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United States Government

Department of Energy

memorandum

DATE: August 19, 1994

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ATTN OF: IG-1

SUBJECT: INFORMATION: Summary Report on the Department of Energy's
Management and Operating Contractors' Use of
Government Supply Sources

TO:
The Secretary

BACKGROUND:

To minimize costs of supplies and services to Government agencies and their contractors, the General Services Administration has established the Federal Supply Schedule Program. Entities that participate in the program are known as Government supply sources. These sources consist of the General Services Administration, other Government agencies, or private vendors under a contract with the General Services Administration. This program is designed to allow Government agencies the option of ordering standard commercial items directly from the Federal supply sources while taking advantage of the discounts associated with the General Administration's volume buying.

Under the program, the General Services Administration enters into contracts with commercial firms to provide supplies and services at stated prices for given periods. The General Services Administration publishes Federal Supply Schedules which provide the necessary information for Government agencies and their contractors to use in obtaining supplies and services.

DISCUSSION:

In the past two years the Office of Inspector General has issued five reports on Management and Operating contractors' use of Government supply sources. Four of the five audits disclosed that the Department's Management and Operating contractors did not always use Government supply sources when these sources were available at a lower cost to the Government. The reports pointed out that these contractors expended \$13.6 million more for goods and services than was necessary.

Management did not entirely agree with the audit findings. They raised issues which questioned the very basis for the Federal Supply Schedule Program and its application to the Department's contractors. The purpose of this report is to highlight unresolved issues and to assist the Department in

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resolving areas of continuing concern so that policies related to the use of Government supply sources can be clarified for use throughout the Department. The issues addressed in this report were discussed with officials in the Office of the Deputy Assistant Secretary for Procurement and Assistance Management.

John C. Layton
Inspector General

Attachment

cc: Deputy Secretary
Under Secretary
Deputy Assistant Secretary for
Procurement and Assistance Management

U. S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

SUMMARY REPORT ON THE DEPARTMENT OF ENERGY'S
MANAGEMENT AND OPERATING CONTRACTORS' USE
OF GOVERNMENT SUPPLY SOURCES

Report No. DOE/IG-0355
Date Issued: August 19, 1994

Office of Audits
Washington, D.C. 20585

U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

SUMMARY REPORT ON THE DEPARTMENT OF ENERGY'S
MANAGEMENT AND OPERATING CONTRACTORS'
USE OF GOVERNMENT SUPPLY SOURCES

TABLE OF CONTENTS

	<u>Page</u>
PART I - OVERVIEW.....	1
INTRODUCTION.....	1
BACKGROUND.....	2
SPECIFIC AREAS OF CONCERN.....	2
CONCLUSION.....	4
PART II - SUMMARY OF INDIVIDUAL AUDIT REPORTS.....	6

PART I

OVERVIEW

INTRODUCTION

Since 1992, the Office of Inspector General (OIG) audited the use of Government supply sources by five Department of Energy management and operating (M&O) contractors. The Department of Energy Acquisition Regulation (DEAR) prescribes that M&O contractors should use Government supply sources to satisfy their requirements for goods and services when these sources are made available to them and when it is economically advantageous. Four of the five audits disclosed that M&O contractors did not always use Government supply sources when these sources were available at a lower cost to the Government. As a result, these contractors incurred costs of approximately \$13.6 million more for the supplies and services than necessary. The audit reports addressing these issues are summarized in Part II.

Management did not agree with all aspects of the audit findings. It raised several objections which, when analyzed, questioned the very basis for the Federal Supply Schedule Program and its application to the Department's contractors. These included: (1) questions about the Regulation language establishing the Federal Supply Schedule Program, (2) the impacts the Federal Supply Schedule Program had on the ability of the M&O's to meet their small and small disadvantaged business procurement targets, and (3) the cost effectiveness of the Federal Supply Schedule Program itself. In addition to management's objections to several of the audit findings, we noted that the re-invention concepts embodied in the National Performance Review (NPR) appear not to support the policy of centralized procurement.

The purpose of this report is to highlight unresolved issues so that policies related to the use of Government supply sources can be clarified for use throughout the Department's complex.

BACKGROUND

To minimize costs of supplies and services to Government agencies and their contractors, the General Services Administration (GSA) established the Federal Supply Schedule Program. Entities that participate in the program are known as General supply sources. These sources consist of the GSA, other Government agencies, or private vendors under contract with the GSA. They provide Federal agencies with diverse supplies and services. The program was designed to allow Government agencies to order standard commercial items directly from a contractor while enjoying the discounts associated with the GSA's volume buying for store stocked items. Under the program, the GSA enters into contracts with commercial firms to provide supplies and services at stated prices for given periods. The GSA publishes Federal Supply Schedules to provide the necessary information for the Department as well as other Government agencies and their cost type contractors to use in obtaining supplies and services.

SPECIFIC AREAS OF CONCERN

In responding to our reports, the Department's managers concluded that there were three impediments which precluded the widespread use of the GSA Federal Supply Schedule Program. These impediments and the OIG position taken in the audit reports are described in the following paragraphs.

Regulation Language

The DEAR paragraph 970.5101 prescribes that M&O contractors "...should meet their acquisition requirements from Government sources of supply, when these sources are made available to them and when it is economically advantageous." Some Department managers stated in response to our audit reports that neither the DEAR nor other regulations mandate the use of Government supply sources for M&O contractors. They argued that the term "should" in the DEAR is permissive, not mandatory. The Office of Procurement, Assistance and Project Management, Office of Policy advised a Department manager that the use of the term "should" indicates a strong preference for use of the sources, not a mandatory requirement. One Department manager also stated that there was no regulation that required M&O's to make purchases at "fair and reasonable" prices or even at the lowest price obtainable. Therefore, this manager concluded that failure to use a Government supply source did not constitute non-compliance with either the M&O's contract or the Department's policy.

Our position, as reflected in the audit reports, was that the language in the DEAR concerning this issue was clear. For example, DEAR 970.5101(e) requires contractors to adequately document the reasons why items were purchased from commercial vendors when they were available from Government supply sources. We raised the issue as to why this documentation would be required if use of Government supply sources was not mandatory. The audits disclosed that there was confusion among Departmental management as to the intent of the regulatory language. Therefore, the Department needs to come to a common understanding of the DEAR language regarding the use of the Federal Supply Schedule Program by the M&O contractors.

Small and Small Disadvantaged Businesses

The Small Business and Small Disadvantaged Business Subcontracting Plan (April 1984) required M&O contractors to support the Government's policy to provide maximum practicable opportunity to small and small disadvantaged businesses. Failure to support the plan is considered a material breach of contract and can result in termination of the contract for default. Management has pointed out that many, if not most, of the types of supplies and materials available from small and small disadvantaged businesses are the types available from Government supply sources. Several Department managers, in response to the OIG audit reports, stated that they could not use Government supply sources because such action would effectively make it impossible for them to meet their small and small disadvantaged business contract requirements.

GSA representatives informed us that purchases from Government supply sources would serve to satisfy Departmental contractor commitments to purchase from small and small disadvantaged businesses. This is because GSA's contracts are awarded to small and small disadvantaged businesses to the maximum practical extent. The Department needs to reconcile the positions expressed on this issue to clarify any inconsistency between competing requirements to use the Government source of supply and the requirement to use small and small disadvantaged businesses.

Cost Effectiveness of the Program

One of the issues raised consistently during the audits dealt with the price of supplies and the costs to the M&O contractors to administer the Federal Supply Service Program. Although some managers concurred in principle with our recommendations to use Government supply sources, they stated that the actual cost of the program may exceed the benefit. For example, the Manager, Oak Ridge Operations Office described the

economies associated with express buying methodology as compared with purchasing from Government supply sources. Express buying allowed buyers to handle up to 40 separate purchases per day on a telephone order basis. Using the calculations in our audit report, it was pointed out that buyers would spend 7 hours per day just to determine if the requisitioned items were available from Government supply sources. Management further stated that telephone orders would generally have to be replaced by a written order to a Government supply source. Management argued that this would require increased staff. In addition to staff increases, management indicated that it would need new auxiliary computer equipment to operate the systems.

We recognized the complexity of determining the most economical source of supply. However, we were not convinced based on the evidence presented that buying from commercial sources would be more economical than buying from the Government supply source. A comprehensive cost-benefit analysis should be performed to resolve these questions.

NATIONAL PERFORMANCE REVIEW

During the course of our review, we evaluated the impact of the concepts embodied in the NPR on the viability of the Federal Supply Schedule Program. In the NPR Internal Team Report to the Secretary of Energy, dated September 1993, it was stated that the procurement process within the Department is cumbersome, time consuming, and inefficient; and the cost of preparing and processing the requisitions can often be more than the cost of the item being purchased.

The NPR itself discourages large, centralized buying services in favor of empowering procurement officials to use their own initiative to buy locally. This approach appears to raise additional questions regarding the Federal Supply Schedule Program. The Department needs to determine if any requirement imposed on the M&O contractors to use Government supply sources is consistent with the programmatic direction established by the NPR.

CONCLUSION

The overall conclusion of the audit reports was that M&O contractors were not always using the Government supply sources as intended by the Federal Supply Schedule Program. Yet, based on our analysis of the comments of the Department's managers to the reports, significant policy questions exist concerning Departmental policy regarding M&O contractor's purchase of supplies and services through Government supply sources. At the five M&O contractors that were audited, these contractors spent

hundreds of millions of dollars annually on supplies and services. Considering the magnitude of these expenditures, we believe that consistent policies should be established which allow the Department and its contractors to acquire supplies and services as effectively and efficiently as possible. These policies should serve to fully resolve the questions Department managers raised when responding to our audit recommendations as well as to any relevant issues in the NPR.

Office of Inspector General
Office of Inspector General

PART II

SUMMARY OF INDIVIDUAL AUDIT REPORTS

Audits on the use of Government supply sources by the Department's management and operating (M&O) contractors were performed at (1) Argonne National Laboratory, (2) Savannah River Site, (3) Wackenhut Services Incorporated (Savannah River Site), (4) Martin Marietta Systems, Inc., and (5) Fernald Environmental Management Corporation. A synopsis of the reports issued for those audits are provided in the following paragraphs.

Argonne National Laboratory's Use of Government Supply Sources, ER-B-92-04, March 17, 1992

The University of Chicago is responsible for managing and operating the Argonne National Laboratory under a cost-plus-management allowance contract with the Department. The Argonne Procurement Department was delegated the functional responsibility to conduct its procurement operations in compliance with the contract. The audit was performed from July 3 to November 15, 1991, and it included procurement activity for the first three quarters of Fiscal Year 1991. During this period Argonne issued 17,166 purchase orders valued at about \$40.2 million.

The audit disclosed that Argonne did not always purchase supplies and equipment from Government supply sources when these sources were available, economically advantageous, or otherwise to the Government's best interest. This condition existed because Argonne did not have (1) specific, clearly written procurement policies and procedures that required the use of Government supply sources when it was advantageous to the Government, or (2) information concerning goods and services available from Government supply sources. Consequently, Argonne incurred about \$1.2 million of questionable costs in FY 1991.

Management agreed that Argonne's written procedures should be stated more clearly but did not agree to require Argonne to fully comply with Department of Energy procurement regulations. Although management agreed to acquire appropriate information to identify Government supply sources, they did not agree to recover the unallowable \$1.2 million costs claimed and reimbursed to Argonne.

Use of Government Supply Sources at the Savannah River Site, ER-B-92-07, August 10, 1992

The Westinghouse Savannah River Company was responsible for managing and operating the Savannah River Site under a

cost-plus-award-fee contract with the Department. The audit was performed from August 1 to December 6, 1992, and it included procurement activity for the 12 months ended July 31, 1991. During this period Westinghouse issued 34,068 purchase orders, 4,146 releases against blanket order agreements, and 4,537 orders against price agreement contracts. The total value of these purchases approximated \$185 million.

The audit found that Westinghouse did not always use Government supply sources when these sources were available at a lower cost to the Government. Specifically, Westinghouse did not (1) research the items being purchased or code orders correctly, (2) have adequate information from Government supply sources, and (3) have detailed item descriptions to determine whether the items were available from Government supply sources. As a result of not following Departmental policies, Westinghouse incurred \$9.6 million of costs that we considered potentially unallowable.

Management agreed to correct the procedural problems identified in the report "within the constraints of available staff" but stated that the \$9.6 million costs were not unallowable on the basis that was stated.

Report on Audit of Use of Government Supply Sources at Wackenhut Services Incorporated, ER-L-93-12, September 30, 1993

The Department had contracted with Wackenhut Services Incorporated to provide security guard services at the Savannah River site. This audit was performed from June 21 through 24, 1993, and it included a review of Wackenhut Incorporated's procurement activity for the 12 month period ended April 30, 1993. During this period, Wackenhut issued 1,149 purchase orders with a total value of \$3.9 million.

Our audit found that Wackenhut generally used Government supply sources when these sources were available, economically advantageous, or otherwise in the Government's best interest. Since Wackenhut was generally using Government supply sources, there were no recommendations made in this report.

Report on Audit of Martin Marietta Energy Systems, Inc.'s Use of Government Supply, ER-B-94-04

The Department had contracted with Martin Marietta Energy Systems, Inc. to manage and operate three of its production, research, and environmental restoration facilities in Oak Ridge, Tennessee. The audit was done from June 21 to November 24, 1993. It included procurement activity for the 12 month period ended April 30, 1993. During this period, Energy Systems executed about \$266 million in procurement actions for equipment and supplies.

The audit showed that Energy Systems had taken certain actions to procure from Government supply sources. However, of 256,000 procurement actions totalling \$266 million, Energy Systems issued only 754 purchase orders valued at \$1.6 million to Government supply sources. The auditors found that Energy Systems did not take advantage of numerous opportunities to purchase items at lower cost from Government supply sources. For example, a sample of 74 accelerated procurements and 80 traditional purchase orders disclosed that about 31 percent of the accelerated procurements and 24 percent of the traditional purchase orders contained items that could have been purchased at a cost savings. Government supply sources were not always used or otherwise properly documented because of two factors: procedures were inadequate, and requestors provided inadequate item descriptions. As a result of these conditions, Energy Systems incurred approximately \$2.5 million in potentially unallowable costs.

Although management concurred or concurred in principal with our recommendations, they stated that the costs of implementing the recommendations could in some instances exceed any potential benefits.

Report on Audit of Fernald Environmental Restoration Management Corporation's Use of Government Supply Sources, ER-B-94-05, April 21, 1994

The Fernald Corporation, a wholly owned subsidiary of Flour Daniel, Inc., was awarded a \$2 billion cost-plus-fixed-fee contract with the Department in December 1992. The purpose of the contract was to assume responsibility for cleanup of the Fernald Environmental Management Project. The audit was performed from June 9, 1993 to January 13, 1994, and it included procurement activity for the six months ended May 30, 1993. During this period, Fernald Corporation issued 4,959 purchase orders for equipment, materials and supplies worth approximately \$42 million.

Although Fernald Corporation's policy required their buyers to use Government supply sources when it was economically advantageous or otherwise in the best interest of the Government, the policy was not implemented. This condition was found to exist because the contractor had not established adequate management controls to ensure buyers' compliance with company policy. As a result of this condition Fernald Corporation incurred about \$267,000 in unnecessary costs.

Management generally agreed with our audit finding and recommendation. However, management did not agree with the computation of cost savings resulting from the use of Government supply sources because additional administrative costs were not taken into account.

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