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Report to Rep. Ronald V. Dellums; by Victor L. Lowe, Director, General Government Div.

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Postal Service contracting activities for highway transportation of mail were reviewed. The review focused on whether: small firms were being denied an opportunity to obtain contracts; wide variances in bids were unusual; firms awarded mail transportation contracts were later given improper price increases; and bonding companies were misusing bid information received from competing transportation firms.
Findings/Conclusions: Virtually all main highway contracts are awarded through formal advertising. Officials believe that 99 percent of the highway transportation contractors are small businesses. The wide variations are not unusual; the differences seem to be the result of the economic or competitive position of the bidder. Large computation errors in bids were noted. Price adjustments to contractors were generally due to inflation and were generally in accordance with postal regulations. No indication was found that bid information was misused by bonding companies. (RRS)

UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

GENERAL GOVERNMENT DIVISION

DEC 28 1976

B-114874

The Honorable Ronald V. Dellums
House of Representatives

Dear Mr. Dellums:

Your January 8, 1976 letter requested that we review certain U.S. Postal Service contracting activities for highway transportation of mail. Based on your letter and subsequent discussions with your Oakland District Office staff, we focused our review on whether: (1) small firms were being denied an opportunity to obtain transportation contracts with the Service, (2) wide variances in bids on contracts were unusual, (3) firms awarded mail transportation contracts were later given improper price increases to recover from low bids, and (4) bonding companies were misusing bid information received from competing transportation firms.

In summary, we found that:

--most highway contracts were apparently awarded to small businesses;

--wide variances in contract bids were not unusual and appeared to be caused by (1) differences in contractors' business conditions, (2) differences in expected return on investment, (3) omissions or mistakes in bids, and (4) unfamiliarity of some bidders with postal contracting regulations;

--price adjustments to contracts were generally due to inflation and in accordance with postal regulations; and

--there was no indication that bonding companies were misusing bid information to permit a potential contractor to gain an advantage over its competitors.

Our review was performed at the Service's Headquarters and its Western Region. Additional information is provided below.

GGD-77-14

MOST HIGHWAY MAIL CONTRACTS APPARENTLY AWARDED TO SMALL FIRMS

The Service spends hundreds of millions of dollars annually to transport mail by air, water, rail, and highway. As of March 1976, highway transportation contractors held contracts valued at $277 million annually. Virtually all mail highway contracts are awarded through formal advertising, the most competitive form of Government procurement.

The Small Business Administration defines small firms in the trucking industry as those whose annual receipts do not exceed $5 million and have less than 500 employees. In discussions with your Oakland staff, we were asked to determine the extent the Service contracted with firms whose annual receipts did not exceed $500,000 or had less than 50 employees. Service records do not contain information on annual receipts or numbers of employees of firms doing business with the Service and it was not possible for us to determine conclusively the number of contractors falling in either category. However, there are a number of indications that most highway transportation contractors are probably small businesses.

As of March 1976, Service records show that there were over 9,000 firms, holding about 11,600 contracts, involved in the highway transportation of mail. As shown below, the total annual value of each firm's contract(s) is generally small.

Value of Highway Mail Contracts as of March 1976

Annual contract values	Number of firms	Percent of firms	Total value of contracts (in millions)	Percent of contract value
Less than $20,000	7,045	76	$ 61	22
$20,000 to $99,999	1,742	19	71	26
$100,000 to $499,999	404	4	83	30
$500,000 or more	64	1	62	22
TOTALS	9,255	100	$277	100

Service records also show that most contracts are in the name of individuals rather than trucking firms. This, coupled with the relatively small dollar value of most contracts and the concentration of contractors in the lower range of contract values, indicates that most are small businesses. Our discussions with 21 randomly selected highway transportation contractors in the Western Region disclosed that 18 had no income from sources other than their postal contracts.

Service officials believe that 99 percent of highway transportation contractors are small businesses. The information available appears to support this view.

REASONS FOR BID VARIANCES AND CONTRACT PRICE INCREASES

Two issues raised were whether (1) wide variances in bids on contracts were unusual and (2) price adjustments were made to permit a contractor to recover from an unreasonably low bid.

Variances in Bids Not Unusual

On the surface, wide variances in contractors' bids may appear questionable. Our examination of the bids submitted on 35 contracts showed that a large percentage difference between bids on the same contract is not unusual. The percentage difference between the low and high bid on each of the contracts is categorized below.

Percentage Difference Between Low and High Bid

Percentage Difference	Number of Contracts
less than 25	3
25 to 50	18
51 to 100	6
more than 100	8

In addition to large percentage differences, there were large dollar amount differences on the higher value contracts. We analyzed the bids submitted to determine where variances occur. Based on this review we identified a number of areas where bids may vary.

Many differences in bids seem to be the result of the economic and competitive position bidders are in at the time bids are prepared. Bids differ greatly in the amount shown as needed to cover depreciation on vehicles, general overhead and management expenses, desired return on capital invested, and the cost of fuel. We also noted that large computation errors were made in bids submitted. Following are some examples of annual cost differences we found in contractors' proposals submitted on the same contracts.

--Vehicle depreciation and interest expenses shown on a winning bid were $3,900. A competitor's bid included $34,000 for this cost category. Such a variance might indicate that the high bidder had to purchase new vehicles while the winning bidder had older vehicles already depreciated to a great extent.

[illegible]ders' proposals usually showed differences in the [illegible]pected return on funds invested in capital assets. One bidder included $36,867 for return on investment compared to $780 bid by the low bidder. The low bidder in this case might have been willing to accept a small return on investment so that unused business capacity could be employed.

--Vehicle insurance expenses varied greatly. One bidder's insurance expenses were $17,600, but another bidder showed less than one half of this amount, or $7,960 for insurance.

--One bidder's fuel consumption rate was 5 miles a gallon compared to a competitor's rate of 4 1/2 miles a gallon. This seemingly small difference added 22,825 gallons of fuel or $9,815 to the losing bidder's costs.

--A losing bidder's oil costs were overstated by $34,830 because of a computation error. Another losing bidder's fuel costs were overstated by $30,540, also because of a computation error.

We found that not all bidders fully understand postal regulations governing price adjustments. Five of 21 bidders we interviewed stated they were unaware of the Service's contract price adjustment provisions at the time of their bid submissions. A firm with knowledge of postal contracting knows that certain anticipated cost increases (such as fuel price increases) need not be included in the bid. Rather, should these increases occur, the contractor can pass the additional cost to the Service under the contract price adjustment provisions. As a result, some firms may have included in bids not only their current costs but those cost increases anticipated over the term of the contract. Thus, some bids may have been higher than necessary simply because firms did not fully understand the contract price adjustment provisions.

Contract Price Adjustments to Peflect Increased Costs Appear Reasonable

Mail trucking contracts usually cover a four-year term, and about 80 percent are renewed for a second four-year term, according to a Service official. Postal regulations permit two basic types of changes to these contracts. However, neither type of change permits contract price increases to correct bid errors or omissions.

The first category, service changes, consists of changes to schedules which affect pickup and delivery points or the frequency of trips. These types of changes may increase or decrease a contractor's costs and, therefore, result in changes in contract prices. However, these changes are initiated by the Service and are undertaken because of changing mail flow patterns. Consequently, we did not review these cost changes. We did note, however, there was generally little cost growth due to service changes on the contracts we reviewed.

The second category consists of price adjustments occurring because of changing economic conditions over which the contractor has little or no control. During the first 12 months of a contract, cost adjustments for changing economic conditions are to be restricted to fuel increases and increases caused by newly enacted statutes or ordinances. In subsequent years, contract price increases may also be given for contractors' wages, general overhead costs, and some operational costs. Contractors are required to support all cost changes requested.

To review contract price adjustments, we randomly selected 30 of the 470 mail trucking contracts awarded in the Service's Western Region during the 3-year period ending December 31, 1975. The average age of the contracts was 22 months and the average increase of these contracts over their original value was 17 percent. On several contracts, there had been no cost increases.

Nine contracts, however, had economic cost adjustments during the first year which were granted because of fuel price increases and for a newly enacted statute. These adjustments were permissible under Service regulations. After the first year, we found cost adjustments were made for either economic reasons or service changes.

To determine the reasonableness of cost growth after the first year, we compared contract price increases to the Consumer Price Index (CPI)--a measure of the inflationary trend of the economy. Thirteen of the contracts we reviewed had only economic adjustments after the first year. On 12 of these, the percentage increase in the contract resulting from economic adjustments was less than the CPI increase during the period the contract had been in effect. The cost growth on the other contract was slightly higher than the CPI. The reasons cited for these economic adjustments included increased costs for fuel, cost-of-living, wages, and taxes.

The remaining contracts with cost adjustments were due to service changes or a combination of economic and service changes. As stated earlier we did not review cost adjustments for service changes. The economic adjustments on these contracts did not appear excessive when compared to the Consumer Price Index or the initial value of the contracts.

During our review, we found instances where contract files lacked supporting documentation for the price adjustments made. In addition, Service personnel had made some minor computation errors when computing contract price increases. Just prior to our review, Service auditors also had similar findings. The Service's audit report recommended that postal personnel be instructed to closely examine contractors' requests and make sure that contract price increases approved are correct and adequately supported. Western Region officials stated that in response to the audit findings intensive training sessions were being given to personnel responsible for approving contract price increases.

NO INDICATION THAT BID INFORMATION IS MISUSED

The Service requires each bidder to obtain a performance bond to insure fulfillment of all obligations under a mail trucking contract. e bond protection is provided through suretyship - a three party relationship in which a surety (an individual or corporation) becomes obligated to the Service for the contractor's faithful performance of the contract.

Surety companies have access to bidder's price proposals before the bid solicitation closing date. The Service requires bidders to obtain bonds from sureties before the bids are submitted to the Service. A similiar bonding procedure is followed on Government construction projects where performance bonds are required. Surety company officials told us that contract price proposals are needed in order to evaluate a bidder's capability to peform.

In discussions with your Oakland staff, concern was expressed that a bonding company might be in a position to misuse bid information by telling one bidder the amount bid by another. In any business arrangement where one firm receives confidential information of another, there is always the possibility that the information could be misused. However, detection is difficult without benefit of specific allegations. The Service official responsible for highway transportation contracting in the Western Region stated that he knew of no instances or allegations of bonding companies misusing bid information. There is a factor inhibiting improper use of bid information. In 34 of 36 contracts we reviewed, more than one bonding firm was involved. Thus, in most cases the bonding companies did not have complete information on the bids being submitted.

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The Service agrees with the information contained in this report. A copy of this report is also being sent directly to your Oakland District Office.

Sincerely yours,

Victor L. Lowe
Director