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REPORT TO THE COMMITTEE ON
POST OFFICE AND CIVIL SERVICE
HOUSE OF REPRESENTATIVES



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Observations On Sole-Source
Procurement And Overruns

U. S. Postal Service

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

GGD-75-81

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MAY 9 1975



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-171594

The Honorable David N. Henderson
Chairman, Committee on Post Office
and Civil Service
House of Representatives

Dear Mr. Chairman:

In response to the Committee's request, we are providing you with our observations on sole-source procurement and overruns in the U. S. Postal Service.

As your office agreed, agency comments have been obtained and are included as appendix II.

We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

A handwritten signature in cursive script that reads "James B. Stacks".

Comptroller General
of the United States

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COMPTROLLER GENERAL'S
REPORT
TO THE COMMITTEE ON
POST OFFICE AND CIVIL SERVICE
HOUSE OF REPRESENTATIVES

OBSERVATIONS ON SOLE-
SOURCE PROCUREMENT
AND OVERRUNS
U. S. Postal Service

D I G E S T

WHY THE REVIEW WAS MADE

The Chairman asked GAO to examine the way the Postal Service lets its contracts on a sole-source basis and what appears to be an excessive amount of cost overruns in relationship to these contracts.

GAO limited its review to sole-source contracts awarded during fiscal year 1973 by the Service's headquarters Procurement and Supply Department.

FINDINGS AND CONCLUSIONS

The Service could, in some cases, have avoided sole-source procurement. There did not appear to be a problem of excessive cost overruns on sole-source contracts.

Sole-source contracting

From July 1972 through March 1974, the headquarters Procurement and Supply Department awarded 261 sole-source contracts having a current value of \$97.9 million. These contracts represent about 25 percent of the total number of contracts awarded by the Department and 44 percent of the total dollar value. (See p. 3.)

A wide variety of goods and services were procured on a sole-source basis. Complex

items, such as Mark II facer cancellers, and simple items, such as plastic letter mail tray covers, stamp collection starter kits, and executive office furniture, were procured on this basis.

Two reasons frequently used by the Service to justify sole-source procurement were

--the item was needed urgently or immediately and/or

--the contractor was the only source of supply.

GAO reviewed selected sole-source procurements and concluded that, in certain cases, these justifications were questionable and the Service could have avoided sole-source procurement. (See pp. 3 to 6.)

Cost overruns on
sole-source contracts

During fiscal year 1973, the Department awarded 159 sole-source contracts having a value of \$5,000 or more. The initial value of these contracts was \$36.1 million. By June 1974, the value of the contracts amounted to \$66.8 million, or a \$30.7 million increase. (See p. 6.)

GAO selected nine contracts for review which accounted for \$28.2 million of the \$30.7 million increase. Analysis of this increase on the nine contracts showed that

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--\$18.3 million represented the difference between the value of the letter contract and the definitized contract amount. This amount would not be classified as cost overrun since it arose through normal contracting procedures. (See p. 7.)

--\$7.5 million represented the value of contract amendments caused by changes in work scope, for which the Service receives additional supplies or services. (See p. 8.)

--\$2.4 million represented additional funding on one contract for which the Service received no additional supplies or services. (See p. 8.)

The remaining \$2.5 million

represents the net increase of 46 contracts--9 decreases and 37 increases. GAO believes that cost overruns on sole-source contracts is not a significant problem in the Service's procurement operations. (See p. 9.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

On February 27, 1975, the Postmaster General replied to GAO's report. He concurred in GAO's findings and briefly summarized the Service's corrective actions, those complete as well as those in process. GAO believes these actions should reduce the use of sole-source contracting. There has, in fact, already been a decrease in such contracts. (See p. 9.)

CHAPTER 1
INTRODUCTION

The Chairman, House Committee on Post Office and Civil Service, requested that we examine the way the Postal Service lets its contracts on a sole-source basis. Additionally the Committee expressed interest in what appeared to be an excessive amount of cost overruns in relationship to these contracts. (See app. I.)

GENERAL CONTRACTING POLICIES
AND PROCEDURES

The Postal Reorganization Act authorized the Service to develop its own procurement policies and procedures. These are set forth in the Postal Contracting Manual and are patterned after the Armed Services Procurement Regulation.

The manual provides that all purchasing, whether by formal advertising or by negotiation, be competitive to the maximum practicable extent.

A formally advertised contract results from soliciting bids; the award is made to the responsible bidder whose bid will be most advantageous to the Service--price and other factors considered. This method provides the greatest assurance that fair and reasonable prices are obtained.

Negotiated contracts can be awarded on a competitive or non-competitive basis. The Service uses five procurement methods in negotiating contracts:

- Price competition.
- Design or technical proposal.
- Special sources.
- Informal purchases.
- Sole-source procurement.

The first four methods either contain elements of competition or represent purchases through or from Federal agencies. The fifth method, sole-source procurement, is devoid of competition and gives less assurance that fair and reasonable prices will be obtained. However, Federal and postal regulations recognize that sole-source contracting may be justified under certain conditions.

Service officials advised us that they do not currently have the means to summarize data on contracting activities throughout the Service's operations. Summary procurement data is not available at headquarters from Postal Service field operations, such as supply centers and regional, district, and individual post offices.

SCOPE OF REVIEW

We have limited our review to those contracts awarded by the Service's headquarters Procurement and Supply Department because (1) the Department is the only activity with readily available procurement data, (2) Service officials have advised us, and our review showed, that most of the sole-source procurement occurred in this Department, and (3) allegations concerning extensive sole-source contracting and cost overruns concerned this Department's procurement activities.

Our review was limited to contracts awarded during fiscal year 1973. Service officials said adequate procurement statistics were not available before July 1972.

CHAPTER 2
SOLE-SOURCE
CONTRACTING AND OVERRUNS

The Service could, in some cases, have avoided sole-source procurement. There did not appear to be a problem of excessive cost overruns on such contracts.

SOLE-SOURCE CONTRACTING

Procurement and Supply Department records show that, from July 1972 through March 1974, a total of 1,054 contracts valued in excess of \$5,000 were awarded. Of these, 261 were sole-source contracts. The value 1/ of the 1,054 contracts, at the time of our review, was \$222.6 million, of which \$97.9 million represented the value of the sole-source contracts. Sole-source contracts represented 25 percent by number and 44 percent by value of the contracts awarded. The value of these contracts may change as a result of contract amendments because many of them are still active.

JUSTIFICATIONS QUESTIONABLE

The two reasons frequently used by the Service to justify sole-source procurement were that

- the item was needed urgently or immediately and/or
- the contractor was the only source of supply.

The use of these reasons--both of which are contained in the Postal Contracting Manual--seemed to depend on the complexity of the particular procurement. For example, urgency was cited in the procurement of such simple items as plastic letter mail tray covers and neighborhood delivery and collection boxes, and the latter reason was used to support procuring complex Mark II facer cancelers and engineering design work.

Immediate need

The following are examples of the circumstances under which immediate need was used to justify sole-source procurements.

1/ Definitized contract price plus contract amendments affecting price.

Plastic tray covers

The following events occurred in this procurement. These covers were reportedly designed to protect letters from becoming "dog eared" and nonmachinable when letter mail trays are stacked.

- October 16, 1972--the Service received, from a contractor, an unsolicited proposal for furnishing tray covers.
- November 9, 1972--sole-source contracting approved on the basis that the tray covers were urgently needed since the covers would save time and money in processing letter mail.
- November 15, 1972--the Logistics and Engineering Department indicated a requirement for 500,000 tray covers.
- February 9, 1973--negotiations were concluded reducing the contractor's proposed price from \$2.48 to \$1.74 per unit.
- April 20, 1973--the contractor was certified eligible by the Small Business Administration for participation in its contracting program.
- May 29, 1973--a contract was awarded for 500,000 tray covers at a total cost of \$870,000.
- January 21, 1974--the Service received a letter from the contractor asking for a price increase.
- January 25, 1974--the Service notified the contractor that it had failed to furnish an acceptable tray cover.
- February 22, 1974--the Service received a letter from the contractor's legal counsel asking for termination of the contract.
- March 1, 1974--the Logistics Department requested the Office of Procurement to purchase the contractor's mold and contract for 10,000 covers for test purposes.
- August 7, 1974--the contract was terminated and the Service purchased the contractor's mold for \$24,020.

The handling of this procurement is questionable since the justification requesting approval of sole-source contracting stated the tray covers were needed immediately; however, over 2 years have passed since the procurement was approved and only tray covers for test purposes

have been received. In addition, the requirement has been changed from 500,000 to 10,000 covers, and those are to be used for test purposes. We believe that, for an item like tray covers, the Postal Service should have developed specifications and solicited competitive bids.

Neighborhood delivery and collection boxes

In April 1971, the Service decided it needed 6,000 neighborhood delivery and collection box units. However, because of internal delays in obtaining design drawings and acceptable specifications, bids were not solicited until July 1972 even though the requesting office had continually attempted to expedite the procurement of this item.

While the internal delays held up the solicitation of bids, site obligations had been made for installing units at selected sites. To meet these arising obligations and until a large production contract could be awarded, the Service on August 18, 1972, awarded a sole-source contract for manufacturing 500 units, to be used on an interim basis, to the contractor which had developed and designed the unit and had the only existing tooling. This procurement was justified on the basis that the units were needed immediately. On October 23, 1972, the Service awarded a competitive contract for manufacturing 6,000 units.

Although the justification for this sole-source contract--immediate need--appears to be valid, the circumstances which brought about this urgency, namely the delay in preparing a procurement package for this simple item, reflects adversely on the efficiency of the Service's procurement operation.

Only source of supply

When the contractor had exclusive data rights or patented copyrights on the items to be procured, the procurement was justified on the basis that the contractor was the only source of supply. This reason also has been used to justify procurements when additional sources existed, but the Service contends it lacked specifications or the contractor had special knowledge. The following are examples where this questionable justification was used.

Facer-cancelers

The Service purchased Mark II facer cancelers on a sole-source basis. These purchases were justified on the basis that only one firm could supply the equipment since it had the data rights. Although

the Service purchased the first facer cancelers approximately 17 years ago, it just recently entered into a contract to purchase the data rights. The acquisition of these rights should enable the Service to procure this equipment competitively in the future.

Office furniture

Between February 22 and June 1, 1973, 11 sole-source contracts were awarded to 10 contractors for purchasing executive-type furniture. The aggregate price of these contracts was \$436,923. According to Service documents, various chairs, sofas, and tables were purchased for areas primarily used by the Board of Governors, the Postmaster General, and the Deputy Postmaster General. These contracts were justified on the basis that only one source could provide the furniture.

A Service official stated that competition was obtained by shopping around and looking at brochures and catalogs. He expressed the belief that competitive procurement would have resulted in substantial administrative costs, particularly for preparing design specifications. He used the analogy of an individual shopping for furniture for his home as the way the Service procured this particular furniture.

OVERRUNS

We have been unable to find a clearly appropriate readymade definition for use in evaluating the alleged cost overruns absorbed by the Service in its sole-source contracts. We, therefore, have developed this ad hoc definition: a cost overrun occurs when an increase in the original contract price is passed on to the Government and the scope of the contract has not changed.

Cost overruns--using the above definition--incurred by the Service on sole-source contracts do not appear excessive. During fiscal year 1973 the agency, for sole-source procurements of \$5,000 and over, awarded 159 contracts initially valued at \$36.1 million. By June 1974, the value of these contracts had increased to \$66.8 million--a \$30.7 million increase.

We selected for review 9 of these 159 contracts. These nine contracts accounted for \$28.2 million of the total \$30.7 million increase. The remaining \$2.5 million was the net increase of 46 contracts--9 decreases and 37 increases. Our analysis of the increased contract costs for the nine contracts showed that:

- \$18.3 million represented the difference between the initial value of seven letter contracts and the subsequent definitized value.
- \$7.5 million represented the value added to five contracts for amendments caused by changes in work scope.
- \$2.4 million represented additional funding on one contract from which the Service received no additional services or supplies.

Definitization of letter contracts

A letter contract is a written preliminary contractual instrument which authorizes immediate commencement of manufacture of supplies or performance of services. A letter contract is generally used when the requirement demands that the contractor be given a binding commitment so that work can be commenced immediately and a definitive contract cannot be negotiated in sufficient time to meet the requirement.

A definitized contract should contain the agreements reached as to the scope and the total value of the work.

According to the Service's procurement regulations, funding under a letter contract is limited to 50 percent of the total estimated value of the contract. Definitization of the letter contract should take place at the earliest possible date but not later than

- 180 days from the date of the letter contract or when
- 40 percent of the production of supplies or performance of the work is reached.

Of the nine contracts we reviewed, seven had originally been letter contracts. The additional cost added to these contracts through definitization was \$18.3 million. Since the funding of a letter contract does not represent the full value of the work to be performed, the increased funding resulting from definitization of the contracts would not be considered as cost overruns.

Five of the seven contracts were definitized within the time frame set forth in the Postal Contracting Manual. The remaining two involved late definitization. These two letter contracts accounted for \$6.1 million of the \$18.3 million cost increase. One contract involved the continued development and improvement of the Letter Mail Code Sort System; the other involved the interior construction and remodeling of the Service's headquarters building. The former contract was not definitized until almost all the work had been completed; the latter contract had not been definitized as of July 1974--21 months after the letter contract was awarded. Service officials cited the lack of total funding for the Letter Mail Code Sort System and the urgency of the move to the new headquarters as the reason for late definitization of these contracts.

Late definitization of letter contracts represents poor procurement practice because the contractor has not been bound to a previously agreed to price and therefore has less incentive to perform economically than on other types of contracts. After the contractor has completed performance and incurred its cost, the contracting officer has limited leverage in price negotiations. Also it cannot be determined if the difference in cost between the letter contract and the definitized contract contains any costs which would be classified as cost overrun.

Changes in work scope

Sometimes it becomes necessary to order additional quantities of supplies or have additional services performed after a contract has been definitized. At times, it is more advantageous to amend the original contract for the additional supplies or services rather than award a new contract. Of the nine contracts reviewed, five involved modifications to the definitized contracts to increase the scope of the work. Cost increases due to contract amendments represent \$7.5 million.

For example, amendments to one contract accounted for \$5 million. Under this contract the Service is acquiring the publications "United States Stamps and Stories" and "Stamp Collecting Starter Kits." The Service's original requirement for each was based on a market test. When the products were retailed nationwide, the demand exceeded the original estimate. Therefore, the Service amended the contract to purchase additional quantities at a cost of \$5 million.

While the contract has experienced a cost increase, the Service has received value for the additional cost in the form of increased supplies of these items.

Increase in contract cost not involving a change in work scope

Of the nine contracts reviewed, only one involved a cost overrun of the type usually related to poor contracting. This contract involved developing the Code Sort Optical Character Reader II. The contract was definitized in February 1973 with a target cost and fee totaling \$2,592,000. In addition to amounts added to the original contract because of changes in the scope of the work, an additional \$2.4 million in funding was added to the cost of performing the contract. According to Service officials, the most significant cause of this additional funding was underestimating the cost of completing the project. Service officials acknowledged that the underestimating was due to poor cost estimating by both the Service and the contractor.

CONCLUSIONS

The Service could, in some cases, have avoided sole-source procurement by

- ascertaining requirements earlier,
- determining urgency of need more accurately,
- developing procurement packages more quickly, and
- acquiring data rights.

There did not, on the other hand, appear to be a problem of excessive cost overruns on sole-source contracts. These cost gains, for the most part, did not represent situations when there was an increase in contract cost without a change in scope; only one such instance was noted.

AGENCY COMMENTS

On February 27, 1975, the Postmaster General replied to our report and concurred with our findings. (See app. II.) He stated that the Service had known of the deficiencies we noted for some time and briefly summarized the Service's actions to date, which include:

- Establishing an Office of Operational Requirements at headquarters with counterparts in regional offices, responsible for identifying requirements for nonfixed mechanization. Additional control points have been and will continue to be established in functional areas to forecast future requirements, assure adequate data packages for competitive procurements, and coordinate with the Procurement and Supply Department on procurements.
- Drafting a directive which will delineate offices responsible for preparing, revising, reviewing, and controlling all Postal Service specifications, drawings, and other data ancillary thereto.
- Establishing a Postal Service policy to secure data and patent rights on all new items developed at Postal Service expense and for Postal Service use.
- Vesting sole authority for approving sole-source procurements over \$5,000 in the Assistant Postmaster General for Procurement and Supply.

These actions, if effectively carried out, should help to reduce the incidence of sole-source contracting. There has, in fact, already been a decrease in these contracts.

NINETY-THIRD CONGRESS

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U.S. House of Representatives
 COMMITTEE ON POST OFFICE AND CIVIL SERVICE
 207 CANNON HOUSE OFFICE BUILDING
 Washington, D.C. 20515

April 8, 1974.

Honorable Elmer B. Staats,
 The Comptroller General of the
 United States,
 General Accounting Office,
 441 G Street, N.W.,
 Washington, D. C., 20548.

Dear Mr. Staats:

Our Committee's Postal Facilities, Mail, and Labor Management Subcommittee is contemplating hearings on the United States Postal Service's facilities procurement programs.

Along this line, I request an investigation by the General Accounting Office as to the manner in which the Postal Service lets its contracts on a sole-source basis. Additionally, we are interested in what appears to be an excessive amount of cost overruns in relationship to these sole-source contracts.

If you or your staff should have any questions concerning this request, please let me know.

Thanking you for your cooperation and with kindest regards, I remain

Sincerely yours,



THADDEUS J. DULSKI
 Chairman



THE POSTMASTER GENERAL
Washington, DC 20260

February 27, 1975

Dear Mr. Lowe:

I welcome the opportunity to respond to your draft report entitled "Observations on Sole-Source Procurement and Overruns, United States Postal Service."

One of my major goals is to assure the establishment and continuation of a highly professional Postal Service procurement and supply organization that will give responsive support to moving the mail. I appreciate your observations and believe they will serve a useful purpose in further improving our procurement and supply function.

The principal findings of the report were--

- the Postal Service could, in some cases, have avoided the use of sole-source procurement, and
- there did not appear to be a problem of excessive cost overruns on sole-source contracts.

I concur in the findings. It is recognized that some sole-source procurements could have been avoided. As stated in more detail in the conclusions of the report, this could have been accomplished by (1) earlier ascertainment of requirements, (2) more accurate determination of urgency of need, (3) quicker development of procurement packages, and (4) acquisition of data rights.

The Postal Service has been aware of these deficiencies for some time. The following briefly summarizes our corrective actions to date:

1. The Office of Operational Requirements of the Logistics Department has been in operation for approximately one year. This office has the responsibility to identify our firm requirements for non-fixed mechanization in a timely fashion. They are actively working toward improving our procurement data packages in order to provide for a competitive data package. A counterpart

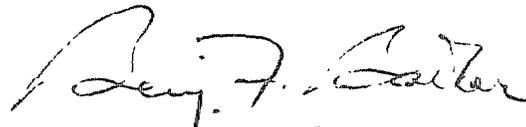
of this function has been established in our regional offices. During the past six months, the Customer Services and Management Information Systems Departments within Postal Service headquarters have also established focal points to forecast future requirements, assure adequate data packages for competitive procurements and overall coordination with the Procurement and Supply Department on procurement actions. We shall continue this program of establishing these control points within each functional area which should further reduce the situations requiring sole-source procurements.

2. Currently a directive exists in final draft form which will clearly delineate offices within the Postal Service which will have the responsibility for the preparation, revision, review and control of all Postal Service specifications, drawings and other data ancillary thereto. Coordination of these activities should assure not only the quicker development of data packages for procurement action, but also greater accuracy within the data packages.
3. We have established a Postal Service policy to secure data and patent rights on all new items developed at Postal Service expense and for Postal Service use.
4. The Assistant Postmaster General for Procurement and Supply was vested with the sole authority for approving sole-source procurements over \$5,000 by the Postmaster General on September 17, 1973. The number and dollar amounts of sole-source procurements have decreased steadily from FY 1973 as evidenced by the records of our headquarters Contract Status Reports. (See enclosed FY 1973 and 1974 and six months of procurement actions for FY 1975.)

I consider that all the above actions, those completed as well as those in process, will decrease our dependency on sole-source procurements and will assure that we obtain our supplies and equipment in a more efficient and economical manner.

Once again, I appreciate your observations concerning our sole-source procurement and overrun posture. Our major problem areas have been identified and corrective action has been instituted. We shall continue these efforts to further improve our acquisition process.

Sincerely,



Benjamin F. Bailar

Mr. Victor L. Lowe
Director, General
Government Division
U. S. General Accounting Office
Washington, D. C. 20548

Enclosures

Mr. W. J. W. W. W. W.
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