



National Security and
International Affairs Division

B-279663

April 6, 1998

The Honorable James Inhofe
United States Senate

Subject: Bus Service Pricing Allegations

Dear Senator Inhofe:

As you requested, we examined allegations that the U.S. Army was overcharged for bus service provided under an acquisition agreement with the Hungarian Ministry of Defense. This agreement facilitates logistic and other support for U.S. military forces assisting with the implementation of the General Framework Agreement (also known as the Dayton Agreement) in Bosnia. U.S. forces routinely transit Hungary in deploying to and redeploying from Bosnia. This letter discusses (1) the U.S. statutory requirements governing the acquisition agreement and (2) our views on the results of two Army reviews of bus service pricing.

BACKGROUND

An acquisition agreement between the U.S. Army Europe (USAREUR) and the Hungarian Ministry of Defense was signed on December 4, 1995. The agreement was amended on March 12, 1996, to facilitate the acquisition of host nation-provided logistic support in connection with U.S. military operations in Hungary and Bosnia. Under the terms of the acquisition agreement, the Hungarian Logistics Directorate—an agency of the Hungarian Ministry of Defense—agreed to observe reciprocal pricing principles. For reciprocal pricing, the supplying country agrees to provide U.S. forces with items and services at prices no less favorable than those it would pay to acquire identical items and services for its own armed forces. For items to which reciprocal pricing does not apply (e.g., items that are not identical), the Hungarian acquisition agreement called for supplying the U.S. needs at the "lowest possible cost."

Goods and services are provided under the agreement pursuant to specific requests submitted by the USAREUR contracting officer—assigned to the USAREUR Liaison Team in Budapest—to the Hungarian Logistics Directorate. According to the U.S. Army Audit Agency (AAA), the Directorate had filled 67 orders as of February 1997, totaling about \$33 million, for a wide variety of supplies and services, including bus service.

The Army had a requirement for bus service to transport U.S. personnel and equipment within Hungary and to Bosnia and Croatia. The prices charged for those services increased between December 1995 and April 1996—for bus service to Bosnia, the price per kilometer almost doubled, rising from \$1.38 in January to \$3.56 in April 1996; for service to Croatia, the price per kilometer increased more than six times, rising from \$0.69 in December 1995 to \$4.70 in April 1996. Prices subsequently declined to \$2.36 per kilometer on both routes from July to September 1996. As of August 1996, the Army had obligated \$2.6 million for bus contracts. A former head of the USAREUR Liaison Team at the U.S. Embassy in Budapest believes that the Army was being overcharged for bus service being provided under the acquisition agreement. This allegation was the subject of audits by USAREUR's Internal Review and Compliance Office (IRACO) and AAA.

RESULTS IN BRIEF

The U.S. Army Europe's Internal Review and Compliance Office and the U.S. Army Audit Agency investigated allegations of overcharges for bus services provided under the Hungarian acquisition agreement. The Internal Review and Compliance Office concluded that the Army was overcharged for bus services because reciprocal pricing arrangements were not followed. The Army Audit Agency concluded that reciprocal pricing provisions did not apply to the bus service contracts. We believe that reciprocal pricing did not apply and that the Hungarian Logistics Directorate should have negotiated for the lowest possible cost. Neither audit determined whether the lowest possible cost was obtained, and there is no way for us to make that determination now. However, the price variation documented in the Internal Review and Compliance Office's report and the report's discussion of a lower price tender made by one of the bus companies for its services suggest that lower prices may have been available.

STATUTORY REQUIREMENTS AND THE ACQUISITION AGREEMENT

Title 10 U.S.C. 2341 *et seq.* authorizes the Department of Defense to enter into acquisition agreements with foreign governments to obtain supplies, services, and logistic support for elements of the armed forces deployed outside the United States. The law expressly waives certain legal requirements that would be applied to defense contracting in other circumstances. The specific waivers, which are listed in 10 U.S.C. 2343, involve (1) seeking competition, (2) prohibiting cost-plus percentage-of-cost pricing, (3) subcontracting under cost-plus contracts, (4) obtaining cost or pricing data, and (5) allowing access to records by the Comptroller General of the United States. Section 2343 also waives a statutory provision concerning the payment of gratuities. However, the agreements must contain a requirement that prohibits self-dealing, bribery, and conflicts of interest, and must allow sufficient access to information about prices to satisfy the need to determine whether pricing was in accord with the agreement.

With regard to price, the statute expresses a strong preference that acquisition agreements include reciprocal pricing terms. This principle means that, when a foreign government procures supplies and/or services from its contractors for U.S. forces under an acquisition agreement, the price charged should be no more than the supplying country would pay for identical items purchased for its own armed forces. However, the reciprocal pricing requirement is limited to identical items and permits "taking into account price differentials due to delivery schedules, points of delivery, and other similar considerations."¹ If the United States and the foreign government cannot agree on reciprocal pricing, the statute permits the Secretary of Defense to enter into an agreement that, after price analysis, would ensure that the United States pays only an amount that is "fair and reasonable."²

These statutory provisions do not apply when the United States contracts directly with suppliers in a foreign country without the intermediary of the foreign government. However, the U.S. acquisition agreement with the Hungarian Ministry of Defense is subject to the statute.

¹10 U.S.C. 2344 (b)(1)(A).

²10 U.S.C. 2344 (b)(2)(A).

ARMY REVIEWS OF BUS PRICING ALLEGATIONS

The following presents the results of IRACO's and AAA's audits of bus service pricing and our views on the audit findings:

IRACO's Audit

At the request of the head of the USAREUR Liaison Team in Budapest, IRACO investigated the bus service contracts. In October 1996, IRACO issued its report, which concluded that the lowest possible prices for bus transportation were not obtained because the Hungarian Ministry of Defense should have, but did not, adhere to reciprocal pricing principles on the bus contracts. This conclusion was based on the fact that the acquisition agreement's prices were higher than independent price quotes obtained by IRACO for travel within Hungary. On the basis of the independent price quotes, IRACO estimated that the Army was overcharged by about \$1.2 million.

According to the IRACO audit, one of the bus companies contracted with by the Hungarian Logistics Directorate made a lower priced offer for bus services directly to the U.S. Army. However, the acquisition agreement with the Logistics Directorate was used to provide the bus services instead.

AAA's Audit

AAA, at the request of the Deputy Commander in Chief, USAREUR, subsequently reviewed contracting under the acquisition agreement. AAA's report, issued in March 1997, concluded that the Army was billed and it paid based on the applicable prices specified in each order. The report also concluded that reciprocal pricing provisions did not apply to the bus service contracts because the prices for bus services cited in the IRACO report for travel within Hungary did not adequately consider the Army's bus requirements. Furthermore, AAA observed that, although not required by law or the agreement, competition was sought on the bus service contracts.

GAO's Views

We believe that the services procured were not identical to the services offered in the independent price quotes obtained by IRACO for travel within Hungary. The fact that the procured transportation included travel into Bosnia is a significant difference in the service. This factor would legitimately have affected prices compared with transportation within Hungary or between Hungary and countries that were not experiencing internal civil conflict. Accordingly, we believe that reciprocal pricing did not apply and that the

Hungarian Logistics Directorate should have negotiated for the lowest possible cost. Neither audit determined whether the lowest possible cost was obtained, and there is no way for us to make that determination now. However, the price variation documented in the IRACO report and the report's assertion that one of the bus companies made a lower price tender of its services directly to the U.S. Army suggest that lower prices may have been available.

SCOPE AND METHODOLOGY

To examine the allegations regarding the bus contracts and the acquisition agreement between USAREUR and the Hungarian Ministry of Defense, we reviewed the IRACO and AAA audit reports in detail and discussed the allegations with the former head of the USAREUR Liaison Team. We did not independently verify the IRACO and AAA audit work. To assess the basis for claims regarding the applicability of reciprocal pricing, we reviewed the relevant statutes and their legislative history. We conducted our review between January and March 1998 in accordance with generally accepted government auditing standards.

We are sending copies of this letter to the Commanding General, USAREUR; the Chief, IRACO; the Deputy Auditor General, Logistical Audits, AAA; and the former head of the USAREUR Liaison Team. Copies will also be made available to others on request.

If you or your staff have any questions concerning the letter, please contact me on (202) 512-3504. Major contributors to this letter were Margaret Armen, Steven H. Sternlieb, and William T. Woods.

Sincerely yours,



Richard Davis
Director, National Security
Analysis

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