

GAO

Report to the Chairman, Subcommittee
on General Services, Federalism, and the
District of Columbia, Committee on
Governmental Affairs, U.S. Senate

June 1994

SUPPLY CONTRACT TERMINATIONS

GSA Is Missing Opportunities to Recover Costs From Vendor Default



General Government Division

B-256290

June 15, 1994

The Honorable Jim Sasser
Chairman, Subcommittee on General Services,
Federalism, and the District of Columbia
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

This report responds to your request that we review the General Services Administration's (GSA) efforts to assess and collect claims against supply vendors who default on contracts and increase the government's costs. The potential for these costs is great because (1) GSA terminates, in full or in part, hundreds of supply contracts annually due to vendor default and (2) our previous work showed that GSA continued to do business worth over \$1 billion with at least 285 vendors who had histories of poor performance on earlier contracts.¹

GSA can incur costs when supply contracts or individual purchase orders under those contracts are terminated because vendors failed to meet product specification or delivery schedule requirements. These costs can include (1) the costs of acquiring, holding, and disposing of defective products; (2) replacement product price increases when GSA has to pay higher prices to obtain replacement products; and (3) GSA administrative costs, such as staff time.

Results in Brief

Although GSA assessed \$2 million in claims in fiscal year 1992 against vendors who defaulted on contracts and had collected almost \$1 million of these assessments as of May 1993, it is missing other opportunities to recover such costs. Our analysis of 40 judgmentally sampled contracts, out of 261 GSA identified as having been awarded in fiscal year 1990 and subsequently terminated between fiscal years 1990 and 1993, showed that 20 of the contracts had replacement product price increases or administrative costs that GSA had not sought to recover. Overall, our work showed that GSA also had not pursued claims for costs incurred in holding and disposing of defective products or adequately accounted for and collected amounts due under the claims it had assessed against vendors.

¹See General Services Administration: Actions Needed to Stop Buying Supplies From Poor-Performing Vendors (GAO/GGD-93-34, Jan. 11, 1993).

Due to documentation limitations, we were not able to determine specifically why GSA had not sought to recover these costs for the 20 contracts. However, our work indicated that GSA had not adequately emphasized the importance of assessing claims against vendors to recover the costs associated with defaulted contracts. Also, GSA was ill equipped to pursue such claims because it lacked complete and reliable data on the universe of defaulted contracts and the magnitude of potential claims against vendors. In addition, GSA had poor claims administration practices that jeopardized its ability to collect claims it did assess. Lack of cost data did not permit us to (1) quantify the amount of unclaimed replacement product price increases and administrative costs related to the 20 contracts, (2) identify the nature or full extent of defective product costs that may have been associated with the 40 sampled contracts, or (3) project the total amount of unclaimed costs for the universe of defaulted contracts. However, our work and available data indicate that the total amount of unclaimed costs could be significant and that these costs are worth pursuing.

During our work, GSA (1) emphasized to its contracting officers the importance of assessing claims against vendors to recover these costs and (2) initiated several actions aimed at improving its ability to monitor and collect claims it assesses. These actions are steps in the right direction, but additional GSA actions and sustained management attention will be needed to help ensure that the full range of costs incurred as a result of vendor default are identified, assessed, and collected.

Background

GSA's Federal Supply Service (FSS) has an extensive supply procurement, warehousing, and distribution system to acquire almost 25,000 items and resell them to federal agencies. During fiscal year 1992, GSA's 8 commodity centers nationwide awarded over 2,000 common-use supply contracts, and federal agencies bought over \$2.2 billion worth of supplies from GSA.

Each year, GSA terminates in full or in part hundreds of supply contracts due to vendor default. When this occurs, the Federal Acquisition Regulation allows GSA to pursue claims to recover costs incurred as a result of vendor default. Such costs can include any price increases associated with purchasing replacement products, GSA administrative costs, and the costs of acquiring, holding, and disposing of defective products. Contracting officers are responsible for determining the costs GSA incurred as a result of vendor default and assessing claims against vendors. Because claims can be assessed for different types of costs

incurred at different times, multiple claims can be assessed for a single contract.

GSA's Office of Finance is responsible for recording, tracking, and collecting claims that the agency has assessed against vendors who defaulted. If a vendor does not pay a claim within 30 days, GSA's finance division in Kansas City is to take further collection action. Under title 2 of the GAO Policy and Procedures Manual for Guidance of Federal Agencies, GSA is required to have internal controls to prevent missed, erroneous, or duplicate transactions in collecting these claims. Pursuant to the Debt Collection Act of 1982, GSA is required to assess interest, penalties, and administrative charges on delinquent claims. If a claim remains uncollected, GSA can refer it to a collection agency or the Justice Department.

Objectives, Scope, and Methodology

Our September 1992 report on GSA's overall vulnerability to fraud, waste, and mismanagement identified purchases of common-use supplies and equipment as one of GSA's eight most vulnerable activities.² Our January 1993 report on GSA's supply procurement activities discussed its practice of continuing to award competitive, indefinite delivery contracts valued at over \$1 billion to repeat poor-performing vendors.³ As part of this work, we found indications that GSA was not effectively pursuing costs resulting from poor vendor performance and contract terminations. Accordingly, you asked that we review the effectiveness of GSA's efforts to assess and collect claims against defaulted vendors.

To meet this objective, we (1) reviewed and analyzed relevant laws, regulations, and policies; (2) examined data on potential claims to recover costs from defaulting vendors, claims that were assessed, and collections for 40 judgmentally selected contracts of 261 supply contracts GSA identified as having been awarded in fiscal year 1990 and subsequently terminated in full or in part for vendor default between fiscal years 1990 and 1993; (3) assessed GSA's management information related to contract terminations and claims; (4) assessed GSA's claims administration practices for claims it made; and (5) discussed the adequacy of GSA's data on contract terminations and its cost recovery efforts with responsible GSA officials.

²General Services Administration: Actions Needed to Improve Protection Against Fraud, Waste, and Mismanagement (GAO/GGD-92-98, Sept. 30, 1992).

³GAO/GGD-93-34, Jan. 11, 1993.

We are not projecting the results of our 40 sampled contracts to the universe of 261 terminations because complete GSA data on potential claims were lacking and the reliability of the GSA-identified universe was questionable. From this universe of 261 terminated contracts, we initially selected a stratified sample of 59 contracts that was intended to be representative of the types of commodities and the dollar values of defaulted contracts. However, we found that, contrary to GSA indications, 19 of the 59 contracts had not been terminated for vendor default. Our case analysis of the 40 remaining contracts provided specific illustrations of replacement product price increases and associated administrative costs GSA incurred as a result of vendor default and GSA's efforts to pursue them. Because data on the costs associated with defective products generally were not available, our work in this area was limited to (1) discussing GSA's cost recovery practices and efforts with top GSA procurement officials and (2) examining selected examples relating to defective paints.

We did our work at GSA headquarters; its commodity center in New York City; and its finance division in Kansas City, MO. Also, we obtained documents and interviewed officials at the commodity centers in Auburn, WA; Arlington, VA; and Fort Worth, TX. We did our work between March and December 1993 in accordance with generally accepted government auditing standards. GSA provided written comments on a draft of this report. We have included GSA's comments in appendix I and summarized them at the end of this letter.

GSA Did Not Pursue All Potential Claims

Although GSA's records indicated that in fiscal year 1992 it assessed about \$2 million and as of May 1993 had collected about \$1 million in claims against vendors who defaulted, our work showed that GSA missed other opportunities to pursue claims to recover costs incurred as a result of vendor default. Because GSA lacked complete and reliable management information on its efforts to recover such costs, we judgmentally selected for analysis 40 of the 261 supply contracts GSA identified that were awarded in fiscal year 1990 and subsequently terminated for vendor default between fiscal years 1990 and 1993. Our analysis of available data showed that 20 of the 40 defaulted contracts resulted in replacement product price increases or additional administrative costs that GSA had not sought to recover. Of these 20 contracts, GSA had not assessed claims to recover any of the associated replacement product price increases or administrative costs on 17 of them and had assessed claims against vendors for some but not all of such costs on 3 others. Of the other 20

contracts, GSA assessed claims against vendors for all replacement product price increases or administrative costs on 3 contracts and did not incur any assessable costs on 17 of them. Table 1 shows the results of our analysis of the 40 sampled contracts.

Table 1: Results of Our Analysis of 40 Contracts

GAO's observations	Number of contracts
GSA did not assess claims to recover replacement product price increases or administrative costs	17
GSA pursued claims but did not include all replacement product price increases or administrative costs	3
GSA did not incur assessable replacement product price increases or administrative costs	17
GSA pursued claims to recover all replacement product price increases or administrative costs	3
Total	40

Source: GAO analysis.

Lack of GSA cost data did not permit us to (1) quantify the amount of unclaimed replacement product price increases or administrative costs for the 20 contracts, (2) identify defective product costs that may have been associated with the 40 sampled contracts, or (3) project the total amount of unclaimed costs for the universe of defaulted contracts. However, available data for some of the sampled contracts indicated that these amounts are worth pursuing. For example, data showed that 10 of the sampled contracts had unclaimed replacement product price increases totaling \$88,747. Although the unclaimed costs associated with individual defaulted contracts may be small, the total amount could be substantial because GSA terminates hundreds of contracts annually due to vendor default. Furthermore, GSA officials acknowledged that GSA incurs assessable costs in connection with many of these terminations and that claims to recover such costs are worth pursuing because it is not labor intensive to do so.

As mentioned earlier, our case analysis did not include the costs associated with defective products because GSA's management information system lacked data on such costs. However, our work indicated that GSA is also missing opportunities to recover these types of costs. According to the Commissioner of FSS, GSA does not attempt to recover costs incurred in holding and disposing of defective products because it lacks a systematic method to identify and track them. Also, GSA contracting officers lack guidance for calculating and assessing holding and disposal costs. We

noted that such costs can be significant since defective GSA products can be held for long periods and some products, such as paints and other chemical products, are hazardous substances that require special care, handling, and disposal procedures.

In a recently settled case, for example, GSA avoided at least \$420,000 in disposal costs related to 21,000 cans of defective paint when the vendor agreed to take them back. In another example, GSA has continued to hold more than 4,000 cans of defective paint for over 2 years pending litigation, but GSA officials were unable to provide us with an estimate of the holding costs incurred. Since about 10 percent of the 24,700 products that GSA stocks are hazardous and require special handling and disposal, it would be beneficial for GSA to pay more attention to identifying and tracking these costs and assessing claims against vendors to recover them.

Our case analysis also showed that GSA has experienced problems in monitoring, accounting for, and collecting the claims it does assess. As mentioned earlier, GSA can make multiple claims on a single contract because different types of assessable costs can be incurred at different times. For 7 of 13 claims GSA issued related to the judgmentally sampled contracts, GSA (1) made accounting errors in the claims process that impaired its ability to recover the assessed costs or (2) did not assess interest, penalties, and related administrative charges when the claims became delinquent.

Reasons Opportunities to Recover Costs Are Being Missed

GSA missed opportunities to assess and collect claims to recover the costs incurred as a result of contract terminations for vendor default because it (1) had not adequately emphasized the importance of recovering the full range of such costs; (2) lacked complete and reliable data on the universe of defaulted contracts and the magnitude of potential claims against vendors; and (3) had poor claims administration practices that jeopardized its ability to monitor, account for, and collect claims it did assess.

Lack of documentation in the case files did not permit us to determine specifically why GSA had not assessed claims to recover all replacement product price increases or administrative costs for the 20 sampled contracts. However, the Commissioner of FSS and GSA commodity center managers attributed GSA's failure to pursue these claims to inadequate management emphasis. They acknowledged that assessing claims for the full range of costs that GSA incurs from vendor default has generally received little management attention and that GSA could and should

improve its performance in this area. Commodity center managers also acknowledged that the lack of agencywide criteria for calculating the costs of holding and disposing of defective products has resulted in confusion and inconsistent treatment of such costs among commodity centers. During our work, GSA issued a memorandum providing new guidance to all its contracting officers that emphasized the importance of recovering these costs and outlining their claims assessment responsibilities. However, this memorandum did not include guidance or criteria for contracting officers to use in calculating and assessing defective product holding and disposal costs.

In addition to the lack of management emphasis, our work indicated that GSA was ill equipped to pursue claims to recover such costs because it lacked complete and reliable management information on defaulted contracts, associated assessable costs, and claims assessed. Our analysis showed that the contract termination for default data GSA managers had were inconsistent and incomplete. Essentially, GSA managers did not have reliable information on the number of defaulted contracts for a given year. For example, we noted that records of the number of terminations for default from two GSA sources did not match for 82 percent of the contracts awarded in 1990, 49 percent in 1991, and 47 percent in 1992.

Even if its defaulted contract data were more reliable, GSA still would have had difficulty ensuring that claims were assessed against defaulted vendors because its management information system did not capture and quantify the costs that were incurred as a result of such defaults or track whether contracting officers assessed claims to recover them. During our work, GSA initiated actions designed to improve the quality and usefulness of its defaulted contract data by (1) tracking all terminations for vendor default to help ensure that its management information system is capturing such data and (2) identifying some of the causes of system errors and correcting them. It also has begun developing data on the various administrative costs that are incurred as a result of vendor default.

Finally, poor claims administration practices jeopardized GSA's ability to monitor, account for, and collect the claims it did assess against defaulted vendors. Our analysis of the claims GSA assessed in connection with the 40 sampled contracts showed that poor claims administration practices impaired its ability to collect them. For example, GSA's management information system omitted one claim worth about \$17,000. In another case, GSA credited a vendor's payment of about \$3,000 to the wrong claim. In several delinquent claims, GSA did not assess related interest, penalties,

and administrative charges. For example, GSA did not charge vendors about \$3,400 in interest and penalties when it collected over \$40,000 in claims that were from 3 to 10 months overdue.

Officials at GSA's finance division acknowledged that such claims administration weaknesses existed and attributed them to their (1) failure to follow established procedures that are designed to detect and resolve errors, (2) lack of interoffice communication, and (3) lack of overall management information on claims assessed. They said that they corrected some of the errors we brought to their attention and have begun auditing their files and improving communication to detect and resolve other errors that can jeopardize collections. However, they acknowledged that they would continue to have difficulties in ensuring that all claims are collected without complete and reliable data on total claims assessed.

Conclusions

Lack of management emphasis and complete, reliable data on the universe of defaulted contracts and associated costs have caused GSA to miss opportunities to pursue claims against defaulted vendors to recover these costs. Although unclaimed costs on individual defaulted contracts can be relatively small, in the aggregate they could be substantial since GSA (1) terminates hundreds of supply contracts annually for vendor default and (2) incurs replacement product price increases, administrative costs, or defective product costs on many of them that are worth pursuing. Also, poor claims administration practices have impaired GSA's ability to account for and collect the amounts due under the claims it does assess.

During our review, GSA acknowledged the need to improve its management and oversight of the claims process and initiated actions designed to improve its ability to identify, track, and recover associated replacement product price increases and administrative costs. These actions are steps in the right direction. However, additional actions—such as more complete management information data on contract terminations for vendor default and claims assessed and collected and criteria for contracting officers to use in assessing claims for defective product costs—as well as sustained top management attention will be needed to better ensure that claims to recover the full range of costs resulting from vendor defaults are identified, assessed, and collected.

Recommendations

To help ensure that GSA pursues claims to recover the full range of costs it incurs when vendors default on supply contracts and to improve its

management oversight of the claims process, we recommend that the Administrator of GSA

- ensure that FSS and the Office of Finance complete, effectively implement, and sustain ongoing initiatives that are intended to improve the quality and usefulness of GSA's data for assessing claims and its ability to collect amounts due under the claims it does assess;
- expand the guidance contracting officers use in assessing claims to include criteria for calculating and assessing the costs associated with defective products;
- enhance management oversight by refining GSA's management information system to include complete and reliable data on the universe of contract terminations for vendor default, the nature and total amount of any assessable costs, whether claims have been assessed to recover these costs, and total claims assessed and collected; and
- continuously oversee and evaluate GSA's overall effectiveness in recovering these costs.

Agency Comments and Our Evaluation

In written comments dated March 31, 1994, on a draft of this report, GSA agreed that its management oversight of the claims process needs to be intensified and concurred with our recommendations (see app. I). GSA provided information on its completed, ongoing, or planned actions aimed at improving the effectiveness and management oversight of efforts to recover costs incurred as a result of vendor default. GSA's actions appear responsive to three of our four recommendations. If fully and effectively implemented and sustained, they should help ensure that claims to recover resulting replacement product price increases and administrative costs are identified, assessed, and collected. However, we do not believe that GSA's corrective actions in the defective products area are responsive to our second recommendation.

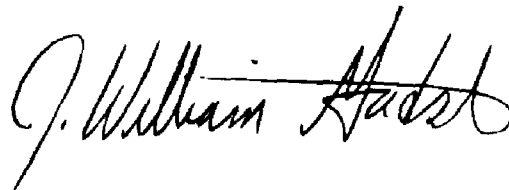
We noted in our draft report that GSA had issued new guidance to its contracting officers on the importance of pursuing claims to recover all costs resulting from vendor default. But, we pointed out that GSA contracting officers still lack guidance or criteria for calculating and assessing the costs of holding and disposing of defective products. GSA's guidance—FSS Acquisition Letter FC-93-2, issued June 17, 1993—provided detailed procedures and worksheets to help contracting officers calculate, track, and assess replacement product price increases and administrative costs. However, this guidance did not include comparable criteria for calculating and assessing defective product holding and disposal costs.

Thus, we continue to believe that GSA needs to expand its guidance to specifically cover these costs.

We are sending copies of this report to the Administrator of GSA, the Director of the Office of Management and Budget, and other interested parties. Copies of this report will also be made available to others upon request.

This work was done under the direction of Michael E. Motley, Associate Director, Government Business Operations Issues. Other major contributors to this report are listed in appendix II. If you have any questions or would like additional information, please contact me on (202) 512-8387.

Sincerely yours,



J. William Gadsby
Director, Government Business
Operations Issues

Comments From the General Services Administration



Administrator
General Services Administration
Washington, DC 20405

March 31, 1994

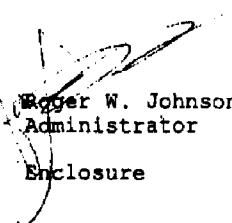
The Honorable Charles A. Bowsher
Comptroller General of the
United States
General Accounting Office
Washington, DC 20548

Dear Mr. Bowsher:

Thank you for the opportunity to comment on the General Accounting Office (GAO) draft report, "SUPPLY CONTRACT TERMINATIONS: GSA is Missing Opportunities to Recover Costs from Defaulted Vendors (GAO/GGD-94-XX)."

While the General Services Administration (GSA) already had procedures in place to recover these costs, we agree that GSA's management oversight needs to be intensified, and we have strengthened procedures accordingly. Other actions have also been taken, planned, or are underway to ensure the efficacy of GSA's cost recovery efforts. Specific comments on the report recommendations are provided in the enclosed statement.

Sincerely,


Roger W. Johnson
Administrator

Enclosure

See pp. 8 - 10.

**Appendix I
Comments From the General Services
Administration**

**GENERAL SERVICES ADMINISTRATION'S COMMENTS
ON THE GAO DRAFT REPORT, "SUPPLY CONTRACT TERMINATIONS:
GSA is Missing Opportunities to Recover Costs from Defaulted
Vendors (GAO/GGD-94-XX)", dated March 1, 1994**

Recommendation 1:

Ensure that FSS and the Office of Finance complete and effectively implement ongoing initiatives that are aimed at improving the quality and usefulness of GSA's data for claims assessments and its ability to collect amounts due under the claims it does make.

Comment:

Concur. Procedures for use by the Administrative Contracting Officers (ACO's) concerning assessment and collection of excess costs from contractors in default were issued by GSA's Federal Supply Service (FSS) in the Supply Operations Handbook, Contract Administration (FPP P 2901.9, chapter 15, paragraph 17) on July 9, 1993. These procedures require the ACO's to develop and maintain a separate file for each termination issued. Each file is to be maintained for five years and will collectively provide reliable data on the number of contract terminations and the amount of recoverable costs assessed.

FSS Acquisition Letter FQ-91-1, "Processing a claim against a contractor when the Government must dispose of hazardous material", was issued on October 22, 1991, and renewed on October 29, 1993. These guidelines provide instructions to the ACO's when hazardous material has been identified for disposal, including factors to be considered when determining disposal costs.

In February 1994, GSA's Office of Finance in Kansas City resumed the sampling of claim files to verify appropriate handling. Also, the programming of the initial data base application for tracking and controlling claims processes should be completed and system usage implemented by July 1994.

Recommendation 2:

Expand the guidance contracting officers use in assessing claims to include criteria for calculating and assessing the costs associated with defective products.

See pp. 8 - 10.

**Appendix I
Comments From the General Services
Administration**

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Comment:

Concur. On May 3, 1993, a memorandum was sent to all FSS commodity centers directing that the center designate an individual to oversee all termination actions. The memorandum included a termination log. The individual designated by the center was tasked with monitoring all terminated contracts and orders to ensure that contracting personnel undertake appropriate actions.

On June 17, 1993, FSS Acquisition Letter FC-93-2 was issued. It provides, with its worksheets, 15 pages of supplemental guidance on assessing both direct and indirect administrative costs covering such items as salary, printing, and transportation, as well as direct additional costs of the item reprocured. It also contains detailed procedures for calculating these costs and provides worksheets to assist in tracking and summarizing the costs. This letter was forwarded to all FSS procuring activities for comment prior to issuance to ensure that it provided relevant guidance not previously provided. Acquisition letters are directives which are part of GSA's regulatory system and are designed to augment other regulations, including the Federal Acquisition Regulation (FAR) and the General Services Administration Acquisition Regulation (GSAR).

FSS has reviewed the Defense Federal Acquisition Regulation, which has limited guidance on recovering excess costs, as well as other publications. Several other agencies have been canvassed as well; and thus far, it appears that the existing guidance in FSS Acquisition Letter FC-93-2 exceeds the guidance provided by other agencies.

Recommendation 3:

Enhance management oversight by refining GSA's management information systems to include complete and reliable data on the number of contract terminations, the nature and total amount of any recoverable costs, whether or not claims have been assessed to recover these costs and total claims assessments and collections.

Recommendation 4:

Oversee and evaluate on a continuous basis GSA's overall effectiveness in recovering these costs.

**Appendix I
Comments From the General Services
Administration**

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Comment:

Concur. Based on the information being collected on the termination log (discussed in our comments to recommendation 2), FSS is establishing a quarterly summary report as an interim system to assist management in overseeing these activities. Actions are underway to modify our management information system to consolidate source files used in maintaining contract information in both the FSS Offices of Commodity Management and Quality and Contract Administration modules. The consolidation of these data files will eliminate discrepancies between the two sources. Once completed, the system will maintain complete and reliable data on the number of contract terminations.

Additionally, FSS is establishing a single management information system that will cover the entire universe of the termination process, from assessing to collecting claims. The proposed system will interface with existing automated systems and will be available for use by appropriate FSS and Office of Finance officials.

Also, as an interim measure, with the completion of the Office of Finance's accounts receivable claims system (discussed in our comments to recommendation 1), monthly management reports on claims received, collected, delinquent, or written off will be produced for each contracting office.

These management information systems improvements will provide GSA's management with an important tool in overseeing our effectiveness in assessing and collecting these costs.

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