

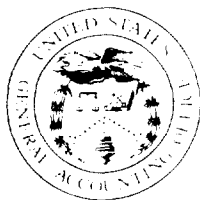
GAO

Report to the Chairman, Environment,
Energy, and Natural Resources
Subcommittee, Committee on Government
Operations, House of Representatives

June 1989

ENERGY MANAGEMENT

DOE Has Not Shown Systems Contracting to Be in Government's Best Interest



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Resources, Community, and
Economic Development Division

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June 20, 1989

The Honorable Mike Synar
Chairman, Environment, Energy,
and Natural Resources Subcommittee
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

At your request, we examined the use of systems contracting by the Department of Energy's (DOE) operating contractors¹ to determine whether DOE is ensuring that systems contracting is in the government's best interest. Specifically, we examined DOE's management and oversight to determine (1) whether DOE has adequately evaluated the costs and benefits of systems contracting and (2) whether DOE has ensured that operating contractors have adequate internal controls over purchases made under systems contracting.

Systems contracting is a method of procuring a family of items—such as office, industrial, and laboratory supplies—from a vendor, who agrees to maintain an inventory of specified items and deliver them at a specified price as they are needed by the operating contractor. As of August 1988, DOE's operating contractors had awarded 110 systems contracts.

As agreed with your office, we focused on the first systems contract issued by a DOE contractor—the office supplies contract awarded by Sandia National Laboratories, located in Albuquerque, New Mexico. We concentrated on Sandia's office supplies contract because it has been in existence the longest and because it was the second most costly of Sandia's 33 systems contracts—about \$4.8 million of the almost \$60 million Sandia spent under all of its systems contracts from April 1985 through September 1988. (See app. II.)

Results in Brief

DOE has not shown that systems contracting is in the government's best interest. While DOE has cited Sandia's positive experience with systems contracting as a basis for encouraging its other operating contractors to consider systems contracting, it has not independently evaluated the costs and benefits of systems contracting or verified Sandia's studies

¹Operating contractors are the private firms or universities that DOE contracts with to operate its nuclear research and production facilities.

claiming savings and other benefits. Further, we found that Sandia could not adequately support the systems contracting benefits cited in internal evaluations. DOE also has not required Sandia to have adequate internal controls in place to ensure that (1) the items purchased under its systems contract for office supplies are the least expensive ones available to accomplish the intended purpose and (2) the prices of items added to the systems contract are competitive.

DOE Has Not Evaluated or Verified the Costs and Benefits of Systems Contracting

DOE has not independently evaluated the costs and benefits of systems contracting, nor has it verified Sandia's claims regarding its merits. In December 1987, the DOE Inspector General reported that DOE had not evaluated the costs and benefits of systems contracting to determine whether this procurement method should be encouraged or discouraged departmentwide. Further, in an April 1988 letter to DOE, the Environment, Energy, and Natural Resources Subcommittee of the House Committee on Government Operations urged DOE to study the feasibility and the costs and benefits of operating contractors' using alternative procurement systems, such as systems contracting, and acquisitions through the General Services Administration (GSA). Despite the Inspector General's findings and the Subcommittee's urging, DOE has yet to independently evaluate the costs and benefits of systems contracting. Even so, its use has been increasing, and DOE has encouraged other operating contractors to consider adopting this procurement method. DOE cites Sandia's positive experience as the basis for encouraging its other operating contractors to consider systems contracting but has not verified Sandia's claims. As of August 1988, 15 of DOE's 17 operating contractors had awarded systems contracts.

In our view, because the methodology used to estimate cost savings has excluded several essential cost factors, Sandia's estimates are questionable and Sandia has not demonstrated that systems contracting is in the government's best interest. In estimating savings from systems contracts, Sandia does not consider changes in unit prices or increases in use that have occurred since the contracts were implemented. Additionally, in estimating the savings from its office supplies contract, Sandia considered only 21 of the 238 items whose prices were established when the contract was awarded. By March 1988, Sandia had purchased almost 9,000 different items under the office supplies systems contract. Sandia did not analyze whether any savings were obtained from these additional items. Further, after more than 4 years of using systems contracts, Sandia has not documented the actual savings that have resulted; instead, it continues to provide DOE with estimated savings.

Sandia's cost savings estimates are also questionable because Sandia did not compare the costs and benefits of buying its office supplies under a systems contract with the costs and benefits of buying those supplies from GSA. DOE requires operating contractors to use GSA when it is economically advantageous to the government. DOE periodically reviews the operating contractors' procurement systems to, among other things, examine the operating contractor's compliance with DOE regulations, such as those concerning the use of GSA. DOE's 1985 review of Sandia's procurement system—the only one conducted at Sandia since systems contracting was implemented—did not cover Sandia's use of GSA. DOE officials, therefore, were unaware that Sandia had not compared systems contracting costs with GSA prices before using systems contracting. Further, our analysis of a small, judgmentally selected sample of office supply items showed that some items were available from GSA at lower prices. While our sample cannot be used to reach conclusions concerning the overall costs and benefits of systems contracting, it illustrates the need for such an analysis before awarding a systems contract for items provided by GSA. (See app. I for details on these issues.)

Some Controls Over Purchases Under Sandia's Systems Contract Not Adequate

DOE has not ensured that Sandia has adequate internal controls over items being purchased under a systems contract. Each of Sandia's approximately 7,200 Albuquerque-based employees can generally order any item under \$1,000 from the systems contractor's office supplies catalog without supervisory approval. According to the contract, the systems contractor is to inform the employee when similar, less costly items are available from the contractor's inventory that could be substituted. However, even if less costly items are available, the employees are not required to purchase them or justify decisions to order more expensive items. Further, although purchases receive post-purchase supervisory review, items costing less than \$25 cannot be returned.

DOE also has not required Sandia to establish internal controls to ensure that items added to a systems contract are obtained at the lowest price consistent with requirements for timeliness and quality. Sandia's office supplies contract was competed on the basis of price bids for 238 items and technical factors, such as the ability to meet delivery time frames and the diversity of items carried. Sandia, however, has purchased almost 9,000 different items from the office supplies systems contractor. The 238 items for which price quotations were originally submitted now comprise about 3 percent of the items provided by the systems contractor. Furthermore, Sandia's estimate of the value of the contract for a 5-year period has increased from \$2.8 million to about \$7.5 million. Given

the magnitude of the change, it is questionable whether the package that was offered for bid is representative of the universe of items now being purchased under the contract. In addition, because the items added to the systems contract were not competitively bid, it is unknown whether other vendors could have supplied the additional items at lower cost to the government. (See app. I for additional details.)

Conclusions

Although DOE has cited Sandia's positive experience as a basis for encouraging other operating contractors to use systems contracting, DOE has not (1) independently reviewed the costs and benefits of systems contracting or (2) evaluated Sandia's studies. Accordingly, it has not shown that the operating contractors' use of systems contracting is in the government's best interest. Further, DOE has not required Sandia to establish adequate internal controls over purchases under its office supplies systems contract. Although we do not know the extent to which inadequate controls may exist over purchases under other systems contracts, the potential exists for problems similar to those we identified at Sandia.

Recommendations

To help ensure that the operating contractors' use of systems contracting is in the best interest of the federal government, we recommend that the Secretary of Energy

- enforce its requirement that GSA be used when it is economically advantageous to the government by having the operating contractors compare and evaluate the costs and benefits of systems contracting with purchases from GSA before awarding such contracts, and
- require DOE operating contractors to provide detailed documentation supporting their evaluations and independently review the contractors' evaluations.

Further, because of problems we identified with the implementation, administration, and oversight of Sandia's office supplies contract, we recommend that the Secretary

- require Sandia to establish adequate internal controls to help ensure that (1) the lowest-cost items available under a systems contract are selected unless otherwise justified and (2) items added to the systems contract are obtained at the lowest prices consistent with requirements for quality and timeliness, and

- determine whether other operating contractors have established adequate controls over their purchases under systems contracts and, if not, require them to establish such controls.

Scope and Methodology

To obtain information and opinions on systems contracting, we reviewed Sandia's feasibility study and interviewed Sandia, DOE, and GSA officials. To evaluate Sandia's use of systems contracting, we reviewed information and internal controls related to Sandia's office supplies contract—the first systems contract Sandia awarded. We also judgmentally selected a sample of items available from the office supplies contract and compared their prices with those of the same or comparable items available through GSA. Because our sample size was limited, our results are not statistically representative of the universe of contract item prices. (See app. III for more information on our scope and methodology.)

We performed our review from August 1987 through October 1988 in accordance with generally accepted government auditing standards. We discussed our review results with agency officials and incorporated their comments as appropriate. However, at your request, we did not obtain official agency comments on a draft of this report.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time we will send copies to the Secretary of Energy and the Director, Office of Management and Budget. We will also make copies available to other interested parties upon request.

This review was performed under the direction of Keith O. Fultz, Director, Energy Issues. Other contributors to this report are listed in appendix IV.

Sincerely yours,



J. Dexter Peach
Assistant Comptroller General

Contents

Letter		1
Appendix I		8
DOE's Oversight of Operating Contractors' Use of Systems Contracting Is Inadequate	What Is Systems Contracting?	8
	DOE Has Not Verified the Costs and Benefits of Systems Contracting	9
	DOE Has Not Ensured That GSA Is Considered as a Supply Source	12
	DOE Has Not Ensured That Adequate Controls Were Established Over Sandia's Purchases	17
	DOE Has Not Ensured That Items Added to Sandia's Systems Contracts Are Obtained at Lowest Prices	18
	A Case Study Illustrates Problems With Systems Contracting at Sandia	19
Appendix II		21
Sandia's Systems Contracts and Payments as of September 30, 1988		
Appendix III		22
Scope and Methodology		
Appendix IV		23
Major Contributors to This Report	Resources, Community, and Economic Development Division, Washington, D.C.	23
	Denver Regional Office	23
Tables		
	Table I.1: Comparison of Systems Contractor and GSA Prices for 20 Stock Items	15
	Table I.2: Comparison of Systems Contractor and GSA Prices for 20 Nonstock Items	16

Contents

Abbreviations

DOE	Department of Energy
GAO	General Accounting Office
GSA	General Services Administration

DOE's Oversight of Operating Contractors' Use of Systems Contracting Is Inadequate

Under contracts with the Department of Energy (DOE), operating contractors—who are either private firms or universities—operate a network of 17 government-owned research laboratories and production plants to produce nuclear weapons for our national defense. The operation of these research and production facilities costs about \$8 billion annually. The contracts between DOE and the operating contractors are fully reimbursable, cost-type contracts (i.e., contractors receive full reimbursement from DOE for all costs incurred).

DOE's operating contractors, in purchasing personal property items—such as office, industrial, and laboratory supplies—are using a procurement method called systems contracting. Sandia National Laboratories (Sandia), a wholly owned subsidiary of AT&T Technologies Corporation, awarded the first systems contract in 1985. As of August 1988, 15 of DOE's 17 operating contractors had awarded a total of 110 systems contracts.

What Is Systems Contracting?

In contrast to typical federal procurement practices, systems contracting shifts the responsibility of acquiring and maintaining inventory from the operating contractor to local vendors. It stresses awarding a single contract for the purchase and delivery of commonly used items on an "as needed" basis rather than purchasing items in bulk and storing them in inventory. Under a systems contract, the vendor (i.e., the systems contractor) agrees to stock and supply, at specified prices, all commonly used items in a particular product family. In return, the operating contractor agrees to purchase stock items (frequently ordered items) from the systems contractor. The systems contractor also offers nonstock items (infrequently ordered items) at a discount from list prices. Systems contracts generally run from 3 to 5 years to allow the development of a long-term relationship between the operating contractor and the systems contractor that would (1) encourage the systems contractor to make the investments needed to serve the operating contractor's needs and (2) provide a guaranteed volume of business that would allow the systems contractor to negotiate better contracts with suppliers.

According to Sandia, the advantages of using systems contracting include eliminating warehousing costs and space, and frequent and timely deliveries of stock and nonstock items. Systems contracting also lowers purchasing and administrative costs by reducing the number of purchase orders and price quotations needed.

Sandia's Systems Contracts

Sandia's first systems contract—for office supplies—was for a term of 3 years, with two 1-year extension options, and was initially valued at \$560,000 per year, or a total of \$2.8 million for 5 years. The contract is in its first option year, and, as of September 30, 1988, Sandia had spent about \$4.8 million under this contract. Sandia has revised the 5-year contract amount to about \$7.5 million. According to Sandia officials, the contract increased because they had underestimated the demand for office supplies.

In evaluating the bidders on the office supplies contract, Sandia officials gave less weight to cost than to technical capability (i.e., ability to provide the goods in a timely manner and variety of items carried).

Since awarding the office supplies contract in April 1985, Sandia has awarded additional contracts for other commodities. As of September 30, 1988, Sandia's expenditures on 33 systems contracts then in effect totaled over \$59.5 million. Appendix II lists Sandia's systems contracts and expenditures on each as of September 30, 1988. Since that time, Sandia had implemented three additional systems contracts (one for selected electronics, one for testing instrumentation, and one for electromechanical products). According to a Sandia official, Sandia will soon implement four more (one for motor pool services; one for belts, bearings, couplings, etc.; and two for Digital Equipment Corporation computers and supplies).

DOE Has Not Verified the Costs and Benefits of Systems Contracting

Despite concerns raised by the DOE Inspector General and the Environment, Energy, and Natural Resources Subcommittee of the House Committee on Government Operations, DOE has not independently evaluated the costs and benefits of systems contracting. While DOE has cited Sandia's claimed positive experience with systems contracting in encouraging its other operating contractors to implement systems contracts, it has not verified or evaluated Sandia's basis for these claims. Our analysis of Sandia's cost savings estimates found them to be questionable.

According to DOE acquisition regulations (48 C.F.R. 970.7103), operating contractors are to procure items in the manner "most advantageous in meeting the overall mission with price, quality, and timely and efficient performance of the contract considered." Because DOE has not independently studied the feasibility of systems contracting or verified its operating contractors' cost savings estimates, DOE cannot ensure that its contractors' use of systems contracting complies with DOE's regulations.

Appendix I
DOE's Oversight of Operating Contractors'
Use of Systems Contracting Is Inadequate

Furthermore, without such study or analysis, DOE's encouraging operating contractors to consider using systems contracting is premature.

**DOE Has Relied on
Evaluations by Sandia and
Other Operating
Contractors**

DOE's Inspector General reported in December 1987 that DOE had not evaluated the costs and benefits of systems contracting to determine whether the approach should be encouraged or discouraged departmentwide.¹ DOE replied, in February 1988, that Sandia's experience and reported annual savings under systems contracting obviated the need for further study of the concept. DOE then surveyed its Operations Offices for information on the current status of systems contracting and circulated a draft policy statement asking that operating contractors implement systems contracting wherever significant cost savings to the government would result. On the basis of the survey results, DOE concluded that system contracting was being widely considered by operating contractors and that the evaluation and implementation of systems contracting should be the direct responsibility of the contractors, with oversight by DOE's Operations Offices.

DOE officials stated that part of what they contract for is the management expertise of their operating contractors, and since Sandia had found systems contracting to be cost beneficial, there was no need for DOE to duplicate or validate Sandia's study. Without an independent validation of the operating contractor's study, however, we do not believe DOE has fulfilled its responsibility to ensure that systems contracting is in the government's best interest.

In April 1988, the Chairman, Environment, Energy, and Natural Resources Subcommittee, House Committee on Government Operations, urged DOE to independently study the feasibility and the costs and benefits of its operating contractors' use of alternative procurement systems, such as systems contracting, and acquisitions through the General Services Administration (GSA). DOE's May 1988 reply did not directly respond to the Chairman's suggestion but said that most DOE operating contractors had initiated or completed feasibility studies. DOE pointed out that the department has a longstanding policy requiring its operating contractors to use GSA when it is economically feasible.

¹Overview Report on Materials Management Audits of Management and Operating Contractors at Naval Petroleum Reserves 1 and 3 and the Albuquerque, Idaho, Nevada, Richland, and San Francisco Operations Offices (U.S. Department of Energy, Office of Inspector General, WR-OC-88-2, Dec. 8, 1987).

Sandia's Estimated Cost Savings Are Questionable

We reviewed Sandia's feasibility study and cost savings methodology and found problems that cast doubt on their reliability. For example, Sandia officials could not provide us with analyses, studies, or other documents to support the cost savings that Sandia's feasibility study estimated would result from systems contracting. When we examined Sandia's methodology to estimate product savings realized by switching to systems contracting, we found that the methodology excluded several essential cost factors. Additionally, after nearly 4 years of systems contracting, Sandia officials have not verified whether any actual savings have resulted.

In its January 1988 briefing to DOE, Sandia estimated annual cost savings totaling about \$5.6 million for the 31 systems contracts then in place. This total was made up of about \$3.9 million from lower product unit prices, \$1.0 million from reduced staffing costs, and \$0.7 million from lower inventory costs.

For each systems contract, according to Sandia officials, Sandia estimated the product price savings by (1) multiplying an item's unit price under the previous purchasing system by the item's estimated annual usage, (2) multiplying the item's unit price under systems contracting by the same annual usage figure, and (3) subtracting the second sum from the first. We believe this methodology is faulty because it does not recognize changes in annual usage or in unit prices that have occurred since the systems contract was implemented.

For example, assume that (1) an item cost \$1.00 under the previous system and \$0.75 under systems contracting and (2) the estimated annual usage of the item was 100 in 1985 when the contract was awarded. Sandia's estimate of savings related to that item would be calculated as follows:

$$(\$1.00 \times 100) - (\$0.75 \times 100) = (\$100) - (\$75) = \$25 \text{ savings.}$$

No adjustment would be made to this estimate even if actual annual usage of the item was found to be 300 or the unit price under systems contracting increased to \$0.95. Such changes would reduce the savings estimate, as shown below:

$$(\$1.00 \times 300) - (\$0.95 \times 300) = (\$300) - (\$285) = \$15 \text{ savings.}$$

In addition, in estimating product price savings for the office supplies contract, Sandia based its calculation on 21 of the 238 original stock

items whose prices were established when the contract was awarded. By March 1988, the number of stock items had increased to about 1,100, and the systems contractor also provided about 7,800 nonstock items. The savings estimates were not revised to reflect the new items purchased under the contract.

By not using actual price differences and quantities in the formula, Sandia's savings estimates have remained static year after year even though total costs have increased. For office supplies, for example, the value of Sandia's 5-year contract amount has nearly tripled, from about \$2.8 million in 1985 to about \$7.5 million in 1988.

Sandia's estimated savings for reduced staffing may also be questionable because an October 1988 internal audit report noted that staffing levels at Sandia appear to be inadequate to effectively maintain the systems contracting system.²

Finally, even though Sandia's first systems contract is now in its fourth year, Sandia could not verify whether actual savings have resulted from the change to systems contracting. Although Sandia is preparing a post-implementation review report, officials have told us that it will again be based on estimated usage. As a result, the savings Sandia will report will again be estimated rather than actual.

DOE Has Not Ensured That GSA Is Considered as a Supply Source

DOE requires the operating contractors to either use GSA as a supply source when it is economically advantageous to the government or document their justification for not buying from GSA. Sandia officials said that they have not used GSA and do not plan to do so under systems contracting. Furthermore, Sandia's systems contracting feasibility study justified systems contracting by comparing estimated systems contracting costs with prior procurement costs, but the study did not compare systems contracting with procurement through GSA. While DOE officials agree with Sandia's policy that once the systems contract is awarded GSA is no longer considered as a potential source, they had assumed that Sandia had complied with the requirement. Consequently, they were not aware that Sandia had not compared prices under systems contracting with GSA prices before adopting systems contracting.

²Internal Audit Report on Systems Contracting—Just-In-Time System (AT&T, FSC8015A, Oct. 12, 1988).

Sandia's officials cited two reasons for not using GSA: (1) They perceive the quality of GSA supplies to be inferior to that of other vendors' supplies, and (2) purchasing items from GSA is not as convenient as it is under systems contracting. Contrary to DOE regulations, however, Sandia has not documented its justification for not buying office supplies from GSA.

We believe Sandia's arguments concerning convenience and quality are questionable because (1) the quality perceptions are based on experiences that occurred years ago and (2) GSA offers delivery options that are nearly comparable to those offered under the systems contract.³ Regarding the quality issue, GSA officials noted that they have taken steps to improve GSA's quality assurance program in response to our 1987 report.⁴ These improvements included better communication of complaint reporting procedures, strengthened procedures on replacements, and better enforcement of procedures to prevent warehouses from shipping defective items. In addition, the GSA officials pointed out that GSA will stock brand name items at a customer's request.

GSA Prices Are Lower for Some Items

Because Sandia had not compared its systems contract prices with GSA prices, we did so for a small, judgmentally selected sample of office supplies of comparable quality. For some of the items sampled, the systems contractor's prices were higher than GSA prices.

From a list of items purchased under Sandia's office supplies systems contract, we judgmentally selected 20 stock and 20 nonstock items. We chose a mix of stock and nonstock items because, comparatively, Sandia pays a lower price for stock items and because the systems contractor has a longer period to deliver nonstock items. Since Sandia officials had cited the poor quality of GSA items as one justification for not using GSA, we restricted our selection to those items whose quality would be unlikely to vary widely from one manufacturer to another. For example, we selected office supplies such as rubber bands, labels, and tape dispensers. Because our sample was limited, its results cannot be used to reach conclusions about the overall costs and benefits of systems contracting. However, the sample illustrates the need for such an analysis

³Under the office supplies systems contract, the vendor offers 2-day delivery for stock items and 5-day delivery for nonstock items. GSA's Customer Supply Centers offer 5- to 7-day delivery or same-day pickup.

⁴GSA Procurement: Quality Assurance for Common-Use Items Should Be Improved (GAO GGD-87-65, June 29, 1987).

Appendix I
DOE's Oversight of Operating Contractors'
Use of Systems Contracting Is Inadequate

before a systems contract is awarded for items commonly supplied by GSA.

For the items selected, we consulted DOE's Albuquerque lead stock clerk, who has experience dealing with both GSA and systems contracting procurements, to determine whether GSA offered items that were comparable in terms of quality and utility. Of the 20 stock items selected, each item or a comparable item was available from GSA, but GSA did not supply a comparable item for 6 of the 20 nonstock items.

While we have no basis for judging the need for or value of Sandia's ability under systems contracting to get a particular office supply within 48 hours, we first selected GSA Customer Supply Center⁵ prices for comparison with the systems contract prices because the supply center delivery time (5 days) was closer to the systems contract delivery time (2 to 5 days). Of the 20 stock items, the GSA supply center price was lower than the systems contractor's price for 13 items, the same for 1 item, and higher for 6 items. On the basis of Sandia's estimated annual usage of these items, we calculated that Sandia could have purchased these items from GSA for about \$17,000 less. (See table I.1.)

Because a 30-day delivery time might be acceptable for some office supply items, we also compared the systems contractor's prices with those of GSA's supply depots. Of the 20 stock items, the GSA supply depot price was lower than the systems contractor's price for 16 items and higher for 4 items. If Sandia had purchased these 20 stock items from a GSA supply depot, we calculated that they could have purchased them for about \$34,000 less (on the basis of Sandia's estimated annual usage of these items).

⁵GSA has 11 Customer Supply Centers located throughout the United States, including Hawaii and Alaska. These supply centers handle smaller order quantities, offer faster delivery, and charge higher prices than GSA's depots (located in New York, Texas, Missouri, and Washington).

Appendix I
DOE's Oversight of Operating Contractors'
Use of Systems Contracting Is Inadequate

Table I.1: Comparison of Systems Contractor and GSA Prices for 20 Stock Items

Item description	Systems contractor's price as a percent of GSA's price		Potential savings ^a	
	Supply center	Supply depot	Supply center	Supply depot
	Adhesive, glue stick	100	129	\$0.00
Binder, 3-ring	74	94	(972.84)	(159.72)
Dictionary, Webster's Collegiate	159	205	2,726.13	3,770.02
Eraser, mechanical pencil .5mm	57	72	(1,055.52)	(572.76)
Index sheet, plain tab ^b	293	378	8,188.84	9,136.86
Label, continuous feed	151	195	198.30	285.60
Lead, refill .5mm	59	74	(1,745.24)	(872.62)
List finder	255	331	1,635.39	1,877.67
Pad, Post-it	157	203	4,592.86	6,398.45
Pen, ballpoint	148	190	3,486.60	5,095.80
Pen, nylon tip	64	82	(3,801.32)	(1,474.65)
Pen, Uni Ball .2mm	107	138	8.50	36.21
Ribbon, typewriter	79	101	(395.20)	15.20
Ruler, 12" wood	112	150	34.32	102.96
Staples, 1/4" (5,000 per box)	101	132	32.00	640.00
Stamp pad	311	395	466.29	513.39
Staples, 3/8" ^c	638	822	80.54	83.90
Tape, dispenser	131	169	495.88	851.62
Tape, transparent ^d	85	107	(3,156.30)	1,352.70
Wastebasket ^e	250	323	6,349.20	7,312.35
Total			\$17,168.43	\$34,511.06

^aCalculations of potential savings were based on Sandia's estimated annual usage of the stock items.

^bGSA's price is for a box of 100 sheets; the contractor's is for a set of 5 sheets. We multiplied the contractor's price by 20.

^cGSA's price is for a box of 5,000; the contractor's is for a box of 1,000. Therefore, we multiplied the contractor's price by 5.

^dGSA's price is for a 12-yard roll; contractor's is for a 36-yard roll. Therefore, we multiplied GSA's price by 3.

^eGSA's price is for a round, metal wastebasket; the contractor's is for a rectangular, fiberglass wastebasket.

The systems contractor's prices were higher than GSA's prices for each of the nonstock items for which GSA offered a comparable item.⁶ The systems contractor's prices were as much as 627 percent of GSA's supply center prices and 807 percent of GSA's supply depot prices. Considering

⁶Six of the 20 nonstock items were not available from either GSA's Customer Supply Centers or supply depots, and one additional item was available only from the supply depots.

Appendix I
DOE's Oversight of Operating Contractors'
Use of Systems Contracting Is Inadequate

the number of these items ordered by Sandia in fiscal year 1988, we estimate that Sandia could have saved over \$4,000 if it had used GSA's Customer Supply Center and over \$5,000 if it had used GSA's supply depot. Table I.2 compares the systems contractor's prices and GSA's prices for the 20 selected nonstock items.

Table I.2: Comparison of Systems Contractor and GSA Prices for 20 Nonstock Items

Item description	Systems contractor's price as a percent of GSA's price		Potential savings ^a	
	Supply center	Supply depot	Supply center	Supply depot
Pads, ruled paper	b	b		
Organizer, desk ^c	404	567	\$141.44	\$154.87
Labels, white (5,000 per box)	b	b		
Labeler, Scotch	132	170	82.47	141.12
Rubber bands, size 64	299	377	2,344.15	2,586.35
Tape dispenser	627	807	60.76	63.32
Calendar refills	210	269	27.55	33.06
Southworth 3-month calendar	239	306	118.90	137.76
Dictionary, Webster's unabridged	b	124		57.30
Thesaurus, Roget's II	166	214	106.68	143.08
Footrest	b	b		
Portfolio, expanding	203	264	196.00	240.00
Folder, hanging	160	206	171.15	234.85
Rolodex, card file ^d	114	147	16.03	40.83
Attache case ^e	235	303	446.25	520.35
Stapler, Swingline heavy duty	588	758	688.50	720.12
Stapler, electric	b	b		
Paper punch, 3-hole heavy duty	201	260	37.64	45.96
Board, porcelain	b	b		
Book rack, walnut	b	b		
Total			\$4,437.52	\$5,118.97

^aCalculations of potential savings were based on the number of items purchased in fiscal year 1988.

^bComparable item not supplied by GSA.

^cGSA's organizer has one section; the contractor's has three.

^dGSA's card file has 500 cards; the contractor's has 4,000 cards. Therefore, we multiplied the GSA price by 8.

^eGSA's attache case has a key lock; the contractor's has a combination lock.

The office supplies systems contract was originally competed on the basis of the prices offered for 238 office supply items and the bidders' ability to meet the technical and delivery requirements specified by Sandia. Sandia awarded the contract on the basis of an evaluation of the bidders' technical and cost proposals, including an evaluation of the diversity of stock offered by each vendor as a measure of the vendor's technical ability to meet Sandia's needs.

The universe of items now being purchased under the contract, however, has changed significantly. Sandia's list of stock items has grown to over 1,100 items because once a nonstock item has been ordered four times or more, Sandia negotiates with the systems contractor to have the item added to the stock list and to establish a price for the item.⁹ Sandia neither issues any requests for quotes for these items nor conducts market studies to determine whether in fact the systems contractor's prices are the lowest available. The prices paid for the nonstock items are a specified percentage discount from the list price of the systems contractor's supplier. As of March 1988, the systems contractor had provided about 7,800 nonstock items, none of which were subjected to any form of competition, and purchases of these nonstock items had accounted for about half the value of the purchases in the first 11 months of fiscal year 1988. Sandia's estimated value of the contract for a 5-year period has increased from \$2.8 million to about \$7.5 million.

Despite these changes, Sandia chose to exercise its option to extend the current contract for a fourth year without any further competition. Sandia cited the vendor's ability to provide goods in a timely manner and the variety of goods carried as the basis for the decision.

A Case Study Illustrates Problems With Systems Contracting at Sandia

Sandia's purchases of a white label demonstrate how weak internal controls and inadequate competition resulted in Sandia's paying considerably more than necessary. This case was brought to our attention by Sandia officials as an example of how the systems contract was reducing costs. Their savings claims were based on a December 1986 letter from the systems contractor informing Sandia, as required by the contract, that comparable labels were available at a lower price. No savings were actually achieved, however, because Sandia continued to order the more expensive labels. Because this was the only example we examined, the extent of this problem is unknown.

⁹The contract requires that the vendor's price for stock items be no higher than the price charged any other customer and lower than the discounted price charged when it was a nonstock item.

Between August 1987 and July 1988, Sandia purchased 30 boxes of the white labels at prices ranging from about \$160 to \$280 per box.¹⁰ The labels suggested by the systems contractor cost about \$20 per box. On the basis of the number of labels ordered through the first three quarters of fiscal year 1988, Sandia could have saved almost \$5,500 if it had purchased the cheaper labels. However, Sandia has no control in place to ensure that employees provide adequate justification for ordering more expensive items after they have been informed that cheaper items could be substituted.

Both the employee who orders the labels and the supervisor told us that the more expensive label, which is used to temporarily label computer tapes, meets precise specifications better than others they had tried because it is easily removable, leaves no residue when removed, and comes in strips with perforations between each label. The supervisor agreed to consider less expensive labels as an alternative.

Even if the user's justification for this particular label warranted its purchase, Sandia could have obtained it at a lower cost. We contacted the manufacturer and obtained price quotes for this label that ranged from \$102 for a single box to \$45 per box for an order of 10 boxes. (The manufacturer also required a minimum order of at least \$250.) At different times, the systems contractor obtained the labels directly from the manufacturer and from a local distributor. The manufacturer charged the systems contractor 196 percent more than the price quote we were given. The systems contractor, in turn, increased the price to Sandia (for various orders) by as much as another 70 percent.

When the systems contractor purchased the labels from a local distributor, the unit price was lower than that previously paid to the manufacturer. The systems contractor, however, did not decrease the price charged Sandia. The systems contractor has agreed to work with Sandia to correct the overcharges.

¹⁰Sandia could not provide historical data on the purchases of these labels prior to August 1987.

DOE Has Not Ensured That Adequate Controls Were Established Over Sandia's Purchases

DOE has not required Sandia to establish controls to ensure that all purchases under systems contracts are necessary. Sandia's purchasing approval and review controls are inadequate to help ensure that supplies purchased through the systems contractor are the least expensive items available to accomplish the intended purpose.

While the employees have access to Sandia's list of stock items, the systems contractor's office supplies catalog does not differentiate between stock and nonstock items and shows only retail prices. Any of Sandia's approximately 7,200 Albuquerque-based employees can order from the systems contractor's catalog and are required to get a supervisor's approval only if they are ordering a catalog item costing \$1,000 or more, or restricted items such as gift-boxed items, leather goods, and attache cases. Although purchases receive post-purchase supervisory review, items costing less than \$25 cannot be returned.

Additionally, Sandia does not require employees to justify their need for the items ordered even when comparable items are available at lower prices. Employees are encouraged to order stock items whenever those items meet their needs because Sandia gets a better price on stock items than on nonstock items. (Stock item prices are set by the systems contractor and agreed to by Sandia; nonstock item prices are a specified percent discount from the list price of the systems contractor's supplier.)⁷ Except for the restricted items previously discussed, however, employees may order a nonstock item instead of a similar stock item or a lower-priced nonstock item without documenting their justification for the order and without obtaining approval. When an employee phones in an order for a nonstock item, the systems contractor, according to the contract, should inform the employee of any stock items that are similar and could be substituted for the nonstock item. If the employee decides to order the more expensive nonstock item, however, Sandia does not require any justification or approval.

⁷The supplier's list price is, in effect, a suggested retail price, while the vendor is actually paying the wholesale price of the item.

DOE Has Not Ensured That Items Added to Sandia's Systems Contracts Are Obtained at Lowest Prices

Because most of the items available for purchase under Sandia's office supplies systems contract were not considered in awarding the contract, DOE has no assurance that the additional items—the new stock items added to the contract and nonstock purchases—were obtained at the lowest price consistent with requirements for timeliness and quality. The 238 items that were the basis for the bids originally submitted now comprise about 3 percent of the items provided by the systems contractor. Furthermore, the estimated value of the contract has nearly tripled. The magnitude of these changes raises questions concerning whether the package that was offered for bid is representative of the range of items now being purchased under the contract.

According to DOE acquisition regulations, operating contractors are to achieve fair and effective competition for procurements (48 C.F.R. 970.7103). Our August 1987 report cited numerous inadequacies in DOE operating contractors' procurement procedures and recommended, among other things, that the Secretary of Energy establish (1) a common definition of competition to ensure consistent application among operating contractors and (2) standard procedures to be followed in seeking competition.⁸ The report illustrated that DOE's lack of a uniform definition of competition could result in different operating contractors reporting a similar contract differently. For example, contractors could define full competition as (1) three bidders for contracts under \$10,000 and six bidders for contracts over \$10,000, (2) two or more bidders, or (3) more than two bidders (the award is considered to be a negotiated competitive contract if only two bids are received). Using these definitions, contractors would report a contract award based on two bidders as (1) a noncompetitive contract, (2) a fully competitive contract, or (3) a negotiated competitive contract. Consequently, DOE could not use the contractors' reports to measure the degree of competition achieved.

In commenting on our 1987 report, the Secretary did not agree with all of the recommended actions and noted that DOE's revised acquisition regulations would provide a standard for fair and effective competition. However, the revised regulations, which became effective on July 27, 1988, state in only general terms what is required to obtain fair and equitable competition, and consequently, the operating contractors can still define competition differently (48 C.F.R. 970.7103).

⁸Energy Management: DOE Controls Over Contractor Expenditures Need Strengthening (GAO/RCED-87-166, Aug. 28, 1987).

Sandia's Systems Contracts and Payments as of September 30, 1988

Commodity	Date implemented	Payment as of September 30, 1988
Active/passive electronics ^a	March 1987	\$3,793,661.20
Bottled water	June 1987	34,126.06
Computer manuals	June 1988	35,069.53
Computer paper	February 1986	699,955.34
Computer supplies	June 1986	496,490.25
Drafting and blueprint supplies	May 1986	1,175,533.15
Electrical supplies	August 1986	3,248,544.18
Fasteners ^b	February 1986	567,444.36
Fittings ^c	May 1987	702,821.11
Forms	April 1988	140,036.90
Gases	April 1986	3,514,634.90
General industrial	July 1986	3,480,395.78
Graphic arts	October 1986	657,917.38
Heating and air conditioning	April 1986	1,179,382.66
Hewlett Packard computers & supplies	November 1987	3,308,128.70
IBM computers & supplies	November 1986	15,933,504.61
Janitorial supplies	August 1985	1,270,136.60
Laboratory supplies	April 1986	2,505,739.95
Lumber	October 1986	286,688.31
Metals (raw stock)	September 1986	1,765,517.58
Office supplies	April 1985	4,791,233.64
O-Rings ^d	December 1986	77,741.35
Paint and supplies	October 1986	146,388.39
Paper	March 1986	1,481,477.78
Photo processing	July 1986	788,879.31
Photo supplies	April 1986	3,295,918.92
Plastics (raw stock)	November 1986	513,243.38
Plumbing supplies	March 1986	1,096,713.63
Rubber stamps	February 1986	39,400.63
Safety supplies	September 1986	851,777.85
Tires	October 1986	151,568.38
Vacuum products	May 1987	1,124,215.06
Wire and cable	December 1987	419,772.29
Total		\$59,574,059.16

^aSemiconductors, integrated circuits, resistors, capacitors, etc.

^bNuts, bolts, screws, etc.

^cAdaptors, crosspipes, tubes, safety relief valves, etc.

^dSealing and gasket materials.

Scope and Methodology

To evaluate Sandia's basis for implementing systems contracting, we reviewed Sandia's feasibility study, which presented the estimated costs and benefits of implementing systems contracting and recommended doing so. We also reviewed an October 1988 internal audit report on systems contracting at Sandia. Further, we reviewed information and internal controls related to Sandia's office supplies contract—the first systems contract Sandia awarded. To determine whether Sandia, through this contract, was paying the lowest available prices for office supplies, we judgmentally selected a sample of items available through the contract and compared their prices with those of the same or comparable items available through GSA. We selected items whose quality would be unlikely to vary widely from one manufacturer to another. Because our sample size was limited, our results are not statistically representative of the universe of contract item prices.

To obtain information and opinions on systems contracting and on procurements through GSA, we interviewed Sandia officials, the office supplies contractor, several users (Sandia employees who had ordered and received office supplies through the contract), and GSA officials at the Washington, D.C., headquarters and the GSA Customer Service Center in Denver, Colorado. We also interviewed officials of DOE headquarters, Washington, D.C., and the DOE Albuquerque Operations Office, Albuquerque, New Mexico. Although we did not comprehensively review DOE's internal controls over its operating contractors, we did review the Secretary of Energy's fiscal year 1987 and 1988 Federal Managers' Financial Integrity Act reports and determined that no material internal control weaknesses in this area had been reported.

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