations, but does not concur that it should be contained in the body of the Offshore Procurement Determination itself.

The DoD will, within this calendar year, develop additional internal guidance to ensure consistency of procedures and guidance in reviewing offshore procurement proposals and in providing implementing instructions to subordinate agencies. It is stressed, however, that the OSP Determination is a Statement

of Policy and supporting documents should be used to implement that decision.

Offshore Procurement Determination in El Salvador. The GAO report indicates some confusion on the relationship among Offshore Procurement Determinations, LOAs, and construction contract. It implies the DSAA has indicated that there is supposed to be a 1:1:1 relationship among the three elements. This is not the case.

The report references December 1987 letters which indicate the case-by-case nature of offshore procurement review for El Salvador construction. This phrasing was meant to explain that each individual project identified by the host country and the USMILGP is reviewed to determine if it warrants support. However, in the implementation of construction projects in El Salvador, the following general procedures have evolved:

(1) The size of a specific project request determines whether an independent LOA will be written for a specific project. For administrative reasons, more than one low-value project will normally be written on one LOA. Depending on the nature of these projects, more than one contract will usually be awarded. For a similar reason, larger multi-faceted single projects may involve more than one contract award if separate awards are made for different types of construction within the project.

(2) The decision as to whether a single Offshore Procurement Determination will be drafted for a specific project is primarily a function of timing. If only one project is under consideration for offshore procurement within a specific time frame (e.g. 2-3 months), it will normally be written as an independent Offshore Procurement Determination. When more than one project is under consideration in the same time period, the projects will normally be written under one Offshore Procurement Determination with the general estimated scope and cost of each identified in the coordination letters to the Departments of State and Treasury. More than one LOA is likely to be written for the multiple projects in this case and accordingly, more than one contract will be awarded.

FINDING K: Determinations Do Not Adequately Reflect Scope and Costs. The GAO found that offshore procurement determinations involving construction are not specific and contain no references to time limitations or monetary ceilings. The GAO reported that, instead, they cite a broad generalized scope and state that the procurement is for construction materials, equipment and/or services; as a result, the determinations have been misinterpreted as blanket waivers. According to the GAO, only a cover memorandum or a coordination document, which is attached to

the proposed determination and reviewed by the Departments of State and Treasury, provides specificity as to the scope of the Determination. The GAO explained that this does not necessarily mean that the program will be implemented as stated, however, because changes in scope to meet program requirements can be made without further concurrence from the Departments of Treasury and State. The GAO stated that since these Departments do not receive information on the final scope and costs of each Determination, the lack of complete information could affect Determination reviews. The GAO observed that DSAA officials maintained that flexibility is required in the Determination language so that changes can be made without submitting a new Determination for every minor change. The GAO found, however, that (1) there are no criteria defining minor and significant changes and (2) if changes to existing Determinations are not communicated to the departments that are responsible for concurring in its use, then the value of obtaining concurrences from these Departments is lessened and the waiver can be misconstrued as a blanket waiver. The GAO concluded that DSAA requirements for flexibility diminishes the function provided by the State and Treasury Department. (pp. 50-54/GAO Draft Report)

Now on pp. 30-32.

See comment 11.

DOD RESPONSE: Partially concur. The DoD agrees that the Offshore Procurement Determinations do not contain time or cost limitations. The DoD strongly non-concurs with the implication, that DSAA arbitrarily permits or encourages expansion of OSP authority obtained in coordination with the Departments of State and Treasury.

The actual Offshore Procurement Determinations are generally written without specific time or dollar limitation. This is due to both the policy nature of Offshore Procurement Determinations and the nature of FMS sales. Because of the mechanical aspects of LOA preparations and contracting; actual procurement and payment of FMS cases usually stretches over more than one year. Similarly, an LOA is the best estimate at a specific time of the final cost of an item or service. The wording of the Offshore Procurement Determination permits reasonable delays or increases in cost to be authorized without the need to process an additional Determination.

The DoD concurs, that this is an area for review and will include this in the guidelines which are under development for managing offshore procurement actions. However, the Offshore Procurement Determination itself is a statement of a policy decision by the administration. As such, it is not intended to be the implementing instruction. The DSAA is taking steps to ensure that implementing instructions provide more detailed guidance.

The GAO implies that the DSAA routinely and arbitrarily changes the scope and costs of OSP Determinations without informing the Departments of State and Treasury. DSAA disagrees with this conclusion. The GAO conclusion is based on its review of one Offshore Procurement Determination issued for construction in El Salvador in July 1986 for an estimated value of \$11.6 million. This Offshore Procurement Determination was ultimately valued at \$14.1 million and included construction projects not originally identified in correspondence to the State and Treasury departments. During this period, there was confusion at the implementing office of the Corps of Engineers on the scope of its authority and DSAA concurs that, in that one case, the offshore procurement authority was expanded beyond the original scope without coordination with the Departments of State and the Treasury.

As the bulk of offshore procurements involve defined order purchases for material and equipment, such as vehicles, weapons, radios, and spare parts; the scope is much easier to monitor than construction where final costs are more variable. Where the value or scope of a project is found to exceed the original estimated scope, Department of State and Treasury personnel are advised at the staff level of this fact. Recent construction examples include civic action projects in Niger and Gambia.

FINDING L: Recent DSAA Actions. The GAO reported that, during the course of its review, DSAA took action to limit its approval for offshore procurement to the Corps. The GAO noted that, in an August 1988 message to the Corps, DSAA stated its approval for offshore procurement under one Determination was specifically limited to the scope of construction as initially requested for two construction projects and to the projects' estimated costs. DSAA further stated that any additional offshore procurement, whether within the cited cases or other existing FMS cases must be coordinated with DSAA on a project-by-project basis. The GAO noted, however, that the guidance to the Corps concerns only the two projects: DSAA does not have written procedures that would apply to all cases. The GAO further stated that DSAA recently directed the Corps not to consider requesting offshore procurement on a third construction project until it was absolutely certain the project could not be accomplished by limiting bidding on the construction proposal to U.S. firms only. (p. 54/GAO Draft Report)

DOD RESPONSE : Partially concur. The GAO does not describe the extent of supplemental guidance provided by the DSAA to subordinate agencies (not just the Corps of Engineers) in executing offshore procurement actions. The following actions have already been taken or are in the process of initiation:

Now on pp. 7, 32-33.

(1) The DoD will, within this calendar year, develop additional internal offshore procurement guidelines which apply to a number of recommendations from the GAO.

(2) The DoD has already initiated action which provides more detailed guidance to subordinate headquarters in the implementation of offshore procurement actions. The GAO has been provided message traffic indicating ten recent offshore procurement actions in which more specific implementation guidance has been given to the implementing agencies, providing specific dollar limitations and a clear statement that the OSP authorization was not a blanket authorization.

(3) In El Salvador, the USMILGP has been advised that OSP approval will only be sought for three of eight projects currently under consideration. The five projects not currently being considered for offshore procurement approval have individual project values in excess of \$1.5 million. The ability of the Corps of Engineers to identify adequate U.S. firm interest for two of the five projects currently under solicitation will determine if an offshore procurement action will be considered for these five projects at a later date.

RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense direct the Director, DSAA--(1) To establish guidance and criteria for reviewing and approving offshore procurement Determinations and (2) Establish procedures for considering labor surplus area firms before making offshore procurement decisions. (p. 15/GAO Draft Report)

Now on p. 8.

See comment 12.

DOD RESPONSE: Partially concur. The DoD agrees with the need to develop additional guidance and criteria for the review and implementation of OSP actions, but does not agree with establishing specific procedures for considering firms in a labor surplus before making an Offshore Procurement Determination.

As expressed by section 42(c) of the AECA, offshore procurement is an exception to normal FMS policy. The development and publishing of specific criteria, procedures, and processes has been perceived as providing legitimization to a process that, for policy and legal considerations, the DoD does not want to encourage. This has led to a decided reluctance to issue any such guidance to subordinate headquarters.

Prior to the increase in the FMS Credit program and the development of a MAP Merger program in the early 1980's, the bulk of military assistance was in the form of grant aid equipment and

provided a significantly lesser amount of grant aid funds with which to make FMS purchases. The creation of the MAP Merger program and the expanded use of forgiven FMS Credit increased the number of countries which could participate in the U.S. FMS system. Accordingly, since 1982-84, there has been an increase in small programs in which neither the U.S. nor the host country budgets could reasonably afford to replace existing Non-U.S. origin equipment with U.S. equipment. This has greatly increased the number of requests, (though not necessarily the dollar value) for Non-U.S. procurement. This necessitates additional policy guidance from DoD in this area.

Within this calendar year, the DoD will develop additional internal guidance to ensure consistency of procedures and guidance in reviewing offshore procurement requests and implementing offshore procurements. It is stressed, however, that the decision to support any particular offshore request is ultimately a policy decision, not a mechanical or procedural decision. Accordingly, DoD guidance in this area will emphasize the appropriate areas for consideration in deciding whether offshore procurement will be authorized.

The DoD does not agree with the GAO that the consideration of labor surplus areas should be made a precondition for making a decision on offshore procurement decisions since that procedure would go beyond the scope of the statutory requirement. In addition, Such a requirement would result, in some instances, in special treatment for special labor interests which might not permit the implementation of military assistance program requirements. (See also DoD response to Finding I.

In accordance with the statute, DoD does consider the impact on labor in the consideration offshore procurement decisions and specifically reviewed this issue in the context of construction in El Salvador. DoD agrees that due consideration should be given to areas of labor surplus and U.S. unemployment will continue to be an issue to be considered in Offshore Procurement Determinations, as well as U.S. trade patterns and trends.

As noted in our response to Finding I, where DoD has been able to adequately assess U.S. market and labor factors which are relevant to a specific offshore procurement request, this has been a significant consideration in offshore procurement approval. The assessment of a potential adverse impact on labor surplus and market availability has, on occasion, resulted in the disapproval of proposed offshore procurements. Where no obvious impact has been discernable, and other policy considerations have been met, offshore procurement action has generally been supported.

Now on p. 8.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense direct the Director, DSAA to provide more specificity in each Offshore Procurement Determination, and limitations on the extent that it can be used. (p. 16/GAO Draft Report)

DOD RESPONSE: Partially concur. The DoD concurs that implementing instructions with increased specificity are appropriate in the implementation of Offshore Procurement Determinations, but DoD does not concur that the Offshore Procurement Determination itself should contain these implementing instructions or be considered implementing document.

As indicated by the GAO report, the Offshore Procurement Determinations are generally written without specific time or dollar limitations. This is due to the policy nature of Offshore Procurement Determinations and the nature of FMS sales.

Offshore Procurement Determination as Policy Statement. As indicated in the cover letter and our response to Finding F, an offshore procurement Determination is a statement of policy based on appropriate review of relevant information. As such, it is not intended to provide implementing guidance any more than other Executive Orders or Findings. As a statement of a policy decision, it needs to be supported by specific implementing instructions or guidance. DoD concurs that additional guidance is needed to ensure proper implementation of Offshore Procurement Determinations, but does not concur that it should be contained in the body of the Offshore Procurement Determination itself.

Practical Consideration of FMS Procedures. Because of the mechanical aspects of LOA preparations and contracting; actual procurement and payment for FMS cases usually stretches over more than one year. Similarly, an LOA is the best estimate at a specific time of the final cost of an item or service. The wording of the Offshore Procurement Determination permits reasonable delays or increases in cost to be authorized without the need to process an additional Determination. As a statement of policy, the Offshore Procurement Determination permits flexibility within the application of reasonable judgement. This is reinforced by the issuance of appropriate implementing documents.

The DoD will, within this calendar year, develop additional internal guidance governing the provision of implementing instructions to subordinate agencies. However, it must be stressed that the Offshore Procurement Determination is a Statement of Policy and supporting documents should be used to implement that decision.

Now on p. 8.

RECOMMENDATION 3: The GAO recommended that the Secretary of Defense direct the Director, DSAA, periodically to inform the Department of State and Treasury of significant changes in the scope of work and modifications to previously approved offshore procurement Determinations. (p. 16/GAO Draft Report)

DOD RESPONSE: Nonconcur. The DoD does not concur with the recommendation that the Departments of State and the Treasury be informed on a periodic basis of significant changes in scope or value of offshore procurements. As worded, this recommendation implies the development of some form of formal report to the Departments of State and Treasury.

Appropriate coordination is already being conducted at the staff officer level to permit appropriate State and Treasury offices to be informed of changes in the approved Offshore Procurement Determinations. This is the appropriate level at which such information should be addressed. The guidelines under preparation in response to Recommendation 1 will address this area to ensure a consistent mechanism to provide appropriate information to the Departments of Treasury and State.

Now on p. 9.

RECOMMENDATION 4: That the Commanding General of the Army Corps of Engineers take immediate steps to develop that ability to audit fully construction contracts awarded to El Salvadoran firms or, if necessary, to use an independent public accounting firm to perform the audits in-country. (p. 16/GAO Draft Report)

DOD RESPONSE: Nonconcur. The DoD does not concur that the Corps of Engineers should develop an independent auditing capability to audit contracts in El Salvador or that public accounting firms might be used to perform this audit function. The DoD nonconcurrency is divided into the following three discussion points:

1. Corps of Engineers Audit Capability. Existing DoD regulations establish that the Defense Contracting Audit Agency (DCAA) is the designated agency to audit DoD contracts. DoD Directive 5105.36 prohibits the establishment of an independent audit capability for the Corps of Engineers or other DoD elements.

2. Use of Public Accounting Firms. If an audit is required of FMS contracts, the Truth in Negotiations Act (P.L. 87-653, as amended by P.L. 90-512) requires that contractor cost and pricing data be evaluated by an employee of the U.S. Government.

3. Appropriate Audit Requirements are Being Met for FMS Contracts in El Salvador.

The FAR, section 15.805-5(a)(1) states "When cost or pricing data are required, contracting officers shall request a field pricing report (which may include an audit review by the cognizant contract audit activity) before negotiating any contract or modification resulting in a proposal in excess of \$500,000, except as otherwise authorized under agency procedures, unless information available to the contracting officer is considered adequate to determine the reasonableness of the proposed price...".

In practice, under this section, letter contracts are normally considered as potential candidates for pre-award audit as deemed necessary by the contracting officer, while contracts awarded under the competitive procedures are not generally pre-award audited.

In summary, out of 19 contracts (Corps Number, not GAO) valued at \$30.08 million awarded for El Salvador FMS in the period under discussion, only 5 letter contracts (valued at \$11.8M) were subject to pre-award audits. All U.S. firm bid information, valued \$7.1 million of this amount was pre-award audited by the DCAA. Of the remaining \$4.7 million in Salvadoran subcontractor bids, only two bids in the value of \$2.066 million subject to pre-award audit were not, in fact, audited. Since the remaining 14 contracts were awarded by competitive process, they were not subject to pre-award audit. Thus, of 19 contracts valued at \$30.08, \$28.02 million in contracts was either audited as required or was not subject to audit.

As indicated above, the appropriate audit requirements of the FAR are, in fact, being met for FMS construction contracts awarded in El Salvador. The establishment on an independent Corps of Engineers audit capability is not only not authorized by DoD regulation, but also not necessary.

SUGGESTION: The GAO suggested that the Congress may want to consider requiring the Department of State to present the details of the construction program in El Salvador in the CPD. (p. 16/GAO Draft Report)

DOD RESPONSE:

DoD does not concur with this suggestion. DoD contends that the Congress is being informed on the construction program in El Salvador through the CPD. The CPD, as it is currently submitted

Now on pp. 10-11.

to Congress, provides two specific areas in which the Congress is informed about the construction program in El Salvador. The two areas are:

-The FY1988, FY1989, and FY90 CPDs provide textual reference to the construction program in El Salvador.

-The FY1989 and FY90 Classified Annexes to the CPD both provide estimated values for the Salvadoran construction program.

FY1988, FY1989, FY90 CPD Text. In all three of the most recent CPDs, the following paragraph was included in the description of the El Salvador program:

"Approximately two thirds of past military assistance programs have been used for sustainment, including ammunition, spares, fuel, and logistical support. The remaining one-third has been used of the purchase of medical supplies, training, infrastructure improvements, mobility, fire support and command, control and communications."

Classified Annex to the CPD. In addition to the above description in the CPD text, the Classified Annex to the CPD contains a projected MAP expenditure plan which identifies as a line item the estimated value of the construction program for El Salvador.

The information provided in the CPD, as it is currently prepared, provides the Congress the opportunity to be aware of the Salvadoran construction program and its projected value. The development of a special reporting requirement to accomplish what is already occurring is unnecessary.

ESGAORES

The following are GAO's comments on DSAA's letter dated March 22, 1989

GAO Comments

1. Like other construction projects in El Salvador, the Regional Military Training Center construction was used to develop the Salvadoran infrastructure and training capability. We did not intend to imply that funds intended for the Center were used for general construction. We clarified the report to show that the amount of these funds used for military construction represented a part of the Training Center program.

We limited our analysis to those contracts awarded from fiscal year 1985 to May 1988. We did not attempt to comment on construction projects in process or under solicitation at the time of our review.

2. Although an \$8 million a year requirement for construction was identified, we did not intend to imply that \$60 million had been approved for proposed construction projects. We clarified the report by stating that construction involving replacement of damaged structures was an estimated cost and has not yet been approved.

3. As of January 25, 1989, the Defense Department began submitting cost and more detailed information on construction in El Salvador in the classified annex of the CPD. Therefore, we deleted our recommendation that the Defense Department include this information in the CPD.

4. We did not intend to suggest that the United States initiates or implements FMS procurements for the Salvadoran government and clarified the report in response to these comments.

5. We agree that price was emphasized in the contract award process, but not to the exclusion of other factors involved in the process. As stated in the report, price is normally considered after managerial and technical factors. Also, technical competence is given more weight than other factors in these decisions. While extensive discussions normally take place between the Corps and the offerors during the contract award process, for most of the Salvadoran contracts we reviewed, awards were made on the basis of initial offers without discussions. Therefore, we did not highlight the aspect of discussions in awarding the contracts for work in El Salvador.

6. We agree that the decision to request and approve offshore procurement authority was not based solely on price, and we did not intend to suggest that in the report. In response to DSAA's comments, we added the

general factors it considers when deciding whether to approve an off-shore procurement. However, without documentation, we could not verify that these factors were, in fact, used in its deliberations. While DSAA states that price is a minor consideration in the decision to procure an item or service offshore, we found no evidence to indicate what weight DSAA applies to the consideration of price.

We disagree with DSAA's analysis of contracts, especially those awarded to U.S. firms. DSAA states that two U.S. contracts were in excess of \$6 million. It appears that DSAA confuses the value of the LOA, which is normally higher than the cost, with the actual contract awards. The contracts awarded to U.S. firms for construction in El Salvador actually ranged from \$800,000 to \$3.3 million. The contracts to Salvadoran firms were awarded within a similar range, from \$300,000 to \$3.4 million. While we agree that larger projects would be more attractive to U.S. firms, we disagree with the implication that U.S. firms did not submit proposals on the smaller projects. Our analysis showed that some U.S. firms offered reasonably competitive prices and were awarded contracts of a size similar to those awarded to the Salvadoran contractors.

Data provided by the Corps indicated that until mid-1987, there had been minimum response from U.S. firms. Although the Corps reported a moderate increase in U.S. firms' interest in selected types of construction in 1987, we believe it is significant that DSAA continued to approve offshore procurement authority without obtaining assurances that U.S. firms were not interested in performing work in El Salvador and might offer competitive prices. In early 1989, after we completed our review, DSAA decreased its approval for offshore procurement in El Salvador, and we added this information to our report.

7. We changed our report to reflect that all firms were given the same advantages to compete for work in El Salvador.

8. We did not intend to imply that no audits were conducted, and we clarified this in our report. However, key source documents were not provided to DCAA by the Salvadoran subcontractors to provide a full accountability.

9. The report was clarified regarding DSAA's consideration of labor surplus areas in its review of offshore procurement requests and the position of DSAA's General Counsel. DSAA correctly states that we did not address nonconstruction offshore procurements and high-value offshore procurements. While we agree that the value of offshore procurements

is not high relative to the total security assistance program, we believe the dollar value of \$90 million since 1986, excluding Israel, is significant. Although only a small portion of that involved construction-related offshore procurement, this type of offshore procurement authorizations is increasing. The issues addressed in this report involve DSAA's assessment of the impact of offshore procurements on U.S. labor surplus areas, which could affect its approvals for construction-related offshore procurements. As stated in the report, we could find no documentary evidence regarding DSAA's assessment of the impact on labor surplus areas.

10. While we recognize that offshore procurement determinations are policy documents, implementation of offshore procurement determinations varies and is unclear. Determinations can be implemented under one or more LOAs and construction contracts; it is difficult to identify which LOA and construction contract apply to which determination. Since the current process has created confusion with one implementing agency, we believe it is important for DSAA to assure itself that the agency is implementing determinations as mandated. We believe that this can be accomplished by describing the broad outlines of the projects to be included in each determination.

11. We agree that DSAA did not appear to arbitrarily permit or encourage expansion of offshore procurement authority, and we did not intend to imply that in the report. We identified one case in which the offshore procurement determination exceeded its scope. We did not attempt to evaluate all of the offshore procurement determinations in this review. We limited our scope to the three determinations covering contracts awarded for construction in El Salvador between July 1986 and May 1988. We did not attempt to draw conclusions about the extent to which determinations could exceed their scope. However, we believe that the establishment of guidance and procedures to govern offshore procurement authority would clarify its use and would provide reasonable assurances to DSAA that it is being used in accordance with the governing legislation.

12. We do not believe that publishing specific criteria, procedures, and processes would encourage the use of offshore procurement. Such procedures would guard against abusing offshore procurement and provide assurances that exceptions to policy are justified.

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