

GAO

Report to the Secretary of Energy

June 1993

ENERGY
MANAGEMENT

Systems Contracting
Weaknesses Continue



Resources, Community, and
Economic Development Division

B-252820

June 23, 1993

The Honorable Hazel R. O'Leary
The Secretary of Energy

Dear Madame Secretary:

In 1989, we reported that the Department of Energy (DOE) was encouraging its management and operating contractors to use "systems contracts" without any assurance that these contracts were cost-effective.¹ Systems contracts are used to procure commonly used items, such as office, industrial, and laboratory supplies, as they are needed rather than purchasing the items in bulk and storing them in inventory. Specifically, we found that DOE had neither independently evaluated the costs and benefits of systems contracting nor required that adequate internal controls be instituted to ensure, among other things, that contract employees purchased the least expensive supplies available to satisfy their needs. We recommended a number of actions to help ensure that the use of systems contracting is in the government's best interest.

As part of our recent review of procurement practices at DOE's Stanford Linear Accelerator Center (Stanford) and the Lawrence Berkeley Laboratory (Berkeley), we followed up on DOE's actions to implement our 1989 report recommendations. Specifically, we assessed whether the DOE San Francisco Operations Office, which has oversight responsibility for the two facilities, had implemented our recommendations to ensure that (1) systems contracts awarded by its management and operating contractors are cost-effective and (2) internal controls over systems contracts are adequate.

Results in Brief

DOE's San Francisco Operations Office has not implemented our 1989 recommendations to ensure that systems contracts awarded by its management and operating contractors are cost-effective. Specifically, the operations office did not ensure that the Stanford contractor had analyzed and documented the costs and benefits of systems contracting before awarding two contracts for office supplies. And although Berkeley prepared a justification for awarding its office supply contract, the operations office did not review it to ensure that the decision was adequately documented and reasonably justified. As a result, since

¹Energy Management: DOE Has Not Shown Systems Contracting to Be in Government's Best Interest (GAO/RCED-89-118, June 20, 1989).

January 1990 the Stanford and Berkeley contractors have expended over \$2 million for office supplies without any assurance that the contracts are cost-effective.

The San Francisco Operations Office also has not determined whether controls over systems contracts are adequate at the Stanford and Berkeley facilities. Our work at the two facilities identified weaknesses similar to those we reported in 1989. For example, although systems contracts are primarily intended for purchasing items specified in the contracts, controls are inadequate to prevent the routine purchasing of other merchandise available through the systems contractor. As a result, during a period of about 9 months in 1992, Stanford and Berkeley expended over \$540,000 for thousands of supply items with no assurance that prices paid for the items were competitive with prices from other supply sources.

Background

Systems contracting is a relatively new method of procuring commonly used supplies at DOE facilities. In contrast to the more typical practice of purchasing items in bulk and storing them in inventory, systems contracting is a stockless system, allowing management and operating contractors to obtain commonly used items in a particular product family, such as office supplies, from a local vendor on an as-needed basis.

Under a systems contract, the vendor (i.e., the systems contractor) agrees to supply, at prices specified under the contract, items previously carried in the stockroom at DOE facilities. And although systems contracts are primarily intended for purchasing these supplies, infrequently ordered—or “nonstock”—items (items that would not have been carried in the stores inventory) are also available. Systems contracting offers a number of potential operational benefits, including (1) reduced warehousing costs; (2) frequent and timely delivery of a wide range of stock and nonstock items; and (3) lower administrative costs for purchases because, among other things, fewer purchase orders and price quotations are needed.

The Stanford and Berkeley facilities—research facilities managed and operated by contractors working for DOE—awarded their first systems contracts for office supplies in November 1989 and May 1990, respectively. Both contractors awarded their systems contracts to the vendor offering, among other things, the best price for the commonly used supplies identified in each solicitation (70 items at Stanford and 250 at Berkeley), as well as a discount on other merchandise available in the vendors’ catalogs of office supplies. Each facility initially estimated that

expenditures for office supplies would total about \$250,000 annually. By the end of fiscal year 1992, however, annual expenditures had escalated to about \$460,000 at Stanford and approximately \$590,000 at Berkeley. Costs under these contracts are reimbursed fully by DOE.

The San Francisco Operations Office Has Not Ensured That Systems Contracts Are Cost-Effective

The San Francisco Operations Office has not adequately implemented our 1989 report recommendations to ensure, among other things, that contractors evaluate and document the costs and benefits of systems contracting before awarding the contracts. Also, the office has not subsequently ensured that the contracts are, in fact, realizing cost savings. Consequently, more than 4 years later, DOE still has no assurance that systems contracts awarded by the Stanford and Berkeley contractors are cost-effective.

1989 Report Identified Systems Contracting Deficiencies

Under DOE's acquisition regulations, management and operating contractors must procure items in the manner most advantageous in meeting the overall mission, by considering, among other things, price, quality, and the timeliness and efficiency of the contract's performance. DOE also requires management and operating contractors to (1) use government sources of supply, such as the General Services Administration (GSA), when it is economically advantageous to the government or (2) document their justification for not buying from GSA. Yet, in 1989 we found that DOE was encouraging its management and operating contractors to adopt systems contracts without any assurance that the contracts were cost-effective or otherwise in the government's best interest. Among other things, DOE had not independently evaluated the costs and benefits of systems contracting or verified contractor claims about the merits of systems contracting.² Furthermore, DOE had not ensured that GSA was evaluated as a supply source before the award of a systems contract for office supplies.

We concluded that DOE had not demonstrated that systems contracting is in the government's best interest. Therefore, we recommended, among other things, that the Secretary of Energy (1) require DOE's management and operating contractors to evaluate and document the costs and benefits of systems contracts—by assessing, among other things, whether supplies could be obtained more economically from GSA—before awarding systems contracts and (2) independently review the contractors' evaluations.

²Our 1989 report focused on the first systems contract awarded by a DOE contractor—a 1985 contract for office supplies at the Sandia National Laboratories in Albuquerque, New Mexico.

DOE agreed with our recommendations and, on January 16, 1990, directed all contracting offices to independently evaluate the costs and benefits of systems contracts awarded by each management and operating contractor to ensure that the overall cost to the government had been reduced through the application of systems contracting techniques. According to the letter and accompanying guidance, the offices were expected to ensure, among other things, that

- the study supporting each contractor's decision to implement systems contracts included adequate documentation, for example, documentation that government sources of supply were considered but not selected and the reasons why not, and
- documentation reasonably supported and justified the contractor's decision by including an independent determination that systems contracting reduced overall costs to the government.

Headquarters directed all offices to perform initial reviews of systems contracting and prepare action plans for addressing our recommendations by March 16, 1990. In June 1990, the Director of DOE's Office of Review and Analysis certified that DOE had completed all actions necessary to implement the recommendations, including an assessment of the adequacy and thoroughness of the San Francisco Operations Office's action plan. As a result, DOE terminated our recommendations in its audit tracking and resolution system.

The San Francisco Operations Office's Actions Fall Short

By letter dated March 15, 1990, the San Francisco Operations Office informed headquarters that it had completed its initial review of systems contracts. Instead of independently assessing whether its contractors had evaluated and adequately documented the costs and benefits of systems contracts as directed in detailed headquarters guidance, however, the operations office provided the guidance to the contractors and relied on information supplied by them to prepare its response to headquarters.

On the basis of information provided by the Stanford contractor, for example, the operations office informed headquarters that Stanford's decision to award its systems contract for office supplies was based on a number of considerations, including pricing, reduced inventory investment, increased customer satisfaction and convenience, and reduced operating costs. The operations office also informed headquarters that the Stanford and Berkeley contractors "have stated that the files contain the appropriate documentation relative to the practicality of using

government sources of supply.” However, operations office officials did not verify information supplied by the contractors to ensure that the studies had been performed and adequately documented. Instead, they simply forwarded the information to headquarters.

We contacted officials at Stanford and Berkeley to determine whether a cost/benefit analysis had actually been performed and whether adequate documentation existed supporting their respective decisions to use systems contracts for office supplies. Although Stanford awarded its first contract for office supplies before headquarters instructed the operations office to implement our recommendations, Stanford officials told us that they had conducted a pilot test of systems contracting before awarding the contract in November 1989. However, because the purpose of the pilot was to determine whether the contracting technique would be operationally feasible at the facility, the pilot did not assess the costs and benefits of implementing the contract.

Furthermore, although Stanford’s procurement manual, as approved by DOE, calls for using government sources of supply when it is advantageous to do so and when supplies meet Stanford’s quality and schedule requirements, Stanford did not evaluate or document the feasibility of obtaining office supplies through GSA. Finally, while Stanford awarded another contract for office supplies in November 1990—after headquarters directed action on our recommendations—Stanford did not subsequently evaluate and document the costs and benefits of the contract or assess GSA as an alternative supply source before awarding the contract, nor was it required to do so by the operations office.

In contrast to Stanford, Berkeley performed and documented an analysis of systems contracting before awarding its May 1990 contract for office supplies, even though the operations office had not required Berkeley to do so. Berkeley did not, however, compare the costs and benefits of systems contracting with purchases from GSA because, according to its justification for awarding the contract, GSA could not duplicate the service offered under the contract. Furthermore, while Berkeley prepared a justification, the operations office did not review it.

Finally, although the operations office’s March 1990 letter to headquarters indicated that the office would review systems contracts during its next review of purchasing systems—termed “contractor purchasing system reviews” (CPSR)—at the facilities, it did not do so. According to the operations office officials responsible for performing the reviews, they

simply overlooked their commitment to review systems contracts when they performed their 1991 CPSR reviews and follow-up activities at the Stanford and Berkeley facilities. Furthermore, they said that they had not viewed systems contracts as an area warranting oversight during CPSR reviews because the dollar amount of individual transactions is relatively small and the contracts were awarded competitively. Consequently, since January 1990 contractors operating the Stanford and Berkeley facilities have expended over \$2 million for office supplies without any assurance that the contracts are, in fact, cost-effective.

The San Francisco Operations Office Has Not Ensured That Controls Over Systems Contracts Are Adequate

The San Francisco Operations Office also has not determined whether controls at the Stanford and Berkeley facilities are adequate, as recommended in our earlier report. Our work at the two facilities identified weaknesses similar to those reported in 1989.

1989 Report Identified Inadequate Controls Over Systems Contracts

As previously discussed, systems contracting offers a number of operational benefits—benefits that could reduce overall costs to the government. However, in 1989 we found that controls over systems contracts were inadequate to ensure that this objective was being realized. For example, although the contractor included in our earlier review awarded its contract, in part, on the basis of competitive bids for 238 commonly used office supplies, controls were inadequate to ensure that employees actually purchased this merchandise and not other supplies. As a result, we found that 97 percent of all items provided under the contract had not been subjected to any form of competition. Furthermore, even when comparable, less expensive merchandise was available, controls were inadequate to prevent employees from ordering the more expensive merchandise when not justified.

Because the potential existed for similar problems elsewhere, we recommended that the Secretary determine whether other management and operating contractors had established adequate internal controls over their systems contracting purchases to ensure that (1) the lowest-cost items available under a systems contract are selected unless otherwise justified and (2) the prices for other items purchased under the contract are obtained at the lowest prices consistent with requirements for quality

and timeliness. If controls were found to be inadequate, we recommended that the Secretary require the contractors to establish adequate controls.

DOE agreed with our recommendation and directed its offices to independently assess whether controls over systems contracts were adequate. The San Francisco Operations Office said it would assess systems contracts during its next CPSR at the facilities. DOE closed out our recommendation after certifying, in June 1990, that all actions necessary to implement it had been taken.

Control Weaknesses Continue at Stanford and Berkeley

Because the operations office did not follow through with its commitment to review systems contracting during its CPSR activities at the facilities, it also did not assess the adequacy of controls at the facilities. As in our earlier work, we found that employees at the Stanford and Berkeley facilities are free to order a wide selection of office supplies with few supervisory controls.

At Stanford, for example, employees can order almost any item available in the vendor's 1,000-page catalog—except furniture and merchandise in excess of \$200—without justifying or obtaining approval for their purchases. Specifically, we found that employees ordered cameras and film, cassette recorders, a foot rest, adjustable wrist rests for computer keyboards, a cordless screwdriver, a vacuum cleaner, a knife set, a briefcase, batteries, an electronic foot warmer, and other personal heaters without justifying the orders or obtaining approval. And although Berkeley restricts purchases of such items as expensive pen and pencil desk sets, top-of-the-line calculators, and briefcases, employees can still order about 10,000 items in the vendor's office supplies catalog without justification or approval.

Officials at both facilities stated that they relied on the judgment and discretion of their employees to order supplies in a cost-effective manner.³ Such latitude and discretion are appropriate for purchasing commonly used items specified in the contract because, in the absence of a systems contract, employees could freely obtain this merchandise from the supply room at each facility. However, before systems contracting, if an employee wished to order merchandise not carried at the facility, approval would have been required. In the absence of similar controls, DOE has no

³Berkeley also prepares biweekly reports detailing employees' office supply purchases. According to Berkeley officials, the reports provide an effective control over office supply purchases because they contain information supervisors would need to review and question employees' purchases.

assurance that purchases under systems contracts are necessary and appropriate.

Furthermore, because contract employees at both facilities routinely order merchandise that has not been subjected to price negotiation, DOE has no assurance that merchandise is obtained at the lowest cost consistent with requirements for timeliness and quality. Stanford and Berkeley used competition to arrive at prices for commonly used office supplies at each facility. However, as in 1989, controls are inadequate to ensure that the contracts are primarily used for items specified in the contract. Instead, over a period of about 9 months between January and September 1992, employees purchased thousands of other items at a cost of over \$540,000. In fact, 62 percent and 71 percent of all expenditures at the Stanford and Berkeley facilities, respectively, were for nonstock office supplies during this period. Although both vendors provide discounts on catalog purchases pursuant to their bids on the contracts, DOE has no assurance the prices paid for individual office supplies are competitive with prices on the open market or through GSA.

In addition, in the absence of controls to ensure that systems contracts are used as intended, we found that the Stanford contractor used its office supply contract to special-order almost \$3,800 in equipment that the vendor did not carry. According to Stanford officials, using the systems contract was more convenient than ordering the merchandise directly from the manufacturer—as they had in the past—because there was no need to prepare a purchase order. While this practice may be more convenient, a senior buyer at the facility informed us that Stanford paid a “hefty” markup to obtain the merchandise through the systems contractor.⁴

Finally, even when comparable, less expensive merchandise is specifically priced in the contract, neither contractor requires employees to order it. As a result, employees at the facilities purchased, among other things,

- toner cartridges for laser printers at prices up to almost \$92, although the price for reconditioned cartridges had been negotiated with the vendor for about \$47;⁵

⁴The buyer could not recall how much more had been paid to obtain the supplies from the systems contractor rather than directly from the manufacturer.

⁵Officials at the Stanford facility, where the purchases occurred, explained that they were testing the feasibility of using reconditioned toner cartridges during the period of our review. According to the officials, the reconditioned cartridges were not officially accepted as replacements until October 1992.

- boxes of 3.5-inch computer disks at prices up to about \$24, although the negotiated price for unformatted disks was less than \$13; and
- rollerball pens at an average price of about \$1.12, although the price for comparable pens had been negotiated at an average cost of about 50 cents.

If controls had existed to ensure that contract employees purchased the commonly used items specified in the contracts, the Stanford facility would have saved more than \$8,000 during the 9-month period between January and September 1992 on its purchases of toner cartridges and computer disks. Similarly, Berkeley would have saved almost \$3,000 on its purchases of pens during the last 6 months of 1992. Because these examples cover a limited time and involve only 3 of the 320 commonly used items originally subjected to competition, the total savings available if employees were required to order the least expensive merchandise available under the contract, unless justified and approved, is unknown.

Conclusions

Systems contracts are intended to result in cost-effective operations. However, 4 years after our initial report, DOE still has no assurance that systems contracts awarded by Stanford and Berkeley are cost-effective. Similarly, controls over the contracts are inadequate to ensure that the objective of systems contracting is realized at the two facilities.

San Francisco Operations Office officials do not view systems contracts for office supplies as an area warranting oversight during CPSR reviews, largely because the dollar value of individual purchases is relatively small. We disagree with this view. First, expenditures for office supplies have essentially doubled at each facility since the contracts were awarded—to about \$590,000 at the Berkeley facility and approximately \$460,000 at Stanford during fiscal year 1992. Second, while our examples quantify only \$11,000 in excessive spending for office supplies, the potential savings are far greater, since we reviewed just three of the hundreds of commonly used items purchased during a 6- to 9-month period in 1992. Also, because the majority of each facility's expenditures is for nonstock supplies, which have not been subjected to price negotiation among competing supply sources, significant savings are likely in this area as well. Finally, and most importantly, in today's budget environment, every effort must be made to ensure that federal dollars are being spent as efficiently as possible. Lax oversight of contractors and poor internal controls over purchases are unacceptable, regardless of the amount involved.

We recognize that systems contracting offers a number of potential benefits, including the frequent and timely delivery of a wide range of supplies. But simply adopting this contracting method, as DOE has done, without first assessing whether it is in the government's best interest and subsequently determining that these benefits are not being offset by higher procurement costs, fails to protect the taxpayers' interests. Furthermore, because DOE headquarters terminated our recommendations without following up to ensure that adequate corrective actions had, in fact, been taken, similar deficiencies are likely throughout DOE. As a result, we believe that our earlier recommendations are still valid and that DOE should ensure that they have been implemented at all DOE facilities that use systems contracts.

Recommendations

To ensure compliance with the recommendations in our June 1989 report, we recommend that the Secretary of Energy evaluate the adequacy of actions taken by each DOE contracting activity to ensure that our earlier recommendations were implemented, including actions by the San Francisco Operations Office to assess other systems contracts within its purview. As part of this effort, DOE should ensure that systems contracts are primarily being used to purchase commonly used merchandise specified in the contract. If actions are determined to be inadequate, the Secretary of Energy should ensure that appropriate actions have been completed before terminating this recommendation in DOE's audit tracking and resolution system.

Agency Comments and Our Evaluation

We discussed the facts in this report with San Francisco Operations Office officials, including the Branch Chief of the Contracts and Assistance Management Division, and contractor officials from Berkeley's Material Management Department and Stanford's Business Services Division. The officials generally agreed with the facts presented. Comments clarifying the accuracy of the information presented have been incorporated where appropriate.

We also provided a draft of this report to DOE headquarters officials and met with the Directors of the Office of Property Management and the Office of Contractor Management and Administration to discuss DOE's comments. The officials agreed with the factual accuracy of the report. They also agreed with the need to evaluate and document the cost/benefits of systems contracting as recommended in our earlier report. However, the officials clarified that, in their view, analyses of systems contracts

should not focus exclusively on cost. They said other factors, such as timeliness, reliability, quality, and proximity to government supply sources, must also be considered to arrive at an overall assessment of the advantages and disadvantages of systems contracts. This view is consistent with the intent of our recommendations on systems contracting.

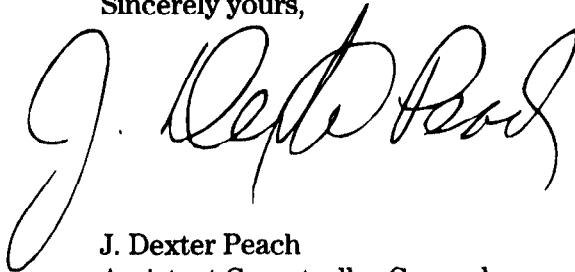
Scope and Methodology

To gather information for this report, we interviewed officials at DOE's San Francisco Operations Office and contractor officials at the Stanford and Berkeley facilities. We also reviewed pertinent documentation, including DOE's official response to our 1989 report recommendations and related correspondence directing action on our recommendations, the operations office's action plan for implementing our recommendations, information from DOE's audit resolution and tracking system, and operations office reports documenting the results of CPSR reviews at the facilities. Our assessment of the adequacy of controls at the facilities is based on our review of applicable DOE procurement regulations and policies, the contractors' purchasing manuals and policies, the office supply contracts, and our analysis of employees' purchases between January and September 1992. We performed our work from July 1992 through May 1993 in accordance with generally accepted government auditing standards.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement of the actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this letter and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this letter.

This work was performed under the direction of Victor S. Rezendes, Director, Energy and Science Issues, who can be reached on (202) 512-3841 if you or your staff have any questions. Major contributors to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in black ink, appearing to read "J. Dexter Peach". The signature is written in a cursive style with a large initial "J" and a long, sweeping underline.

J. Dexter Peach
Assistant Comptroller General

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