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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

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HUMAN RESOURCES DIVISION

RELEASED

OCTOBER 2, 1979

B-115369

The Honorable Henry Bellmon
United States Senate

Dear Senator Bellmon:

Subject: Review of Department of Health, Education, and Welfare Guidelines for Acquiring Automatic Data Processing Systems Under the Social Security Act (HRD-79-126)

HEW

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This is in response to your request that we review requirements governing federally funded computer acquisitions. You were concerned that the Department of Health, Education, and Welfare (HEW) may be imposing onerous requirements on a State when it procures and uses computers in administering programs under the Social Security Act. Although your request was prompted by a specific procurement action in Oklahoma, your request applied to HEW regulations governing State computer acquisitions in general.

You specifically asked that we address the following:

- Does Federal law require that HEW follow the procedures it is using to review and approve proposed computer acquisitions by the State?
- If so, what changes could be made in Federal law to free the States from current restraints on upgrading computer systems when a State wishes to improve its existing systems through incremental changes?
- Would such legislation reduce Federal, State, and local expenditures for computer systems?

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In summary, we found that:

- Federal law does not require that HEW follow the specific procedures it is using to review and approve proposed computer acquisitions by States.
- Should the Congress desire to change HEW's regulations governing automatic data processing (ADP) acquisitions by States, it could do so by enacting specific legislation.
- Such legislation is not needed, in our opinion, for reducing expenditures for computer systems because HEW's existing regulations do not appear to constrain States from making economical computer acquisitions. Although HEW requires the maximum of practical competition, it permits other methods if a State can demonstrate that they are more economical.

FEDERAL LAW DOES NOT REQUIRE HEW
TO FOLLOW ITS SPECIFIC PROCEDURES

Federal law does not expressly require HEW to follow the specific computer acquisitions procedures that it has established. However, Federal law does require the Secretary of HEW to issue rules and regulations to efficiently administer social security programs, and it is on this basis that HEW has set up its regulations for computer acquisitions by States.

These HEW regulations, which have the force and effect of statutes and are binding on the State, provide that (1) States must obtain written approval by HEW when acquiring ADP services or equipment costing more than \$25,000 and (2) procurement of ADP equipment and services must include a requirement for maximum practical competition. There must be competition unless it can be demonstrated that this is not the most economical procurement method. These requirements apply when the procurements are primarily used to support social security programs.

HEW's rationale and explanation of the legal basis for the regulations are contained in a letter dated August 30, 1978, from the Assistant Secretary for Management and Budget, HEW, to the Director, Department of Institutions, Social and Rehabilitative Services (DISRS) of the State of Oklahoma.

In essence, HEW recognizes that it has a vital interest in the use of Federal funds because:

- Greater public and legislative demands for strict accountability of Government funds makes it imperative that all levels of Government exercise good stewardship of the moneys entrusted to them.
- The systems that support Federal-State social security programs are very costly and directly affect the management and efficiency of multibillion dollar programs administered by Federal and State governments.

HEW maintained that, under any State grant program with Federal financial participation, costs may be allocated to the Federal Government if they are necessary and reasonable for proper and efficient administration of the program. To assure that Federal contributions do not exceed the costs which are necessary and reasonable, HEW's Office of General Counsel concluded that HEW may require States to submit for approval proposed acquisitions of equipment. Without HEW's prior approval, States cannot be assured that HEW will participate in funding the acquisition.

THE CONGRESS COULD CHANGE LEGISLATION

Should the Congress desire to change HEW's regulations governing ADP acquisitions, it could do so by enacting specific legislation. We believe, however, that existing legislation and regulations are adequate and flexible enough to permit States to use the most economical method of acquisition.

At any rate, the advisability of such a change in legislation would depend on whether the change would reduce expenditures for computer systems. This issue is discussed in our response to your third question, which follows.

CHANGES IN LEGISLATION ARE NOT NEEDED FOR REDUCING EXPENDITURES

In a report to the Congress entitled, "Developing State Automated Information Systems to Support Federal Assistance Programs: Problems and Opportunities" (FGMSD-78-31), we pointed out that HEW's reimbursement to States for ADP acquisitions and operations through its Health Care Financing

Administration (HCFA) was estimated at \$250 million in fiscal year 1977. In February 1979 HEW estimated that HCFA's reimbursements to States for ADP acquisitions and operations had increased to over \$400 million annually.

The policy of the Federal Government is to require free and open competition for acquiring computer equipment and services. In theory, minimizing the noncompetitive acquisitions of ADP resources allows the Government to obtain the maximum benefit from these resources by using the most economical method for acquisitions. However, because of the problems encountered in changing from one vendor's system to another (for example, developing the programs required to run on the new system), competitive procurement may not always be the most economical method for ADP acquisitions.

HEW's regulations require that States obtain HEW approval of planned ADP acquisitions. These regulations do not require a State to change its acquisition methods. However, a State needs to submit documentation to HEW which demonstrates that the method it uses for a specific procurement is the most economical under the circumstances.

Our review of computer acquisitions in five States (including Oklahoma) showed that the most economical procurement method depended on the unique factors of the specific acquisition. Because the existing HEW regulations permit either competition or sole-source procurement (if a State can demonstrate that sole-source procurement would be more economical than open competition), we believe a change in legislation is not necessary for reducing expenditures for computer systems.

We reviewed nine ADP acquisitions--three based on competition and six based on sole-source procurement--by five States. HEW approved all nine acquisitions--eight before and one after the State had completed the procurement. Based on our analysis of the technical evaluation documents, contracts, and reports and on discussions with State officials, it appears that the most economical procurement method was used in all nine instances, based on the information available to the State at the time of the procurement.

We reviewed four different computer acquisitions in Michigan--one in 1974, a second in 1975, a third in 1977,

and a fourth in process in 1979. According to State officials and our analysis of the supporting documentation, full competition was the most economical method for the 1974 acquisition and sole-source procurement was the most economical procurement method for acquisitions in 1975 and 1977 and the one in process in 1979.

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In 1974 the State's Department of Social Services decided to acquire more computer capacity through full competition. Two factors influenced the State's decision to use full competition: (1) The manufacturer of the ADP equipment the State had been using was no longer in business and (2) because the State was changing from a batch operating environment to a statewide online system, it was faced with changing systems with any vendor, and it wanted to gain the advantages of competition. Officials of both the State procurement office and Department of Social Services stated that they felt full competition was the most economical choice in this case.

In 1975 the State determined that the capacity of the new system was not sufficient, and it acquired the additional capacity on a sole-source basis. State officials believed this was the most economical method, since they had recently undergone a fully competitive acquisition in 1974. In 1977 the State again determined that its ADP capacity was insufficient, and it again decided that the most economical approach, as in 1975, was to acquire the additional capacity on a sole-source basis.

The 1975 and 1977 acquisitions increased the cost of the 1974 contract by \$2.6 million--from \$7.3 million to \$9.9 million.

In 1979 the Department of Social Services determined that its ADP capacity was again inadequate--due to program growth and added requirements. The Department of Social Services prepared an alternative procurement analysis for the State procurement board, which showed that the cost of full competition, if it was necessary to change vendors, would be substantially in excess of a sole-source procurement.

We reviewed one acquisition in Texas. Texas officials stated that, at the time the contract was awarded, they believed full competition was the most economical method for this acquisition but later discovered it was not. When the contract was awarded, the winning contractor's bid was lower than the incumbent contractor's bid by about \$1.1 million, thus appearing to result in a cost savings. However, during conversion to the new contractor's system, additional costs of an estimated \$5 million to \$10 million were incurred due to the lengthy dual operation of the new and old system. These additional costs more than offset what appeared to be cost savings due to competition.

In Oklahoma we reviewed one acquisition which was made using a sole-source method of procurement because the additional equipment was needed immediately. This acquisition was made without HEW's prior approval; however, HEW subsequently approved it. HEW also required that the State obtain approval of its planned ADP acquisitions in the future, as required by HEW regulations. State officials estimated that the sole-source method saved \$2.5 million to \$12 million because of the high cost of changing to another contractor's equipment. However, State officials were not able to provide us with the details of their estimates.

We examined two acquisitions in New York. The first acquisition was made using competition and, according to State officials, was more economical than the sole-source method. In the second acquisition, State officials believed that sole-source was more economical.

In 1976 officials of New York's Department of Social Services decided to acquire a new system using competition because the operation was being changed from a highly decentralized batch operation to a statewide online system. Accordingly, the State was faced with changing systems with any vendor and it wanted to gain the advantages of competition. According to State officials and based on our analysis of the documentation we obtained, this decision resulted in a savings of \$12.9 million--which was the difference between the winning contractors' bid and the bid of the incumbent contractor.

In 1978, after New York had acquired the system, it determined that the system was insufficient for meeting its needs and doubled its capacity by a sole-source procurement

method. State officials stated that sole-source procurement was used because changing to another contractor's system would have cost an estimated \$3 million more.


In New Jersey we reviewed another acquisition which was made by competition and, according to State officials responsible for the acquisition, competition resulted in lower costs than the sole-source method. State summary documentation showed that competition resulted in \$2.7 million less cost. The State was still putting the system into operation at the time of our review, and we could not determine its actual cost experience.

Based on our analysis of the nine procurements in these five States, we believe that the most economical procurement method depends on the unique factors for each State acquisition. Since HEW regulations permit other than full competition, if other methods are found to be more economical, we believe a change in legislation is not needed for reducing expenditures.

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As agreed with your office, unless the report's content is publicly announced earlier we plan no further distribution of this report until 10 days from the date of this report. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,


Gregory J. Ahart
Director