Report No. D-2011-110 September 27, 2011

Inspector General
United States Department of Defense

Better Management of Fuel Contracts and International Agreements in the Republic of Korea Will Reduce Costs

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Acronyms and Abbreviations

COR	Contracting Officer's Representative
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
GOCO	Government-Owned, Contractor-Operated
ROK	Republic of Korea
USFK	U.S. Forces Korea

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SEP 27 2011

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Better Management of Fuel Contracts and International Agreements in the Republic of Korea Will Reduce Costs (Report No. D-2011-110)

We are providing this report for review and comment. The Defense Logistics Agency Energy can help DoD reduce costs by better managing and administrating its fuel contracts and international agreements in Korea. We considered management comments on a draft of this report in preparing the final report. The complete text of the comments is in the Management Comments section of the report.

Although management comments were responsive to the recommendations, the Defense Logistics Agency was unable to provide a revised estimate of potential monetary benefits shown in the report because negotiations with the applicable contractors had not been completed. We request that the Commander, Defense Logistics Agency Energy, provide comments on the estimated monetary benefits by November 28, 2011.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-8866 (DSN 664-8866).

Alice F. Carey
Assistant Inspector General
Readiness, Operations, and Support

Results in Brief: Better Management of Fuel Contracts and International Agreements in the Republic of Korea Will Reduce Costs

What We Did

We reviewed the effectiveness and oversight of 16 contracts and 3 international agreements that Defense Logistics Agency (DLA) Energy managed in support of fuel operations in Korea and the accuracy of fuel inventories. DoD paid $550.8 million for procurement, storage, and delivery of fuel purchased from vendors in Korea during FY 2010.

What We Found

DLA Energy officials effectively managed and provided sufficient oversight for 13 contracts and 1 international agreement. However, DLA Energy officials did not effectively administer the contract for operating Army service stations. This occurred because contracting officers and their representatives did not verify that the contractor was paid for only work performed, and the contract lacked provisions for adjusting fixed charges to reflect changes in customer requirements. As a result, the contractor charged DLA Energy:

- $144,815 as of January 31, 2011, to operate a cash sales function at Camp Humphreys, Korea that never took place. DoD would have paid $413,758 during the 5-year term of the contract if these charges continue; and
- an estimated $121,628 for discontinued operations at three service stations.

Additionally, the contractor issued fuel to customers who did not provide the required documents because the contractor was unaware of this requirement, and the contracting officer's representatives did not effectively monitor operations.

DLA Energy also made incorrect payments and calculation errors related to two of the three international agreements. DLA Energy

- overpaid $159,629 in monthly service charges because of a calculation error However, as a result of our audit, DLA Energy recouped these funds;
- did not recoup $17,151 of a $1.7 million advance paid to a service provider because DLA Energy personnel did not identify calculation errors made during the negotiation process; and
- incorrectly reconciled the fuel account balances under the Fuel Exchange Agreement because of data and procedural errors.

In addition, we found problems related to two other contracts. DLA Energy

- inconsistently interpreted the "Bunker" contract for 12 deliveries because the contract did not clearly state what fuel price to use when no fuel price was published; and
- paid a contractor an undetermined amount for an "automatic-fill" service that Government personnel performed. This may have been prevented if DLA Energy had performed adequate research before awarding the contract.

Resolving these problems could reduce costs by more than $712,166 and improve accountability.

What We Recommend

We recommend that the Commander, DLA Energy, recoup funds from contractors for services not provided, modify appropriate contracts to clarify language, and strengthen oversight and controls to ensure the Government receives what it is paying for.

Management Comments and Our Response

DLA provided responsive comments to our recommendations and proposed actions to improve operations and achieve monetary benefits. However, negotiations that would quantify monetary benefits were still in process. We request DLA to provide a summary of monetary benefits in response to the final report.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Commander, Defense Logistics Agency Energy		Recommendations 1-8

Upon completion of negotiations with the contractors discussed in Recommendations 1 and 8, please provide comments by November 28, 2011, to the final report.

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Introduction

Objective

Our objective was to evaluate the management of bulk fuel operations in Korea at the wholesale level. Specifically, we reviewed the effectiveness and oversight of Defense Logistics Agency (DLA) Energy contracts and international agreements for procurement, storage, and distribution of bulk fuel and the accuracy of fuel inventories. The announced objective included a review of fuel requirements. However, we may review fuel requirements, including requirements for contingency operations, in a separate project. See Appendix A for a discussion of the scope and methodology and prior coverage related to the objective.

Background on Bulk Fuel Operations in Korea

DLA Energy manages the procurement, storage, and distribution of wholesale petroleum (fuel) products for DoD. DLA Energy's mission is to provide DoD with comprehensive energy solutions in the most effective and economical manner possible. In accomplishing this mission, DLA Energy awards and manages numerous contracts and participates in international agreements for the procurement, storage, and delivery of fuel. DLA procurement and operational contracts for fuel were awarded at DLA Energy headquarters. However, DLA Energy has an office in Korea that provided contract oversight and quality management of DLA-owned fuel both in support of U.S. Forces Korea (USFK) and shipped from Korea to U.S. forces outside Korea. During FY 2010, DLA Energy spent $141.1 million under contracts and international agreements to support USFK. In addition, DLA Energy paid $409.7 million to purchase fuel from Korean commercial companies for delivery on tankers from Korea to other locations throughout the world.

DLA Energy Needs to Improve Contracting Internal Controls

DoD Instruction 5010.40, "Managers' Internal Control Program (MICP) Procedures," July 29, 2010, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified control weaknesses in DLA Energy's management and administration of bulk fuel-related contracts in Korea. Specifically, contracting officers and their representatives did not verify that the contractor was paid for only work performed, and the contract lacked provisions for adjusting fixed charges to reflect changes in customer requirements. We will provide a copy of the report to the senior official responsible for internal controls in DLA Energy.

Finding. DoD Can Reduce Fuel Costs Through Better Management of Contracts and Related International Agreements

DLA Energy effectively managed and provided sufficient oversight for 13 of 16 contracts and 1 of 3 international agreements in place during FY 2010. However, DLA Energy did not effectively administer the contract, valued at $4.4 million, for operating Army service stations because contracting officers and their representatives did not verify that the contractor was paid for only work performed, and the contract lacked provisions for adjusting fixed charges to reflect changes in customer requirements. As a result, the contractor charged DLA Energy:

- $144,815 as of January 31, 2011, to operate a cash sales function at Camp Humphreys, Korea that never occurred. DoD would have paid $413,758 during the 5-year term of the contract if these charges continue; and
- an estimated $121,628 for discontinued operations at three service stations.

Additionally, the contractor issued fuel to customers who did not provide the required documents because the contractor was unaware of this requirement, and the contracting officer's representative (COR) did not effectively monitor operations.

DLA Energy also made incorrect payments and calculation errors related to two of the three international agreements. DLA Energy

- overpaid $159,629 in monthly service charges because of a calculation error. However, as a result of our review, DLA Energy recouped these funds;
- did not recoup $17,151 of a $1.7 million advance paid to a service provider because DLA Energy personnel did not identify calculation errors made during the negotiation process; and
- incorrectly reconciled the fuel account balances under the Fuel Exchange Agreement because of data and procedural errors.

In addition, we found problems related to two other contracts. DLA Energy

- inconsistently interpreted the "Bunker" contract for 12 deliveries because the contract did not clearly state what fuel price to use when no fuel price was published; and
- paid a contractor an undetermined amount for an "automatic-fill" service that Government personnel performed at Osan Air Base, Korea. This may have been prevented if DLA Energy had performed adequate research before awarding the contract, or if DLA Energy had appointed a COR to monitor the contract.

Resolving these problems will reduce operational costs and improve accountability. See Appendix B for a Summary of Potential Monetary Benefits of more than $712,166.

DLA Energy Management and Oversight of Contracts and International Agreements in Korea

DLA Energy personnel administered 16 contracts and 3 international agreements in place during FY 2010 to support the procurement, storage, facility management, and delivery of fuel for USFK and to other locations. The total cost of these contracts and international agreements was $550.8 million for FY 2010. DLA Energy effectively managed and provided sufficient oversight for 13 contracts and 1 international

agreement. However, DLA Energy could improve the oversight and administration for three contracts and two international agreements.

Need to Improve Management and Administration of the Contract for Operating Army Service Stations

DLA Energy awarded a 5-year contract (SP0600-09-C-5904) with three 5-year options, valued at $4.4 million for the initial 5 years, to AHN Tech-Korea Corporation, which began on May 1, 2009. The contract required AHN Tech-Korea to operate and maintain Government-owned, contractor-operated (GOCO) petroleum fuel facilities at 10 Army installations in Korea for a fixed monthly fee. The facilities included service stations for ground vehicles at each site, aviation refueling operations for two sites, and retail cash sales at five sites. The contract contained a breakdown of the cost for operating each site. The contractor was paid a fixed fee of $68,959.58 per month for operating the 10 sites (plus a few minor cost reimbursable line items to be charged if needed).

Excess Charges for Operating Camp Humphreys Service Station

The primary mission of the service station at Camp Humphreys was to provide fuel for Government vehicles and aircraft. Because most fuel for vehicles was issued to military customers using automated procedures, the contractor's presence was not required to issue this fuel. The contract also called for operation of cash sales at Camp Humphreys, which required the contractor to be present during all operational hours. However, the contractor never implemented cash sale operations because the Army and Air Force Exchange Service (Exchange) began operating a service station for civilian customers before the contractor began operations in May 2009. The contract stipulated a monthly price of $21,508.10 for operating the Camp Humphreys service station, which included a monthly cost of $6,895.96 for a cash sales operation. However, the contract stated that when the cash sales were discontinued, the contracting officer would deduct the cash sales portion ($6,895.96) from the monthly price. Although AHN Tech-Korea never provided a cash sales operation, it continued to charge for the service through January 2011.

We questioned DLA Energy personnel on why they continued to pay the contractor for the cash sales operation that was never performed. They stated that command personnel at Camp Humphreys requested that DLA Energy not delete the contractual requirement for a cash sales operation because it was needed as a contingency option in case the Exchange service station could not provide fuel for civilians. However, the only support for DLA Energy's assertion was an e-mail from the COR requesting DLA to keep the cash sales service as a backup contingency option just in case the Exchange service station had problems and could not dispense fuel. Our discussions with the COR indicated that he thought DLA Energy would put some type of contingency clause into the contract to implement this requirement. Because no one questioned this payment before our audit, it was probable that AHN Tech-Korea would have continued to bill DLA Energy monthly for $6,895.96 for the 5-year term of the contract, costing DoD $413,758. DLA Energy should modify the contract to delete the requirement for a cash sales operation at Camp Humphreys and recoup the funds paid to the contractor for services that it did not perform ($144,815 billed as of January 31, 2011).

Overpayments to Contractor for Closed Facilities

The contractor stopped operating Army service stations at 3 of the 10 installations—Camps Eagle, Long, and Stanley in Korea—because the Army discontinued the requirement. However, the contractor did not stop billing for the three installations.

Consequently, the contractor overbilled DoD by an estimated $121,628 for services it did not provide through January 31, 2011.

In April 2010, the DLA Energy contracting specialist asked the COR for documentation on the official closing dates for the facilities. In the meantime, the contractor continued to bill DoD for $68,959.58 each month to operate all 10 sites, and the Defense Finance and Accounting Service (DFAS) paid those invoices. After we discussed the contractor's overbilling with the DLA Energy Korea office, the contracting officer modified the contract on November 12, 2010, to recoup $57,550 paid for July through October 2010. However, the modification did not include a reduction in the payments for the period actual operations were discontinued at Camps Eagle and Long, or for the discontinued service at Camp Stanley, as shown below. The contracting officer should recoup an additional $64,078.

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Estimate of Contractor Overbilling for Services Not Provided

Location	Monthly/Daily[1] Charge per Contract	Date Customer Service Stopped	Date Tank Cleaning Completed	Contractor Overbilling Period	Potential Over-Payments
Camp Eagle	$8,632.49 monthly/ $278.47 daily	Jan 18, 2010		2 months plus 26 days[2]	$18,379
			Apr 13, 2010	6 months plus 17 days[3]	56,529
Camp Long	$5,755.00 monthly/ $185.65 daily	Apr 16, 2010		25 days[2]	3,481
			May 11, 2010	5 months plus 20 days[3]	32,488
Camp Stanley	$2,929.82 monthly/ $94.51 daily	Sept 9, 2010		4 months and 5 days[2]	9,144
			Jan 14, 2011	17 days through Jan. 31, 2011	1,607
	Total				**$121,628**
	Less Amount Recouped from Contractor for Modification 10				**$ 57,550**
	Additional Amount to Recoup from AHN Tech-Korea				**$ 64,078**

[1]The contract did not show a daily charge, but it stated that the price should be "prorated for part months." We computed a daily rate based on a 31-day month.
[2]We assumed it was reasonable for the contractor to charge 25 percent of the monthly charge shown in the contract because the contractor had to arrange for cleaning the fuel tanks, post daily inventories, and possibly perform other miscellaneous duties. Camps Eagle and Long had cash sales before they closed, which required the contractor to be present during operational hours.
[3]After we brought the overpayment to their attention, DLA Energy personnel modified the contract and deleted the monthly payments for Camps Eagle and Long as of November 2010.

Improvements Needed in the Contract Provisions

The contract with AHN Tech-Korea did not contain other provisions for adequate billing adjustment for phased-out or discontinued services or for reviewing the contractor's bill. Modifying the contract could help ensure that future overpayments do not occur.

Contract Lacked Provisions for Phasing Out/Discontinuing Services

The contract solicitation showed that 6 of the 10 original sites would close at an unspecified time. Before the audit was completed, operations were discontinued at the three installations previously discussed, and DLA Energy paid the contractor an additional amount for cleaning the fuel tanks. However, the contract did not contain sufficient provisions for phasing out fuel facilities and final tank cleaning. Specifically, the contract did not discuss the following:

- potential reductions in monthly fees for four sites other than Camp Humphreys if cash sales operations were discontinued,
- a reduction in monthly fees after operations ceased before the final fuel tank cleaning was completed, which could be a few months after the service station closed, and
- a fee for cleaning out the fuel tanks after operations ceased.

To prevent future overpayments, DLA Energy should modify the contract to explicitly state the portion of the monthly fee that should be paid as services are phased out. Once in place, the COR and contracting officer should enforce these provisions.

Contractor's Invoices for Monthly Service Went Directly to DFAS

The contract required AHN Tech-Korea to send the monthly invoices directly to DFAS for payment. Neither the contracting officer nor the COR reviewed or certified these monthly bills. As a result, AHN Tech-Korea submitted invoices for services that it did not provide. The risk of overbilling is high because AHN Tech-Korea continued to bill for services not performed in the past and because of ongoing and planned base realignment and closures in Korea. DLA Energy should require the COR to review and approve future invoices to help ensure AHN Tech-Korea only submits bills for services rendered.

A 5-Year Service Contract With Three 5-Year Options Is Too Long

DLA Energy personnel awarded the Army GOCO contract to AHN Tech-Korea for a 5-year period, with three 5-year options, for a firm-fixed price (and a few minor task orders), from May 1, 2009, through May 1, 2029. Awarding a contract for firm-fixed prices[1] in U.S. dollars, for a 20-year period, incurs a significant amount of risk to both the Government and the contractor because of potential exchange rate fluctuations. During contract negotiations, a prospective contractor mentioned that because of this risk, "contractors must bid an excessively high price." However, the DLA Energy officials responded that the offers should factor in all these issues when submitting bids.
The Federal Acquisition Regulation 17.204, "Contracts," states that service contracts, to include option period, should not normally exceed 5 years. Nevertheless, section 2922, title 10, United States Code allows the Secretary of Defense to issue contracts for "storage, handling, and distribution" of liquid fuels for up to 5 years, with additional options for a total of 20 years. We realize that DLA Energy personnel would not

[1]The total price included specific price increases for each of the three 5-year options.

necessarily award the three 5-year options automatically because the Federal Acquisition Regulation 17.207, "Exercise of Options," requires the contracting officer to determine that an option is the most advantageous method of fulfilling the Government's need. However, in our opinion, awarding this service contract to provide personnel to operate and maintain Army service stations, for a total of 20 years including options, was not the best practice.

We questioned the decision to award this contract with three 5-year options when DLA Energy was aware of the potential closure of 6 of the 10 service stations when U.S. forces in Seoul and installations north of Seoul relocate to Camp Humphreys. DLA Energy should recompete this contract at the end of the initial 5-year period, unless it can effectively determine and document that awarding an additional option to a contractor who billed the Government for services not performed is in the best interest of the Government.

Inadequate Controls Over Issuing Fuel at Army Service Stations

Most of the fuel issued by the GOCO Army service stations went directly into military vehicles, whose drivers had a Vehicle Identification Link key (similar to a credit card). The key allowed the drivers to pump their own fuel, which would be automatically charged to the unit identified on the key. However, the AHN Tech-Korea's standard operating procedures also allowed the contractor to issue fuel in containers to personnel who provided a letter of authorization signed by the installation transportation officer or designated representative to prevent unauthorized issuance and use of fuel. The procedures also required a justification to include the required quantity, type of fuel, number of containers, driver's name, and office telephone number of requester.

After receiving written requests from customers, contractor personnel at the Camp Casey service station dispensed more than 13,000 gallons of gasoline from November 1, 2010, through February 5, 2011, into 5-gallon cans. However, requests were not always approved by the required individuals and did not include the driver's name and number of containers. We also found that AHN Tech-Korea personnel, who issued the gasoline, were not aware of their standard operating procedures.

Non-compliance with fuel issuance procedures could result in unauthorized issuance and use of Government-owned fuel. The COR should monitor this function and ensure the contractor enforces the controls specified in AHN Tech-Korea's standard operating procedures.

Incorrect Payments Made and Better Documentation Needed for International Agreements

DLA Energy administered the following three agreements in support of fuel operations with the Republic of Korea (ROK) on the behalf of the U.S. Government and USFK.

- The Kunsan Pier Agreement permits the joint-use of real estate in connection with operation of the Kunsan Pier and Dolphin while sharing operating costs. The U.S.

share for FY 2010 was $158,845. We did not note any problems related to this agreement.

- The Bulk Fuel Support Agreement allows DLA Energy to use the commercial South-North Pipeline with associated commercial and military-owned storage facilities for fees. The ROK employed two companies—Daehan Oil Pipeline Corporation and SK Corporation—to provide storage, transportation, and terminal services for DLA-owned bulk fuel. These services cost $9.5 million for FY 2010.
- The Fuel Exchange Agreement allows U.S. and ROK Armed Services to exchange and reimburse aviation, ground, and marine fuels at worldwide refueling points.

DLA Energy effectively managed and provided sufficient oversight of the Kunsan Pier Agreement. However, we found overpayments related to the other two agreements as discussed in the following paragraphs.

Audit Identified and DLA Energy Recouped $159,629 of Overbilling

Under the Bulk Fuel Support Agreement, SK Corporation personnel billed DLA Energy monthly for fuel support services. The agreement set fixed monthly facility rental fee to be charged for the first 5 years and stipulated that the charges for subsequent periods would be based on actual quantities of fuel throughput. However, SK Corporation personnel erroneously kept billing a fixed fee past the 5-year period, for 14 months from May 2009 through June 2010. After discovering the error, DLA Energy personnel requested and received a repayment of $1,469,566 from SK Corporation in October 2010. However, while validating the fees paid under the agreement, we discovered that DLA Energy did not include all of the 14 months when recovering the facility rental fees overbilled. When calculating the overpayment, DLA Energy excluded the facility rental fee for May 2009. When we brought it to their attention, DLA Energy personnel promptly took corrective action and recovered $159,629 from SK Corporation for facility rental fees overbilled. We do not recommend additional actions because the DLA Energy overpayment was an isolated error and did not represent a systemic weakness by DLA Energy personnel.

> *When we brought it to their attention, DLA Energy personnel promptly…recovered $159,629 from SK Corporation for facility rental fees overbilled.*

Service Provider Underpaid DLA Energy $17,151 for an Advance Received

The Bulk Fuel Support Agreement (Agreement) required DLA Energy to pay SK Corporation an advance payment of $1,667,151 to upgrade its facilities appropriate to perform agreed upon services. The Agreement also stated that SK Corporation agreed to repay the advance payment by offsetting equally prorated amounts against service charges over the first 5 years of performance.

SK Corporation personnel provided documentation to show that they repaid the advance by reducing service charges from $0.78 to $0.66 per barrel for storage, and $1.22 to $1.04 per barrel for other facility rental fees. We verified that $0.66 and $1.04 were charged as claimed. However, the amount that SK Corporation repaid by reducing service charges for the 5-year period was $1,650,000, which was $17,151 less than the advance that SK Corporation received. The discrepancy occurred because SK Corporation personnel used values from Microsoft Excel spreadsheets that carried decimal points throughout the calculation process when projecting the advance and repayment. Yet, for billing, SK Corporation personnel used service charges resulting from rounding to the nearest cent. It also appeared that DLA Energy personnel did not thoroughly verify the calculation before they incorporated the advance and repayment provisions in the Agreement. DLA Energy should recover $17,151 from SK Corporation.

DLA Energy personnel did not identify small calculation errors in the documentation used to support the basis of the repayment calculation, and did not maintain adequate documentation of the negotiations supporting the Agreement. We obtained additional documentation from SK Corporation personnel to verify the basis for the repayment. Currently, DLA Energy and ROK personnel are working on a new Bulk Fuel Support Agreement to replace the existing agreement, which expires in 2014. DLA Energy personnel should thoroughly review and maintain documentation to support decisions reached for future agreements.

Procedural Improvements Needed for the Fuel Exchange Agreement

Under the Fuel Exchange Agreement, DLA Energy maintained a separate account for the ROK Army, Air Force, and Navy. Each ROK Service and DLA Energy personnel (the Parties) reconciled each account quarterly by offsetting fuel balances using the oldest transaction first. The Parties repaid the remaining balance owed either by replacement-in-kind or in cash, except for the ROK Army, which transferred its balances to the ROK Air Force for settlement.

During FY 2009 through FY 2010, the ROK Navy paid $6,980,530 to settle the fuel balances. However, we discovered instances where the ROK Services erroneously used incorrect exchange rates to convert Korean Won into U.S. dollars and incorrect standard fuel prices, which raised the costs of ROK-owned fuels charged to DLA Energy. DLA Energy personnel stated that they did not verify all the data elements ROK Services presented for reconciliation. As a result, the ROK Navy underpaid DLA Energy by $6,137. The ROK Navy has agreed to pay the underpayment.

For the same 2-year-period, the ROK Air Force settled the fuel balances three times in cash, paying $6,303,113 in total after offsetting the balances transferred from the ROK Army. However, the account balances in the settlements contained procedural errors, which resulted in a net underpayment of $9,446 by DLA Energy.

The discrepancies occurred because DLA Energy, the ROK Army and the ROK Air Force:

- did not use ROK standard fuel prices to calculate costs of ROK ground fuel supplied to the U.S.;
- did not account for fuel balances transferred from the ROK Army as fuel-by-fuel replacement;
- inconsistently used U.S. & ROK standard prices to convert ROK ground fuels to JP8 aviation fuel equivalent; and
- used an exchange rate for a month that was incorrect.

As a result, DLA Energy received a net overpayment of $3,309 ($6,137 minus $9,446) from the ROK Services. For recent reconciliations, the Parties began to use standard fuel prices of the supplying party in calculating the costs of ground fuel and converting them to JP8 fuel equivalent, which was consistent with the agreement. However, DLA Energy should improve the reconciliation process by placing additional controls and procedures to prevent and detect data errors as well as properly account for fuel balance transfer.

Inconsistent Procedures for Determining Fuel Pricing for the "Bunker" Contract

DLA Energy paid $77.6 million for 236 fuel deliveries from Korea to ships under contract SP0600-06-D-0384 (Bunker contract) during the 4 years, ending in September 2010. The price for this fuel was based on fuel prices posted from the Platts[2] Bunkerwire report. Our review of the pricing for this fuel showed that DLA Energy personnel did not use the same procedures when choosing the fuel price because they did not interpret the contract consistently for 12 of the 236 deliveries.

Platts Bunkerwire publishes daily fuel prices, Monday through Friday; however, at times, Platts does not publish a daily fuel price. The contract stated the fuel reference price to be used would be Tuesday of the calendar week in which a delivery is made. It further states that if there is no publication on Tuesday of that week, the item's reference price would be the last previously published price before that Tuesday.

There were 12 instances where a delivery was made and Platts Bunkerwire report did not publish a fuel price on Tuesday. DLA Energy personnel used the most recent published price for eight of the deliveries, and the prior Tuesday's published price for four deliveries. At our request, the contracting officer reviewed the contract language, and with coordination and approval by DLA Energy Counsel and Director of Direct Delivery Fuels, stated that the most recent published price should be used when Platts does not publish on Tuesday. As a result, the contractor was underpaid $45,225 for the four deliveries. DLA Energy is taking actions to repay the contractor. DLA Energy should clarify the contract to avoid further inconsistent pricing by DLA Energy personnel.

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[2] Platts is a global provider of energy and metals information and a source for price assessments in the physical energy markets.

Post, Camp, and Station Contracts Should Be Modified to Delete Requirements for Work Not Performed

DLA Energy awarded four, 5-year contracts (known as Post, Camp, and Station contracts) beginning in October 2009 to four Korean commercial companies for purchase and delivery of diesel and unleaded gasoline to various military bases located in Korea. The price per gallon for delivered fuel was based on average prices (which changed every 2 weeks) shown in Platts Oilgram Price report plus a fixed dollar amount per gallon for each delivery site for the contractor's margin. The contracts included an "automatic fill" provision for certain sites, which included multiple fuel tanks used for heating oil (diesel) located at each installation. The "automatic fill" provision required contractors to establish and maintain a delivery schedule to assure that the fuel in each tank is at least 30 percent full, at all times. DLA Energy included the "automatic fill" provision to reduce workload for Government personnel and transfer responsibility of monitoring fuel tanks to the contractor.

Government Personnel Were Performing Functions That the Contractor Was Paid to Perform

The contract included "automatic fill" provisions for several Army installations and Air Force bases. At Army installations (such as Yongsan, Korea and Camp Humphreys), during the heating season, the contractor used three to eight full-time personnel to monitor fuel tank levels and create fuel delivery schedules. However, contractors did not perform this function at Osan Air Base, Korea. Air Force Instruction 23-204, "Organizational Fuel Tanks," June 24, 2009, required fuel tank custodians to secure each fuel tank with a key to protect fuel from misappropriation, contamination, pilferage, and sabotage, which did not allow the contractor to have access to fuel tank levels. Therefore, Air Force personnel checked the status of fuel and scheduled deliveries and the amount of fuel to be delivered.

Review of contract pricing for "automatic fill" site verses sites without "automatic fill" showed price differences of $0.0786 to $0.2857 per gallon for the contractor's margin. For FY 2010, Osan Air Base purchased 2.8 million gallons of diesel heating oil under contract SP0600-09-D-1258. The difference in margin for this quantity of heating oil purchased for Osan Air Base was $0.1229 per gallon (or about $340,000).

It should be noted that while the contractor's margin was higher for delivery of diesel heating oil, there were other variables in determining price per gallon, such as the distance of delivery and the number of tanks to be filled. Therefore, the potential price reduction would probably be less than $340,000. However, the fact that the contractor was using up to eight employees at Yongsan to perform the "automatic fill" function indicates that modifying the contracts to reduce the cost for services not performed should reduce fuel costs at Osan Air Base.

If DLA Energy personnel had performed adequate research before awarding the contract, the solicitation may have excluded this requirement. Also, if a COR had been appointed to properly monitor the contractor's performance, DLA Energy may have discovered the

problem and modified the contracts to reduce the cost. DLA Energy should modify the applicable contracts to delete the "automatic fill" function for Osan Air Base.

Recommendations, Management Comments, and Our Response

We recommend the Commander, Defense Logistics Agency Energy:

1. Recoup the funds from contract SP0600-09-C-5904 with AHN Tech-Korea for services not provided and modify the contract. Specifically,

a. Recoup the monthly fee of $6,895.96 for a cash sales operation since the inception of the contract and modify the contract to eliminate this charge from future monthly payments.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, partially agreed and stated that the Defense Logistics Agency received notification to discontinue services on January 9, 2011, and has already recouped some of the funds. While AHN Tech-Korea adhered to the terms of the contract by manning the Camp Humphreys service station, the contracting officer will notify the contractor that he plans to recoup additional funds. However, Defense Logistics Agency personnel are uncertain of the amount of funds that will be recouped.

Our Response

Comments from the Director, Defense Logistics Agency Acquisition are responsive. We support the effort to recoup overpayments in fees from AHN Tech-Korea. Although AHN Tech-Korea was not legally bound to remove the charges until officially notified by the contracting officer, AHN Tech-Korea should have removed the charges for the cash sales function that it did not perform since the inception of the contract. Defense Logistics Agency Energy personnel stated that the contractor continued to man the service station even though it did not provide a cash sales function. However, when we visited the Camp Humphreys service station, AHN Tech-Korea did not have additional personnel for cash operations, which it showed were needed in its final proposal dated December 10, 2008. Therefore, we expect AHN Tech-Korea to fully cooperate in refunding the overpayments that we identified in our audit report. We hope that Defense Logistics Agency Energy personnel will consider the contractor's response in returning the funds when it evaluates the contractor's past performance.

b. Recoup an estimated $64,078 (as of January 31, 2011) for services not provided upon closure of the service stations at Camps Eagle, Long, and Stanley.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, partially agreed and stated that $61,897 was recouped from the contractor. Defense Logistics Agency Energy did not agree with our estimate that the contractor should receive only 25 percent of the monthly

payment after operations at Camps Eagle, Long, and Stanley ceased. However, the contracting officer is working with the COR to determine what services were discontinued. The COR will quantify the discontinued responsibilities in terms of contractor-required manning, and the contracting officer will determine actions necessary and recoup additional funds by November 15, 2011.

Our Response

Comments from the Director, Defense Logistics Agency Acquisition are responsive. The information shown in this report, which we confirmed with the COR, already gives enough data to provide Defense Logistics Agency Energy personnel with a reasonable basis for negotiating additional funds to be recouped. Because neither the contracting officer nor the COR implemented effective procedures to curtail the monthly payments when the service stations closed, Defense Logistics Agency Energy personnel will have to negotiate with AHN Tech-Koreato recoup funds paid in the past. As previously stated, we hope the results of these negotiations are considered when Defense Logistics Agency Energy evaluates the contractor's past performance.

c. Require all contractor invoices to be approved by the contracting officer's representative.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, agreed and stated that the contracting officer will modify the contract by September 13, 2011, and require that all invoices be certified by the COR before submission to DFAS.

d. Specify the amount of reductions to the monthly fee if cash sales are discontinued or normal service is curtailed before cleaning out the fuel tanks after operations cease.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, agreed and stated that the contracting officer will modify the contract by November 15, 2011, to include language in the performance work statement that outlines procedures to follow for a facility to be considered "closed." The contracting officer will modify the contract to address measures that the Government will take to negotiate the potential reductions in the contract price and to ensure that a balance is maintained between the level of contractor effort necessary to fulfill contractual obligations and the payment for these actions.

2. Review the performance of the officials responsible for providing oversight of contract SP0600-09-C-5904 and validating the payments to AHN Tech-Korea and based on the results consider any corrective actions, as appropriate.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, agreed and stated that the original COR relinquished his duties. Defense Logistics Agency Energy personnel implemented

standard operating procedures for the Army COR to use as a guide in monitoring the contractor's performance. Defense Logistics Agency Energy personnel also met with the COR, installation personnel, and the contractor to enhance contract oversight. As a result of this effort, Defense Logistics Agency Energy prepared multiple recommendations to improve oversight, which are being implemented. For example, communication between the COR and the contracting office has increased as exemplified in the recent creation of a shared portal intended to house information pertaining to the subject contract and to facilitate discussion of outstanding issues.

3. Recompete contract SP0600-09-C-5904 when it expires at the end of 5 years rather than exercising a new 5-year option, as shown in the contract, unless Defense Logistics Agency Energy can effectively determine and document that awarding an additional option is in the best interest of the Government.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, agreed and will comply with the requirements in the Federal Acquisition Regulation regarding the exercising of options, which requires the Government to recompete a contractual requirement, if the exercise of an option is not in the best interest of the Government.

4. Enforce the provisions of AHN Tech-Korea's standard operating procedures requiring adequate documentation for fuel issued to DoD customers.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, agreed and stated that the COR distributed a memorandum to AHN Tech-Korea and applicable Army personnel reminding them of the requirements on March 11, 2011. The Director, Defense Logistics Agency Acquisition, also stated that the COR provided samples of forms and instructions on how to properly complete them. Also, Defense Logistics Agency Energy personnel modified the contract to incorporate this language on August 16, 2011.

5. Request SK Corporation to return the remaining $17,151 balance of the $1.7 million advance it received in 2004, and establish procedures to ensure the Defense Logistics Agency Energy thoroughly reviews and maintains documentation to support future international agreements.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, agreed and stated that SK Corporation agreed to repay $17,151 to settle the debt in full. In addition, in June 2011, Defense Logistics Agency Energy personnel implemented a new Defense Logistics Agency Energy International Agreement Program Instruction, which outlines the roles and responsibilities associated with managing international agreements. This instruction also provided procedural guidance for managing funding and record keeping for the Defense Logistics Agency Energy International Agreement Program.

6. Establish additional controls and procedures for the reconciliation process under the Fuel Exchange Agreement to prevent and detect data errors and to properly account for fuel balance transfers.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, agreed and stated that Defense Logistics Agency Finance Energy added additional controls to the Fuel Exchange Agreement reconciliation spreadsheet to allow for increased oversight. Tables of standard prices and exchange rates have also been added to automatically calculate costs to each individual transaction instead of a sum total. This will ensure that the oldest transactions are offset first when calculating gallon for gallon offsets.

7. Clarify the pricing policy for fuel deliveries in contract SP0600-06-D-0384 and, if necessary, reimburse the contractor for underpayments caused by the inconsistent interpretation of the contract by Defense Logistics Agency Energy personnel.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, agreed and stated that Defense Logistics Agency Energy personnel clarified their pricing policy. Also, Defense Logistics Agency Energy personnel and the contractor have resolved all pricing issues.

Our Response

Comments from the Defense Logistics Agency for Recommendations 1.c. through 7 are responsive. We accept all proposed or completed actions in response to the report. No additional comments are required.

8. Renegotiate and modify contract SP0600-09-D-1258 to delete the "automatic fill" function at Osan Air Base to reduce the costs of heating fuel delivered, and appoint a contracting officer's representative to monitor adherence to the terms of the Post, Camp, and Station contracts.

Defense Logistics Agency Comments

The Director, Defense Logistics Agency Acquisition, agreed and stated that Air Force submitted a validated requirement for the "automatic fill" function when Defense Logistics Agency Energy issued the solicitation for the contract. However, at approximately the same time that Defense Logistics Agency Energy issued the contract [the contract began in October 2009], the Air Force issued an instruction requiring its personnel to gauge the fuel tanks and place orders to refill the fuel tanks. Based on this change in Air Force guidance, Defense Logistics Agency Energy personnel will modify the contract by September 30, 2011, to delete the automatic fill requirement.

Our Response

Comments from the Defense Logistics Agency are responsive. However, Defense Logistics Agency Energy personnel have not yet issued the modification in Recommendation 8. Therefore, we request that the Commander, Defense Logistics

Agency Energy, provide comments to the final report indicating the results of these contractual negotiations, so we may finalize the monetary benefits estimated in our report and summarized in Appendix B.

Appendix A. Scope and Methodology

We conducted this performance audit from September 2010 through July 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our announced audit objective included a review of fuel requirements in Korea; however, we are conducting a separate audit of fuel requirements with emphasis on requirements for war reserves and contingency operations.

Our review included the following 16 contracts and 3 international agreements in place during FY 2010. DLA Energy spent $550.8 million on these contracts and agreements during FY 2010. However, we expanded our review in some cases to cover periods before FY 2010, as shown below:

- three bulk fuel contracts, which began in January 2010 (SP0600-10-D-0454, 10-D-0455, 10-D-0451). DoD spent $333.7 million during FY 2010 for fuel purchased using these contracts. DoD also spent $123.6 million during FY 2010 on four contracts (SP0600-09-D-0455, 09-D-0456, 09-D-0459, and 09-D-0461), which expired in December 2009;
- four Post, Camp, and Station contracts (SP0600-09-D-1255, 09-D-1256, 09-D-1257, and 09-D-1258). DoD spent $66.2 million during FY 2010 for fuel purchased using these contracts;
- three international agreements with the ROK for fuel support; DoD spent $21.6 million under the Bulk Fuel Support and Kunsan Pier Agreements for 21 months ending September 30, 2010, and received $13.3 million under the Fuel Exchange Agreement during FYs 2009 and 2010;
- three GOCO contracts (SP0600-08-C-5826, 08-C-5833, and 09-C-5904); DoD spent $3.7 million during FYs 2009 and 2010 for management of fuel support facilities and other services;
- contract SP0600-06-D-0384 (Bunker Contract); DoD spent $77.6 million during the 4 years ended September 2010 for fuel delivered from Korean commercial companies to various ships loaded from bunker barges in Korea; and
- contract SP0600-07-D-0465 for “Turbine Fuel, Aviation, Thermally Stable” JPTS fuel. DoD spent $1.5 million for this fuel during FY 2010.

We interviewed DLA Energy and other responsible personnel (including contracting officers and specialists, quality assurance representatives, CORs, logistics, inventory management, and financial specialists) to obtain an understanding of DLA Energy’s fuel contracts and international agreements, and evaluate management of wholesale fuel operations in Korea.

We obtained and reviewed the following information:

- contracts and associated supporting documents, inspection and receiving reports, quality control plans, fuel receipts, fuel discrepancy reports, and contract activity reports for pricing and quality controls/assurance, and controls over fuel delivery and receipt;
- fuel receipts, end-of-month inventory reports, issue/transfer/distribution documentation for support of GOCO sites; and
- Memorandums of Agreement and associated supplements and available supporting documentation, and reconciliation documents to validate the accuracy of payments and fuel account balances.

We verified payments by DFAS of $854 million for the bulk fuel contracts, $66.2 million for the post, camp, and station contracts; and $77.7 million for the bunker contract. We reviewed the quantity from receiving reports against DFAS' contract activity reports. We also compared DFAS' contract activity reports with DLA Energy's fuel price Web site to verify that the price per gallon was correct. We visited two (Kunsan and Pohang) of the three GOCO bulk fuel storage facilities and the testing laboratory at Pyeongtaek operated by PAE Korea Limited and verified the accountability of the Government-furnished equipment provided. We also verified the accuracy of the monthly service charges for these facilities paid by DFAS.

We visited and observed GOCO operations from six of the seven Army service stations in Korea located at Camps Humphreys, Walker, Carroll, Casey, Red Cloud, and Yongsan Army Garrison and the GOCO operation at Osan Air Base under a different contract. We also verified the accuracy of the monthly service fees for operating these stations. Estimated overpayments for the Army GOCO contract are discussed in the report.

We recalculated fees based on the Bank of Korea Consumer Price indices to evaluate the accuracy of payments for the Memorandums of Agreement. We conducted an analysis of the issue and replacement transactions that occurred under the Fuel Exchange Program to validate fuel account balances and assessed the monetary effects of discrepancies if any. We confirmed the receipt of the advance payment by the contractor and tried to verify the contractor repayment of the advance payment.

For the Bunker contract, we assisted the Naval Criminal Investigative Service in investigating several quantity disputes made by Navy and Military Sealift Command personnel. The support included, conducting analysis of the disputes with bunker fuel deliveries over quantity received, by reviewing documentary support from both the contractor and vessel; and observing a bunker fuel delivery and asking inquiries to fuel experts on the quantity disputes. At the time of the audit, neither we nor the Naval investigators had been able to determine the cause of these alleged shortages. Near the end of the audit, DLA Energy quality assurance personnel began taking a more active role in observing these fuel purchases to tighten controls to validate whether actual shortages existed.

Use of Computer-Processed Data

We relied on DLA Energy's Web-posted fuel prices, which came from Platts Oilgram Price Reports, as specified in the applicable contracts. DLA Energy's Web-posted fuel prices present the daily, weekly, and bi-weekly fuel prices for the Fuel contracts procured by DLA Energy. The fuel published prices are taken into DLA Energy's information system, which executes calculations to determine the new fuel price. We used the fuel prices to validate the accuracy of contract payments. We compared DLA Energy's Web-posted fuel prices with the contract activity reports to determine whether the correct fuel price was used. We also performed a limited analysis of the same calculations used to derive the new fuel price. From these procedures, we are confident that DLA Energy's Web-posted fuel prices are sufficiently reliable for the purpose of validating the accuracy of contract payments.

Prior Coverage

During the past 5 years, the DoD Office of Inspector General issued one report related to DLA Energy fuel contracts. This report can be accessed at http://www.dodig.mil/audit/reports.

DoD Inspector General

DoD IG Report No. D-2006-094, "Improper Payments of Defense Fuel," June 29, 2006

Appendix B. Summary of Potential Monetary Benefits[1]

Recommendations	Type of Benefit[2]	Amount of Benefit	Account
None.	Economy and Efficiency. Contract amended.	$57,550[1]	**97X4930.5CF0**
1.b.,c., and d.	Economy and Efficiency and Internal Controls. Recovers payments for work not performed.	$64,078	**97X4930.5CF0**
1.a.,c., and d.	Economy and Efficiency and Internal Controls. Recovers costs for work not performed.	$413,758[3]	**97X4930.5CF0**
None.	Economy and Efficiency. Recovers overbilling by contractor.	$159,629[1]	**97X4930.5CF0**
5.	Economy and Efficiency and Internal Controls. Recoups advance paid to service provider.	$17,151	**97X4930.5CF0**
8.	Economy and Efficiency. Recommends renegotiation on contract for services not provided by the contractor.	Undeterminable	
	Total	**$712,166**	

[1]$712,166 in monetary benefits include $217,179 ($57,550+$159,629) already achieved.
[2]Potential monetary benefits are questioned costs.
[3]Calculation based on the monthly bill of $6,895.96 for a cash sales operation at the Camp Humphreys service station for the 5-year contract. The contractor already billed $144,815 of the $413,758 as of January 31, 2011.

Defense Logistics Agency Comments

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AUG 3 1 2011

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Better Management of Fuel Contracts and International Agreements in the Republic of Korea Will Reduce Costs (Project No. D2010-D000LZ-0272.000)

The Defense Logistics Agency (DLA) has reviewed the Department of Defense Inspector General (DoDIG) Draft Report regarding the Audit of Bulk Fuel Operations in the Republic of Korea. DLA concurs with recommendations 1 through 8. Please find specific responses and additional clarification below:

1. **Recoup the funds from contract SP0600-09-C-5904 with AHN Tech-Korea for the services not provided and modify the contract.**
   a. **Recoup the monthly fee of $6,895.96 for a cash sales operation since the inception of the contract and modify the contract to eliminate this charge from future monthly payments.**

PARTIALLY CONCUR – Notification from DLA's customer to discontinue the services included in the contract was received on January 09, 2011 at which time the contract was modified to remove the requirement for the manning of the service station at Camp Humphreys.

The Performance Work Statement specifies that Camp Humphreys was to be manned during Duty Hours (C-5.1.1.2 Cash Sales and Figure 4). While the Contractor adhered to the terms of the contract by manning the service station, DLA Energy concurs that it will seek reimbursement from the contractor. Although some funds have already been recouped, the Contracting Officer will notify the contractor of DLA Energy's intent to pursue possible recoupment of funds paid by September 30, 2011 and recoup any additional overpayment (if any) November 15, 2011. DLA Energy is partially concurring because of the uncertainty of the amount of funds that may be recouped as a result of this effort

   b. **Recoup an estimated $64,078 (as of January 31, 2011) for services not provided upon closure of the service stations at Camps Eagle, Long, and Stanley.**

PARTIALLY CONCUR - The contract required manning during prescribed hours of operation for Camp Long, while Camps Stanley and Eagle were not required to be manned. In order for the three facilities to be considered "closed" in accordance with the requirements of the contract, procedures must be followed. Proper notification by the Contracting Officer's Representative (COR) must be given to the Contracting Officer (CO) to ensure that contract file is adequately documented and ample notification is provided to the Contractor. Once the notification (verbally or written) is given, the CO prepares a modification to the contract. During the base closure process, the Performance Work Statement states at Paragraph C-3.1 - General scope of work, states "the contractor will be responsible for operating and maintaining the facilities to ensure safe and accurate receipt, storage, transfer, issue, quality control, and accounting for Defense Working Capital (DWCF) – owned petroleum products under their control."

Funds paid after final closure of the three bases, totaling $61,897.42 have already been recouped from the Contractor. The report suggests that additional sums should be recouped from the Contractor. An amount of $64,078 is calculated based on a 25 percent figure which was "assumed to be reasonable". While DLA Energy does not agree that there was a 75 percent reduction in the manning and costs associated with contractual obligations resulting from the base closure process, it does concur that additional funds may be recouped. Rather than apply the 75 percent reduction, the reduction in cost should utilize the Contractor's actual reduction in costs and manning (if any). The Contracting Officer is working with the COR to determine what services included in the Performance Work Statement were discontinued and at what point these occurred. These discontinued responsibilities need to be quantified in terms of Contractor-required manning. Costs identified would then become part of a reduction in overall services and will likely require negotiation with the Contractor. The Contracting Officer is requesting necessary information to take appropriate action from the COR and Contractor and will make a determination on appropriate actions necessary by September 30, 2011 and will recoup any associated funds by November 15, 2011.

c. Require all contractor invoices to be approved by the contracting officer's representative

CONCUR – The contract clause covering payments of fixed monthly fees for Government Owned Contractor Operated services is being modified to have all Contractor invoices sent to the COR for certification prior to going to DFAS. The contract modification will be done by September 13, 2011.

d. Specify the amount of reductions to the monthly fee if cash sales are discontinued or normal service is curtailed before cleaning out the fuel tanks after operations cease.

CONCUR – DLA Energy recognizes that, despite the fact the contract was a performance based service contract, some consideration must be given to pre-established mechanisms for potential price reductions during base closure processes. The contract will be modified to include language in the Performance Work Statement that outlines procedures that must be followed in order for a facility to be considered closed. The contract modification will also address measures that the Government will take to negotiate a potential reduction in contract price and to ensure that a balance is maintained between the level of Contractor effort necessary to fulfill contractual obligations in the Performance Work Statement and the payment for these actions. The Contracting Officer expects to modify the contract by November 15, 2011.

2. **Review the performance of the officials responsible for providing oversight of the contract SP0600-09-C-5904 and validating the payments to AHN Tech-Korea and based on the results consider any corrective actions as appropriate.**

CONCUR – DLA Energy has taken actions to address this situation. At the desire of the Army Installation Management Command (IMCOM), they retain COR responsibility for this contract. The COR originally responsible for this contract relinquished his duties to a newly hired, full time COR in January of 2010. In order to address oversight concerns, DLA Energy has prepared a Standard Operating Procedure specific to this contract that will be used by the COR as a guide to assist in the day-to-day monitoring of the Contractor's performance. DLA Energy representatives traveled to Korea to meet with the COR, base personnel, and the Contractor to enhance contract oversight. As a result of this effort, multiple recommendations were generated that are now being implemented. For example, DLA Energy has implemented a procedure for quarterly COR Oversight visits from DLA Energy Korea personnel. The COR also participates in the monthly Inventory Management conference calls and provides a monthly schedule that outlines the locations to be visited during the month. After these visits the COR prepares a site visit report that is provided to the CO and DLA Energy Pacific leadership. Communication between the COR and the Contracting Office has increased as exemplified in the recent creation of a shared portal intended to house information pertaining to subject contract and to facilitate discussion of outstanding issues.

3. **Recompete contract SP0600-09-C-5904 when it expires at the end of 5 years rather than exercising a new 5-year option, as shown in the contract, unless Defense Logistics Agency Energy can effectively determine and document that awarding an additional option is in the best interest of the Government.**

CONCUR – DLA Energy will comply with FAR procedures at 17.207 covering the exercising of options which requires the Contracting Officer to determine and document that the option is the most advantageous method of fulfilling the Government's need. If the exercise of the option is not in the best interest of the Government, as document by the market research, DLA Energy will recompete the requirement.

4. **Enforce the provisions of AHN Tech-Korea's standard operating procedures requiring adequate documentation for fuel issued to DoD customers.**

CONCUR – This issue was addressed during the DLA Energy site visit during meetings with Contractor personnel. On March 11, 2011 the COR has distributed a memorandum to the Contractor and Army personnel that, among other things, states that "only DoD approved 5-gallon containers and/or 55-gallon drums will be used to receive and transport the fuel" and that "the maximum daily issue per request will be 110 gallons." The memorandum also provided samples of forms and provided information on how to properly complete them and reminded all

that "retail fuel attendants will not issue fuel if conditions" were not met. DLA Energy issued a modification to incorporate this language into the contract on August 16, 2011.

5. **Request SK Corporation to return the remaining $17,151 balance of the $1.7 million advance it received in 2004, and establish procedures to ensure the Defense Logistics Agency Energy thoroughly reviews and maintains documentation to support future international agreements.**

CONCUR - SK Corporation has agreed to repay $17,151 balance due from the 2004 Advance Payment. SK Corporation has agreed to credit an invoice for the amount owed and settle the debt balance in full.

Since the signing of the agreement in 2004, DLA Energy-Bulk has refined the agreement process to a "centrally managed" program. The change helped standardize the DLA Energy review and approval process for each bi-lateral fuel agreement. The change also produced program efficiencies and was later included in a rewrite of DOD 4140.25M, Chapter 17 governing the International Agreement Program.

On June 24, 2011, DLA Energy implemented a new DLA Energy Instruction outlining roles and responsibilities associated with International Agreement Financial Stewardship. The instruction establishes the DLA Energy policies, responsibilities, and procedures necessary to administer financial stewardship functions for the DLA Energy International Agreement Program (IAP). This Instruction also provides procedural guidance for managing funding and record keeping for agreements established under DLA Energy International Agreement Program.

The instruction also enforces a centrally managed process with specific roles and responsibilities delegated to the Regional/sub-Regional Offices.

6. **Establish additional controls and procedures for the reconciliation process under the Fuel Exchange Agreement to prevent and detect data errors and to properly account for fuel balance transfers.**

CONCUR - DLA Finance Energy concurs with the recommendations to establish additional controls and procedures for the reconciliation process under the Fuel Exchange Agreement (FEA).

Additional controls have been added to the Republic of Korea (ROK) FEA reconciliation spreadsheet that allows for increased oversight. Tables for ROK standard prices and exchange rates have been added to the spreadsheet that will aid in automatically calculating costs. Procedural changes have been made to properly account for transactions that have been deferred from one reconciliation to another on a fuel-by-fuel replacement basis. The new procedure is to bring all deferred transactions over individually instead of as a sum total. Bringing each deferred transaction over will ensure that the oldest transactions are offset first when doing the gallon for

gallon offset. Personnel involved with the ROK reconciliation have been briefed and understand all changes. The new procedure was implemented in the ROK Air Force reconciliation that was conducted in July 2011.

7. **Clarify the pricing policy for fuel deliveries in contract SP0600-06-D-0384 and, if necessary, reimburse the contractor for underpayments caused by the inconsistent interpretation of the contract by Defense Logistics Agency Energy personnel.**

CONCUR – DLA Energy has clarified the pricing policy with DLA Energy personnel. According to the contract, DLA Energy personnel will use the most recently published pricing data to determine the fuel reference price. Electronic system issues will also be continually monitored when instances of non-publication of prices occurs and will be emphasized during the migration to EBS. DLA Energy and the Contractor have resolved all pricing issues.

8. **Renegotiate and modify contract SP0600-09-D-1258 to delete the "automatic fill" function at Osan Air Base to reduce the costs of heating fuel delivered, and appoint a contracting officer's representative to monitor adherence to the terms of the Post, Camp, and Station contracts.**

CONCUR - DLA has coordinated with the Air Force Petroleum Agency regarding the scope and impact of the Air Force Instruction 23-204. At the time DLA Energy issued the solicitation, the customer submitted a validated requirement for auto fill. The customer did not advise DLA Energy that it changed its requirement by issuing an instruction to have its personnel gauge the tanks and place orders. Further, the Air Force issued its instruction at approximately the same time as the contract award. Based on the change in guidance set forth in the Air Force Instruction, DLA Energy will modify the contract by September 30, 2011 to delete the auto fill requirement.

We appreciate the opportunity to provide this additional information and clarification regarding our actions in response to the draft report.

NANCY M. HEIMBAUGH
Director, DLA Acquisition

AUG 3 1 2011

Inspector General
Department of Defense