

A *udit*



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BUYING PROGRAM OF THE STANDARD
AUTOMATED MATERIEL MANAGEMENT SYSTEM
AUTOMATED SMALL PURCHASE SYSTEM:
DEFENSE SUPPLY CENTER PHILADELPHIA

Report No. D-2001-077

March 13, 2001

Office of the Inspector General
Department of Defense

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Abstract The Standard Automated Materiel Management System Automated Small Purchase System is a fully automated micro-purchases system used by the General and Industrial Directorate at the Defense Supply Center Philadelphia. As implemented at the General and Industrial Directorate, the Standard Automated Materiel Management System Automated Small Purchase System was used in conjunction with the Standard Automated Materiel Management System Procurement by Electronic Data Interchange to provide electronic commerce linkage to a single blanket purchase agreement vendor. The Defense Supply Center Philadelphia made \$3.79 billion in total purchases during FY 1999 to support DoD and non-DoD customers. The General and Industrial Directorate, which manages one of four commodity lines at the supply center, made about \$779.1 million in purchases. The Defense Supply Center Philadelphia made about \$52.6 million in micro-purchases during the 12-month period from April 1, 1999, through March 31, 2000, using the Standard Automated Materiel Management System Automated Small Purchase System. The General and Industrial Directorate used this system to process 52,323 micro-purchase orders valued at \$34.5 million for the same 12-month period. The audit looked at 9,733 micro-purchases valued at about \$14 million.		

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Acronyms

BPA	Blanket Purchase Agreement
DLA	Defense Logistics Agency
DSCP	Defense Supply Center Philadelphia
NSN	National Stock Number
SAMMS	Standard Automated Materiel Management System
SASPS	Standard Automated Materiel Management System Automated Small Purchase System
SPEDE	Standard Automated Materiel Management System Procurement by Electronic Data Exchange



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**

March 13, 2001

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Buying Program of the Standard Automated Materiel Management System Automated Small Purchase System: Defense Supply Center Philadelphia (Report No. D-2001-077)

We are providing this audit report for your review and comment. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations and issues be resolved promptly. The Defense Logistics Agency comments were not fully responsive and we also revised Recommendation 4. to add more specific action. Therefore, we request that the Director, Defense Logistics Agency, provide additional comments on Recommendations 3. and 4. by May 14, 2001.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Tilghman A. Schraden at (703) 604-9186 (DSN 664-9186) (tschraden@dodig.osd.mil) or Ms. Kathryn L. Palmer at (703) 604-8840 (DSN 664-8840) (kpalmer@dodig.osd.mil). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

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Report No. D-2001-077

(Project No. D2000LD-0116)

March 13, 2001

Buying Program of the Standard Automated Materiel Management System Automated Small Purchase System: Defense Supply Center Philadelphia

Executive Summary

Introduction. The Standard Automated Materiel Management System Automated Small Purchase System is a fully automated micro-purchase* system used by the General and Industrial Directorate at the Defense Supply Center Philadelphia. As implemented at the General and Industrial Directorate, the Standard Automated Materiel Management System Automated Small Purchase System was used in conjunction with the Standard Automated Materiel Management System Procurement by Electronic Data Interchange to provide electronic commerce linkage to a single blanket purchase agreement vendor.

The Defense Supply Center Philadelphia made \$3.79 billion in total purchases during FY 1999 to support DoD and non-DoD customers. The General and Industrial Directorate, which manages one of four commodity lines at the supply center, made about \$779.1 million in purchases. The Defense Supply Center Philadelphia made about \$52.6 million in micro-purchases during the 12-month period from April 1, 1999, through March 31, 2000, using the Standard Automated Materiel Management System Automated Small Purchase System. The General and Industrial Directorate used this system to process 52,323 micro-purchase orders valued at \$34.5 million for the same 12-month period. The audit looked at 9,733 micro-purchases valued at about \$14 million.

Objectives. Our overall audit objective was to evaluate the buying program of the Standard Automated Materiel Management System Automated Small Purchase System. Specifically, we determined whether the buying program had adequate controls for ensuring that contracts awarded for small purchases were at fair and reasonable prices. We also reviewed the management control program as it related to the overall audit objective.

Results. Vendors were not abiding by the terms of blanket purchase agreements with the Defense Supply Center Philadelphia that constrained vendors to a 30 percent markup over vendor cost. As a result, we projected that 4,105 of 9,733 micro-purchases could have been purchased for an estimated \$1.2 million less than the nearly \$14 million paid. If the Defense Supply Center Philadelphia improves management

*Micro-purchase is defined by the Federal Acquisition Regulation part 2, "Definition of Words and Terms," as purchases not exceeding \$2,500 per order.

controls on micro-purchases, it could avoid about \$7.2 million of costs over the 6-year Future Years Defense Program. For details on the audit results, see the Finding section.

See Appendix A for details on our review of the management control program as it relates to the controls for micro-purchases in the Standard Automated Materiel Management System Automated Small Purchase System.

Summary of Recommendations. We recommend that the Defense Logistics Agency, in conjunction with the Commander, Defense Supply Center Philadelphia, implement a competitive procurement procedure by replacing the electronic commerce interface portion of the Standard Automated Materiel Management System Automated Small Purchase System; provide training to Standard Automated Materiel Management System Automated Small Purchase System buyers and develop a user's guide; revise the methodology used by the Contract Integrity Office in calculating vendor overcharges; aggressively pursue collection of overpayments for the purchase orders listed in Appendix C; and develop performance measures and provide quarterly reports on the status of overpricing of Standard Automated Materiel Management System Automated Small Purchase System procurements for all supply centers.

Management Comments. The Defense Logistics Agency concurred with the recommendations to implement competitive procurement procedures, provide training to buyers, aggressively pursue collection of refunds due from vendors, and develop performance measures and provide quarterly reports on the status of overpricing of Standard Automated Materiel Management System Automated Small Purchase System procurements. The Defense Logistics Agency nonconcurred with changing the methodology used to compute vendor overcharges. The Defense Logistics Agency stated that the projected savings cited in the report were overstated because savings from in-house audit programs were not taken into consideration. Additionally, the Defense Logistics Agency stated that the statistical sampling methodology used by the audit team was incorrect. See the Finding section of the report for a discussion of management comments and the Management Comments sections of the report for the complete text of the comments.

Audit Response. Defense Logistics Agency comments were responsive except for the comments on the methodology for computing vendor overcharges and the statistical sampling methodology. The methodology used by the Defense Logistics Agency to identify overcharges did not adequately focus on individual purchase orders in identifying an overcharge. Further, our statistical sampling methodology was valid and our method for determining whether each purchase order was an overcharge or was within the markup limitation was proper. Based on the comments received, we revised the recommendation on collection of overcharges to add more specific action. We request that the Defense Logistics Agency provide additional comments in response to the final report by May 14, 2001.

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Background

Defense Supply Center Philadelphia. The Defense Supply Center Philadelphia (DSCP) is one of three Defense Logistics Agency (DLA) supply centers. The other supply centers are Defense Supply Center Columbus and Defense Supply Center Richmond. DLA supply centers manage spare parts and other consumable items for DoD. DSCP is organized along commodity lines into four directorates—Clothing and Textiles, General and Industrial, Medical, and Subsistence. The General and Industrial Directorate (General and Industrial) contains commodity business units that include benchstock, facilities maintenance, general hardware, metals, move and store material, and operational equipment. DSCP purchases, in support of both DoD and non-DoD customers worldwide, totaled approximately \$3.79 billion in FY 1999. General and Industrial purchases in FY 1999 were \$779.1 million, about 21 percent of total DSCP purchases. During the 12-month period from April 1, 1999, through March 31, 2000, DSCP had about \$52.6 million in Standard Automated Materiel Management System (SAMMS) Automated Small Purchase System (SASPS) micro-purchases.¹

Standard Automated Materiel Management System Automated Small Purchase System. General and Industrial used a variety of contract vehicles and procurement systems to purchase material. For micro-purchases, General and Industrial used SASPS. SASPS, in conjunction with the SAMMS Procurement by Electronic Data Exchange (SPEDE), automated the procurement of noncomplex items² with a dollar value of \$2,500 or less per purchase order. SASPS³ automation was designed to process micro-purchase orders through the procurement system without manual review or intervention.

General and Industrial Blanket Purchase Agreement. General and Industrial uses blanket purchase agreements as the contractual vehicle for micro-purchases made by SASPS. A blanket purchase agreement is not a contract or agreement to sell items at any given price or quantity. Purchases made by DLA customers in the amount of \$2,500 or less are automatically routed through SASPS rather than SAMMS if they are for national stock number (NSN) items that are included in a BPA and the items are not in stock.

A purchase begins when SASPS transmits an electronic data interface request for quote through SPEDE to a vendor who has signed a BPA with General and Industrial. SASPS purchases are limited to vendors who have signed a BPA.⁴

¹Micro-purchases are defined by the Federal Acquisition Regulation part 2, "Definitions of Words and Terms," as those purchases not exceeding \$2,500 per order.

²Noncomplex items are those items that have no special manufacturing requirements or specifications.

³References throughout this report to SASPS are inclusive references to mean SASPS/SPEDE unless otherwise noted.

⁴Although each vendor has a BPA, DCSP stated that the terms of the BPAs for micro purchase are identical except for the list of items to be provided by the individual vendor.

The vendor electronically responds with a quote, and, if that quote is within prescribed parameters, SASPS will automatically transmit a purchase order to the vendor. A contractual obligation is in effect when the Government issues the award notification for the purchase order to the vendor. As of October 2000, there were approximately 231 vendors with BPAs that provide products to General and Industrial.

Objectives

Our overall audit objective was to evaluate the buying program of SASPS. Specifically, we determined whether the buying program had adequate controls for ensuring that contracts awarded for small purchases were at fair and reasonable prices. We also reviewed the management control program as it related to the overall audit objective. Appendix A discusses the scope and methodology used to accomplish the objectives, and our review of the management control program. Appendix B discusses prior coverage.

Standard Automated Materiel Management System Automated Small Purchase System

Vendors were not abiding by the terms of BPAs with DSCP that constrained vendors to a 30 percent markup over vendor cost. Also, items were purchased through one BPA vendor when they were available from other BPA vendors at a lower price. Those conditions occurred because SASPS did not provide the capability to compete purchase orders among BPA vendors, and SASPS buyers were not adequately trained to redirect purchase orders to vendors having a lower price. Further, DSCP programs designed to recover overpayments did not fully achieve their objective. Consequently, DSCP could have purchased items for \$19,809 less for 59 of the 120 purchase orders valued at \$167,156 in our sample. As a result, we projected for the \$14 million subset of the universe included in our review that DSCP spent an estimated \$1.2 million on 4,105 SASPS purchases that could have been put to better use for a 1-year period. If DSCP does not improve management controls, DSCP could lose the opportunity to put \$7.2 million to better use, for that subset only, during the 6-year Future Years Defense Program.

Implementation of SASPS

SASPS is an automated system used by DSCP to make micro-purchases from vendors who have signed a BPA to provide specific items. Purchases for items on the BPAs that exceed the \$2,500 SASPS micro-purchase threshold and purchases for items not included in the BPAs are made through standard contracting methods. SASPS is used in three of the four directorates at DSCP; the Subsistence Directorate does not use SASPS. Rather than SAMMS or SASPS, the Subsistence Directorate uses a unique purchase system that focuses on commercial buying practices and direct vendor delivery.

Both the Clothing and Textile Directorate and the Medical Directorate at DSCP use SASPS in conjunction with SPEDE Rehost to competitively select vendors offering the best price for an item. SPEDE Rehost is a computer application that provides the electronic commerce linkage for a request for quote to be sent to multiple vendors for each micro-purchase order. The Clothing and Textile Directorate and the Medical Directorate accounted for about 34 percent (\$18.1 million) of the \$52.6 million in SASPS purchases made at DSCP during the April 1, 1999, to March 31, 2000, time period.

General and Industrial uses SASPS with SPEDE, which has the electronic commerce linkage that enables a request for quote to be sent to a single vendor with a BPA. An important difference between SPEDE and SPEDE Rehost is that SPEDE automatically transmits the request for quote to only one vendor,

whereas SPEDE Rehost transmits the request for quote to multiple vendors. SASPS, with SPEDE, rotates vendors who sell particular NSNs on a daily basis. All purchase orders for a specific NSN are automatically routed to the vendor that has rotated to the top of the list for that day. As long as the vendor's electronic response to the request for quote for an item's price does not exceed by more than 25 percent any price paid in the past year, SASPS automatically accepts the quote. If the price quote exceeds the 25 percent threshold, SASPS alerts the SASPS buyer to review the purchase order. The buyer may accept the quote, cancel the order, redirect the request for quote to another vendor, or refer the purchase order to the item manager. General and Industrial accounted for about 66 percent (\$34.5 million) of the \$52.6 million in SASPS purchases made at DSCP during the April 1, 1999, to March 31, 2000, time period.

Criteria

Fair and Reasonable Pricing. The Federal Acquisition Regulation prescribes policies and procedures for the acquisition of supplies and services, including construction, research and development, and commercial items—the aggregate amount of which does not exceed the simplified acquisition threshold. Specifically, Federal Acquisition Regulation subpart 13.106-3(a), “Award and Documentation,” states that before making an award, the contracting officer must determine that the price is fair and reasonable. Federal Acquisition Regulation subpart 13.106-3(a)(1) further states that whenever possible, price reasonableness should be based on competitive quotations or offers. However, Federal Acquisition Regulation subpart 13.202(a)(2), “Purchase Guidelines,” states that “micro-purchases may be awarded without soliciting competitive quotations if the contracting officer or individuals appointed in accordance with [subpart] 1.603-3(b) considers the price to be reasonable.”

Blanket Purchase Agreement Terms. The General and Industrial BPAs established conditions and terms for micro-purchases made under SASPS. Specifically, each General and Industrial BPA states:

This Blanket Purchase Agreement (BPA) is not a contract. It is a vehicle establishing the terms, conditions, and provisions applicable to the automated ordering of supplies having a value of \$2,500.00 by the Defense Supply Center Philadelphia (DSCP) using an electronic order, designated a “Call”, and Electronic Data Interchange (EDI). The “Call” is the Government's request for a quotation. A contract will not come into existence until all of the following have occurred: (i) The government has received an EDI response from the BPA Holder in accordance with paragraph 4, entitled ‘Ordering Procedures’; (ii) Any and all reviews, clarifications and adjustments have been made. (See Subparagraph (e) under Paragraph 5, “SAMMS Procurement by Electronic Data Exchange (SPEDE)”); and (iii) The SPEDE Award Report Notification is transmitted to the BPA Holder who responded to the “Call”. The SPEDE Award Report Notification gives rise to a legally binding, bilateral contract.

BPA terms include ordering procedures, general description of the types of items to be provided by the vendor, dollar limitations on total value of orders, allowable vendor markups, warranties, and payment terms. Key provisions of the terms specified in the General and Industrial BPAs are listed below.

- The vendor has an imposed obligation to control costs, including base costs and supplier markups.
- Allowable vendor markup is less than or equal to 30 percent of the cost of goods sold. The markup includes costs such as packaging and marking, freight out, and profit.
- Cost of goods sold is defined as including manufacturing costs, freight in, overhead, labor, and special processing costs that add value to an item if the vendor is also the manufacturer. If the vendor is a supplier, the cost of goods sold includes purchase cost, certification, freight in, and processing costs (for example, plating or heat treating).
- To prevent layering of costs and markups, the vendors agree to purchase required materials and supplies from original equipment manufacturers or authorized distributors.
- If an item has more than one source of supply, the vendor is required to obtain at least two quotes for the item to ensure the most economical price for the Government.
- The prices charged by the vendor for the supplies ordered must be full and complete prices, including taxes, packaging, and shipping. Additionally, the prices charged must reflect any and all volume and trade discounts.

SASPS Purchased Items

Vendors were not abiding by the terms of the BPAs with DSCP that constrained vendors to a 30 percent markup over cost. Also, items were purchased through one vendor when they were available from other vendors at a lower price. DSCP could have purchased items for \$19,809 less for 59 of the 120 purchase orders, valued at \$167,156, in our sample.

Sample Group. We reviewed a stratified random sample of 120 purchase orders valued at \$167,156 made between April 1, 1999, and March 31, 2000, at the General and Industrial. DSCP had about \$52.6 million in SASPS micro-purchases for the same 12-month period. Our stratified sample was taken from a subset of a total universe of 52,323 SASPS micro-purchase orders, valued at about \$34.5 million, at General and Industrial. We focused on higher dollar purchase orders (value of \$500 or greater) that had pricing ratios of 1.5 or greater. The pricing ratio was based on the price DSCP paid for an item

compared to the price at which DSCP sold the same item. That subset consisted of 9,733 purchase orders, valued at about \$14 million. (Hereafter in this report, the subset of 9,733 purchase orders will be referred to as the sample universe.) A breakout of the General and Industrial universe of SASPS purchase orders and the subset from which our sample was selected is shown in Table 1. See Appendix A for a detailed discussion of the stratified sampling methodology.

Table 1. General and Industrial Universe (April 1, 1999, through March 31, 2000)		
<u>SASPS Purchase Orders</u>	<u>Number</u>	<u>Value (millions)</u>
Value less than \$500	31,123	\$ 5.2
Value \$500 or greater	<u>21,200</u>	<u>29.3</u>
Total	52,323	\$34.5
Sample Universe*	9,733	\$14.0
Random Sample	120	\$ 0.167
*Sample universe derived from purchase orders with value of \$500 or greater and a pricing ratio of 1.5 or greater.		

Focus of Review. We evaluated the sample purchase orders and made dollar projections using two approaches. First, we obtained vendor invoices for the sample purchase orders and compared the vendor cost with the price paid by DSCP to determine markups that exceeded the 30 percent allowed by the terms of the BPA. We then calculated the charges that exceeded the 30 percent limitation. Second, from the total General and Industrial universe of SASPS purchases, we identified instances of vendors charging General and Industrial a higher unit price than a second or third vendor charged for the same item. We calculated an overcharge only in those instances where the price was for a quantity less than or equal to the quantity of the sample purchase order. Based on both calculations, 59 of the 120 purchase orders in our sample⁵ could have been purchased for \$19,809 less if DSCP had used a competitive system for obtaining quotes on purchase orders and vendors with BPAs had observed the 30 percent markup limitation. That potential monetary benefit represents about 12 percent of the \$167,156 total value of the sample. Projected across the sample universe, DSCP spent about \$1.2 million more than necessary for 4,105 out of 9,733 SASPS purchase orders in the sample universe. The sample universe was valued at \$14 million.

⁵Six of the 120 purchase orders in the audit sample had been canceled prior to our audit.

Blanket Purchase Agreement Vendor Prices

SASPS did not provide the capability to compete purchase orders among vendors with BPAs. In addition, SASPS buyers were not adequately trained to redirect purchase orders to vendors with a lower price. Further, DSCP programs designed to recover overpayments did not fully achieve their objective.

Competitive Quote Capability. SASPS did not solicit requests for quotes from multiple vendors. As a result, the vendor that could offer the lowest price was not automatically selected by SASPS. In addition, SASPS buyers were not trained to redirect purchase orders to vendors having a lower price. Seventeen of the purchase orders in our sample of 120 purchase orders were for items purchased from an alternate vendor for a lower price during a 15-month time period that included 1 month before and 2 months after the time frame for our audit sample. Six of the 17 purchase orders also exceeded the 30 percent vendor markup. General and Industrial could have purchased the 17 items for \$9,788 less from the alternate vendors. In each instance, the quantity purchased for the lower price was equal to or less than the quantity for the purchase order included in our sample group. For example, General and Industrial purchased one tackle block in August 1999 from vendor A for \$516.61. Four months later, in December 1999, General and Industrial purchased one identical tackle block from vendor B for \$219.80. Based on the lower price available from vendor B, General and Industrial overpaid by about \$297 for the purchase order in our sample.

Although SASPS allows a buyer to redirect a purchase order to a specific vendor that might have a history of better prices, we were unable to find any SASPS buyer in General and Industrial who was aware of that particular capability and who reported using it. In addition, General and Industrial did not have a user's guide or other operating procedures that would provide guidance to the buyers. Buyers had the opportunity to redirect a purchase order only if SASPS had routed a purchase order to a SASPS buyer for manual review because the purchase order exceeded the 25 percent pricing differential threshold programmed into SASPS. If a purchase order does not exceed the 25 percent threshold, SASPS automatically processes and awards the purchase order to the BPA vendor selected that day even though there may be other BPA vendors willing to sell the item for less.

Recovery of Vendor Markups. DSCP programs designed to recover overpayments from vendors did not fully achieve their objective. Forty-eight of the 120 purchase orders in our sample had markups above the 30 percent allowed by the BPAs. The 48 purchase orders had excessive markups valued at \$11,480. Six purchase orders, valued at \$1,459, were also identified as overpriced as a result of the inability of SASPS to compete the request for quote among multiple vendors with BPAs. To avoid double counting, the six purchase orders were not included in the total saving attributed to excessive markups. Therefore, a total saving of \$10,021 for 42 purchase orders was used in projecting the overcharges across the sample universe.

The following two examples illustrate excessive markups from our sample. First, in February 2000, General and Industrial purchased two material stacking pallets at \$699 each from vendor C. Cost data provided by vendor C showed that the vendor had purchased the pallets from supplier A for \$274 each. General and Industrial's cost of \$699 represents a markup of 155 percent by vendor C and an overcharge to General and Industrial of nearly \$686. Second, in May 1999, General and Industrial purchased six round stainless steel washroom sinks for \$409.15 each from vendor D. Cost data provided by vendor D showed that the vendor had purchased the sinks from supplier B for \$39.17 each. The price that General and Industrial paid represents a markup of nearly 945 percent and an overcharge of about \$2,149 (of which \$2,142 was later refunded to the Government). The table in Appendix C contains additional examples of vendor markups that exceeded the allowed 30 percent. The breakdown of purchase orders in our sample and their associated markups is shown in Table 2.

Table 2. Vendor Markups for Sample Purchase Orders			
<u>Number of Purchase Orders</u>	<u>Value</u>	<u>Range of Markup</u>	<u>Overcharge</u>
52	\$ 76,687	30 percent or less	-
24	28,667	30.01 to 40 percent	\$ 456
15	21,178	40.01 to 100 percent	3,487
7	7,809	100.01 to 500 percent	4,281
2	3,776	Greater than 500 percent	3,256
14	18,866	Incomplete data/markup undeterminable	not available
6	10,173	Cancelled purchases	-
120	\$167,156		\$11,480

Enforcement of Blanket Purchase Agreement Terms. In addition to manual reviews by buyers, DSCP had two programs administered by the Contract Integrity Office (Contract Integrity) that were designed to ensure vendors complied with the provisions of the General and Industrial BPAs. Our discussions with DSCP personnel and our audit finding indicate that neither program was fully achieving the desired results.

Price Threshold. The first control program focused on those vendors that exceeded the 25 percent threshold for pricing differentials between a given purchase order and any unit price paid during the previous 12 months. Purchase orders that exceeded the 25 percent threshold were automatically listed on a report provided by the DSCP automated operations personnel to Contract Integrity. Contract Integrity personnel explained that they judgmentally select purchase orders from the list of those exceeding the 25 percent threshold for review but could not provide the criteria used for making that selection.

Contract Integrity also could not provide the total number of purchase orders that exceeded the 25 percent threshold during the April 1, 1999, through March 31, 2000, time frame.

Contract Integrity personnel further explained that they researched each of the selected purchases to determine whether the prices charged General and Industrial were reasonable. Pricing research included review of the vendor invoice that documented the price the vendor paid. If the markup price was determined to exceed the 30 percent allowable vendor markup, Contract Integrity requested that the vendor provide refunds to the Government.

For the April 1, 1999, through March 31, 2000, time frame, Contract Integrity judgmentally selected 128 purchase orders for review from the list of SASPS purchase orders that exceeded the 25 percent threshold. Of those 128 purchase orders, 42 (about 33 percent) were determined to be fair and reasonable. Another 54 purchase orders (about 42 percent) were determined to be unreasonable but supported. In those instances, refunds were not obtained because the vendors supplied invoices showing that the price charged General and Industrial was within the 30 percent markup allowed by their BPA. The 32 remaining cases were overcharges. Contract Integrity reported recovering \$9,259 for 16 of those 32 purchase orders. For the other 16 of the 32 purchase orders with overcharges, Contract Integrity did not collect any refunds. In 12 of those instances, the amount of the overpricing was too small to negotiate or the order was cancelled or modified.

Concerning the last four purchase orders with overcharges, two vendors initially refused to provide invoice information for two of the purchase orders and one vendor was recommended for removal as a BPA vendor because two purchase orders were determined to be unreasonable. Contract Integrity performed a review of each of the three vendors as part of the annual auditing program for specific vendors. (The annual review program is discussed in the paragraph below.) As a result of the individual vendor reviews, the vendor that had been recommended for termination as a BPA vendor was determined to have charged more than the 30 percent markup allowed by the BPA for the items sampled. As of November 2000, that vendor was in the process of making a refund to the Government and was not terminated as a BPA vendor. Contract Integrity determined from in-depth reviews that items purchased from the two other vendors were not overpriced, and as a result, refunds to the Government were not required.

Annual Review. The second control program in place at General and Industrial focused on Contract Integrity annual reviews of selected BPA vendors. Vendors were judgmentally selected for review by the Contract Integrity personnel based on the dollar value of business with General and Industrial, on past experience with the vendor, or on the experience level of the vendor with the General and Industrial BPA program. For each vendor included in an annual review, Contract Integrity personnel selected a statistical sample of purchase orders from the universe of SASPS purchases made from that vendor during the year. Contract Integrity personnel performed a detailed review of each of the purchase orders in the sample that included a review of the

invoices documenting the price paid by the vendor for the item. If the total price paid by General and Industrial for all the purchase orders in the sample exceeded the total of vendor costs for those items by more than the 30 percent markup allowed by the terms of the BPA, the total value for the sample that was over 30 percent was projected against the universe of SASPS purchases made from the vendor. A refund was sought from the vendor based on that projection.

The following example illustrates the weakness in the methodology used by Contract Integrity for identifying overcharges. A recent Contract Integrity review of a BPA vendor showed that 20 percent of the individual purchase orders in the Contract Integrity sample exceeded the allowed 30 percent markup. However, the amount of the markup for the total sample purchase orders was only 29.92 percent of the total vendor cost for the items in the sample. As a result, General and Industrial took no action to obtain a refund on the 20 percent of the individual purchase orders having an excessive markup. Using methodology that focused on comparing total vendor cost with the total price paid by General and Industrial, Contract Integrity identified and collected about \$68,000 in refunds from vendors with BPAs for overcharges during FY 1999.

The method used by Contract Integrity for computing refunds is not in the best interest of the Government and is not in keeping with the terms of the BPA, which limits markups to 30 percent of vendor cost. According to the terms of the BPA, each purchase order that is processed and accepted by a vendor is a contract and a stand-alone transaction. Using the Contract Integrity method of identifying overcharges ignores individual purchase orders that are in excess of the 30 percent threshold by giving credit for those excesses against the purchases with a markup of less than 30 percent. If Contract Integrity applied the same methodology that we used in projecting our sample results, DSCP would increase the refunds collectible from vendors charging excessive markups. The methodology used in our audit gave no credit to vendors for purchase orders that had less than a 30 percent markup. A similar methodology would ensure that the Contract Integrity reviews addressed overcharges as intended in the BPA rather than on a net basis.

Collection of Overcharges. During the audit, three vendors made voluntary refunds valued at about \$4,200 to the Government for 3 of the 48 purchase orders identified as having exceeded the allowable 30 percent markup. As of February 21, 2001, DSCP had not taken action to collect overpayments made to vendors for the remaining 45 purchase orders identified by this audit as having excessive markups. Although 19 purchase orders had markups that may not be feasible to collect due to the small amount of the potential refund, Appendix C of this report lists 14 purchase orders having a vendor markup of more than double the 30 percent markup allowed by the BPAs. The three vendors making voluntary refunds included one vendor from the list of 14 purchase orders in Appendix C. The vendor that sold DSCP the washroom sink for a markup of nearly 945 percent refunded the Government about \$2,142 (out of \$2,149). Contract Integrity personnel stated that they did not have immediate plans to collect refunds for the purchase orders identified during this audit because of

workload considerations. In addition, Contract Integrity personnel explained that they had no established criteria for determining those overpayments that were of sufficient magnitude to warrant collection.

Management Oversight. DLA had not focused management attention on micro-purchase overcharges and did not develop performance measures or goals to track the status of overcharges for purchases made using SASPS. Although SASPS buyers and Contract Integrity personnel received automated reports on potential overcharges, we found no evidence that those personnel provided any status reports to higher level management at DSCP and DLA. Consequently, DLA did not evaluate potential overcharges from SASPS micro-purchases or the refunds collected on a regular basis. Periodic reports from SASPS buyers and Contract Integrity personnel on the status of overcharges and refunds would enable DLA management to assess the performance of the program and the need to improve controls on overcharges. If DSCP does not improve management controls on micro-purchases made by SASPS, DSCP will lose the opportunity to put \$7.2 million to better use over the 6-year Future Years Defense Program based on the projected results of about \$1.2 million from our sample.

Competition Benefits and Proposals

SASPS did not have the capability to compete purchase orders among BPA vendors and ensure that DSCP pays fair and reasonable prices for those purchases. The inability to compete micro-purchases contributed to the weakness in controlling overpricing of SASPS micro-purchases at DSCP.

In recognition of problems associated with the noncompetitive nature of SASPS, DLA headquarters sent a memorandum, dated October 12, 2000, to the supply center commanders requesting comments on several proposals. The proposals addressed the implementation of competitive systems for micro-purchases at all three supply centers. One proposal made in the DLA memorandum was to implement an upgraded version of SPEDE Rehost at all the supply centers. SPEDE Rehost is an electronic data interface that solicits multiple requests for quotes for purchases made under the version of SASPS used by the DSCP Clothing and Textile Directorate and Medical Directorate.

Another proposal made by DLA was to discontinue use of SASPS (both the SPEDE and SPEDE Rehost versions) and use an enhanced version of the Procurement Automated Contract Evaluation System. The Procurement Automated Contract Evaluation System was designed to automatically compete requests for quotes and to automatically make an award based on the best value. We believe many instances of overpricing could be avoided if a competitive purchase system, such as those mentioned in the DLA memorandum, were implemented in place of the SPEDE version of SASPS.

Management Comments on the Finding and Audit Response

DLA Comments. DLA partially concurred with the finding, stating that the projected savings cited in the report were substantially overstated because they do not take into consideration the refunds secured in the routine review of SPEDE awards under the DLA BPA audit program. DLA provided the washroom sink refund of \$2,142 as a case in point and stated that the savings used in projecting future savings should have been \$7, not \$2,149. DLA further noted that “although your auditors [the audit team] initially identified this overcharge, DLA routinely identifies overcharges and receives refunds. For example, within the sample universe reviewed during the audit, DLA received refunds in the amount of \$45,536 from approximately 20 vendors. Those refunds should be included in any projection of savings in future years.”

Audit Response. Although we commend DLA for timely action in collecting \$2,142 for the washroom sink overcharge when it was identified by the audit team, the inclusion of the overcharge in determining the projected benefits of about \$1.2 million was appropriate. DLA provided no evidence that in-house audit programs would have identified this overcharge or any of the other overcharges identified by the audit. As mentioned earlier, over a 1-year period the DLA price threshold review recovered \$9,259 and the DLA annual review recovered \$68,000. This shows how poorly the current procedures were working. In addition, the fact that DLA was able to collect \$2,142 out of the \$2,149 identified by the audit team serves to substantiate the validity of projected potential monetary benefits identified in the report. DLA did not provide any documentation that substantiated that purchase orders reviewed in the DLA audits of selected BPA vendors were among those drawn in the audit sample of 120 purchase orders. DLA also did not document that the \$45,536 refund that DLA obtained from 20 BPA vendors included refunds for any of the 48 purchase orders identified by the audit as exceeding the 30 percent markup. As a result, the \$45,536 recovered by the DLA audit program appears to be independent of the potential monetary benefits used in our projections. However, even assuming all refunds collected by DLA were for purchase orders that were part of our sample universe of 9,733 purchase orders, the \$45,536 that DLA collected would not materially impact our projection of potential benefits (\$1.2 million minus \$45,536). Further, the use of competitive procedures recommended will likely increase potential monetary benefits beyond \$1.2 million.

Recommendations, Management Comments, and Audit Response

Revised Recommendation. As a result of management comments, we revised Recommendation 4. to add more specific action. Because this recommendation was revised, we request that the Director, Defense Logistics Agency, provide additional comments.

We recommend that the Director, Defense Logistics Agency, in conjunction with the Commander, Defense Supply Center Philadelphia:

1. Implement competitive procurement procedures by replacing the electronic commerce interface of the Standard Automated Materiel Management System Automated Small Purchase System with a system that competes requests for quotes with multiple vendors with blanket purchase agreements at all Defense Logistics Agency supply centers.

Defense Logistics Agency Comments. DLA concurred, stating that an assessment of the costs and benefits of making SASPS competitive was in process prior to the audit. DLA further stated that a systems change request had been approved and funded to replace the current version of SASPS/SPEDE with the competitive version, SPEDE Rehost. The estimated completion date is February 2002.

2. Provide training to Standard Automated Materiel Management System Automated Small Purchase System buyers and develop a user's guide that provides information on how to use the capability of the system to redirect purchase orders to blanket purchase agreement vendors offering the best value.

Defense Logistics Agency Comments. DLA concurred, stating that buyers have received on-the-job training on how to use the SASPS/SPEDE system. In addition, a user's guide has been provided to each DLA Inventory Control Point using SASPS.

3. Change the methodology used by the Contract Integrity Office in computing vendor overcharges.

Defense Logistics Agency Comments. DLA nonconcurred, stating that the methodology that the audit recommended was not based on statistically sound practices. DLA further stated that two key statistical errors in our methodology were the judgmental selection of potentially overpriced awards and the misapplication of the stratification process. DLA stated that we stratified the sample and chose awards over the 30 percent markup threshold that would result in the largest refund amounts and that we then calculated an individual overcharge on each separate order without considering awards that were under the 30 percent threshold. DLA also stated that the two statistical errors combined with using the standard unit price to conduct pricing analysis resulted in an overstatement of SASPS potential overpricing.

Audit Response. DLA comments were nonresponsive. A problem with the current methodology is that DLA has used it since 1992. As a result, probably every vendor knows they can mark up a purchase by 25 percent over the highest previous price paid before DLA does a theoretical manual review. Also, the vendors are probably aware that if their overall markups average less than 30 percent they will never be questioned. It is now time to change the process. Appendix A of the report clearly states that the projections of potential benefits apply to a subset of the total universe of SASPS purchase orders. We refer to

this subset as the sample universe. Those 9,733 purchase orders that had a price ratio of 1.5 or greater were designated as the sample universe. A simple random sample was then drawn within each of the subgroups using the SAS⁶ programming language. Determination of whether a sample item exceeded the 30 percent threshold was not accomplished prior to or during random selection of the sample. We know of no way in which that might have been accomplished with the data provided to us by DSCP on the universe of SASP purchases. If DLA had a database that identified which purchase orders exceeded the 30 percent markup, that information was not provided to us and it does not appear that such data was used by Contract Integrity in performing its reviews. The statistical methods we employed were neither judgmental nor misapplied.

Our recommendation refers to the methodology used by Contract Integrity to determine vendor compliance with the 30 percent markup provision of the BPAs, not the statistical sampling methodology used by DSCP to draw a sample of purchase orders for review. As cited in the report, the Contract Integrity annual review of a specific BPA vendor focuses on a net assessment of whether the prices the vendor was charging DLA were within the 30 percent allowed markup. Each individual purchase order included in the sample under the Contract Integrity review was not counted as a stand-alone transaction in identifying an overcharge or collecting a refund. Because the technique of estimating average charges against a 30 percent markup for an entire sample group allows overcharges to be dismissed if the sample also contains charges that are under the 30 percent threshold, DLA is not collecting dollars that could be put to better use.

Additionally, the net audit assessment method used by Contract Integrity is not in keeping with the terms of the BPAs that limit vendor charges to a 30 percent markup. The BPAs state that “if an audit/price review results in a determination that there has been overpricing with respect to any particular call(s) [purchase order(s)], the vendor and DSCP will conduct good-faith negotiations toward the end of adjusting the price downward to an acceptable level.” The BPAs do not state that “on the average” the markup for all purchase orders for a particular vendor will be limited to 30 percent. In addition, as noted in our report, each purchase order is a contract between the vendor and DLA.

We did not perform pricing analysis using the standard unit price. As explained in Appendix A, the ratio of the unit price DLA paid for an item to the standard unit price DLA charges customers was used as the basis of stratifying the universe of SASPS purchases prior to selecting the random sample used for the audit. We used that approach because, according to the SASPS data for April 1, 1999, through March 31, 2000, DLA paid about \$7.4 million more for the items in the General and Industrial universe of 52,323 SASPS purchase orders than it charged its customers. The aggressive pursuit of vendor overcharges would help in keeping prices reasonable for both DLA and its customers. We request that DLA reconsider its position on the recommendation and provide additional comments in the response to the final report.

⁶SAS, originally standing for Statistical Analysis System, is a trademark.

4. Aggressively pursue collection of refunds due from vendors for those purchase orders identified in Appendix C of this report.

Defense Logistics Agency Comments. DLA concurred, stating that it will continue to pursue overcharges in an aggressive manner within the terms of the BPAs.

Audit Response. As a result of DLA comments, we revised the recommendation to add more specific action. We request that the Director, Defense Logistics Agency, provide additional comments, including an estimated completion date.

5. Develop performance measures and provide quarterly reports on the status of overpricing of Standard Automated Materiel Management System Automated Small Purchase System procurements for all supply centers.

Defense Logistics Agency Comments. DLA concurred, stating that it routinely analyzes SASPS data to monitor the automated BPA program and to track vendor pricing and performance. DLA further stated that quarterly performance measures and quarterly reports on the status of SASPS overpricing would be developed.

Audit Response. DLA did not provide the estimated completion date for developing performance measures and quarterly reports. Therefore, we request that DLA provide an estimated completion date in its comments in response to the final report.

Appendix A. Audit Process

Scope

We reviewed a stratified random sample of 120 micro-purchases made through SASPS between April 1, 1999, and March 31, 2000, at the General and Industrial Directorate at DSCP. We confined our review of SASPS micro-purchases to General and Industrial for two reasons. First, General and Industrial made about 66 percent of the \$52.6 million in DSCP micro-purchases. Second, both the Clothing and Textiles Directorate and the Medical Directorate use an electronic interface application, SPEDE Rehost, which provides a request for quote to multiple vendors for each purchase order. The fourth DSCP Directorate, Subsistence, does not use SAMMS or SASPS for making procurements. Subsistence relies on commercial buying practices and direct vendor delivery to make purchases.

DoD-Wide Corporate Level Government Performance and Results Act Coverage. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following goal, subordinate performance goal, and performance measure.

FY 2001 DoD Corporate Level Goal 2: Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-2) FY 2001 Subordinate Performance Goal 2.4:** Meet combat forces' needs smarter and faster, with products and services that work better and cost less, by improving the efficiency of DoD acquisition processes. **(01-DoD-2.4) FY 2001 Performance Measure 2.4.5:** Percentage of DoD paperless transactions. **(01-DoD-2.4.5)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objectives and goals.

- **Acquisition Functional Area. Objective:** Foster partnerships. **Goal:** Decrease paper transactions by 50 percent through electronic commerce and electronic data interchange. **(ACQ-2.3)**
- **Logistics Functional Area. Objective:** Streamline logistics infrastructure. **Goal:** Implement most successful business practices (resulting in reductions of minimally required inventory levels). **(LOG-3.1)**

High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Contract Management high-risk area.

Methodology

We reviewed a stratified random sample of 120 purchase orders valued at \$167,156 made through SASPS at General and Industrial between April 1, 1999, and March 31, 2000. The sample was drawn from a sample universe of 9,733 purchase orders valued at about \$14 million. The sample universe was a stratified subset of the total General and Industrial universe of 52,323 SASPS purchase orders valued at \$34.5 million. For each purchase order in our sample, we obtained procurement history data by NSN from three sources—SAMMS, Federal Logistics Record database, and Haystack.⁷ We reviewed the procurement history to verify vendor price and quantity data provided to us from archived SASPS files. We also compared quantity and price paid for each NSN item during the past 2 years with the prices and quantities for the sample purchase orders to identify potential overpricing.

We evaluated the sample purchases and made potential monetary benefits projections using two approaches. For the first approach, we requested vendor invoices for purchase orders sampled and calculated the maximum price that the vendor was allowed to charge General and Industrial. The allowed vendor cost (cost of goods sold) consisted of the price paid by the vendor for the item plus costs such as freight charges for shipping from the supplier to the vendor. The costs that make up the cost of goods sold are excluded from the 30 percent markup allowed by the terms of the BPA. We compared the price the vendor was allowed to charge General and Industrial with the price actually paid. If the amount paid by General and Industrial exceeded the vendor's cost of goods sold by more than 30 percent, we calculated the value of that overcharge. In the second approach, we reviewed the sample purchase orders and identified the NSNs that had more than one purchase order during a 15-month period that included 1 month before our sample and 2 months after our sample. We then compared the unit price General and Industrial paid in the sample purchase order with the unit prices paid to each vendor that provided the item. We calculated potential monetary benefits only in those instances where the quantity being purchased was equal to or less than the quantity in the sample purchase order. We identified six sample purchase orders that both exceeded the 30 percent markup and were available from an alternate vendor at a lower cost. In those instances, we used the value of the greatest potential monetary benefits for our calculations.

Use of Computer-Processed Data. We relied on computer-processed data from three sources to achieve the audit objective. The first source was the SAMMS database in use at DSCP. Procurement data was also obtained from the Federal Logistics Record database, maintained by the Defense Logistics Support Center,

⁷Haystack is a commercial on-line system that provides procurement history data by NSN for items sold to DoD. It is the product of Information Handling Systems, Incorporated.

Battle Creek, Michigan. We also used procurement data from Haystack, a commercial logistics database developed and maintained by Information Handling Systems, Incorporated. Although we did not perform a reliability assessment of each data element in the data provided, we did determine that the price and quantity data applicable to our audit were reliable in that they agreed with source documents such as vendor invoices. Based on comparison with source documents, we identified six purchase orders in our sample that had been canceled by General and Industrial prior to our audit, and as a result should not have appeared in the universe of SASPS transactions. However, we did not find factual errors in the data reviewed during the audit that would preclude the use of the computer-processed data to meet the audit objectives or that would materially affect the conclusions in the report.

Universe and Sample. General and Industrial had a total universe of 52,323 purchase orders valued at \$34.5 million that were made under SASPS from April 1, 1999, through March 31, 2000. Our review used a stratified random sample of 120 purchase orders valued at \$167,156 drawn from a sample universe of 9,733 purchase orders valued at about \$14 million.

Statistical Sampling Methodology. We focused our review of SASPS purchase orders on a subset of the total General and Industrial universe that appeared to have the highest potential dollar impact and risk for overcharges. We first excluded purchase orders with a value of less than \$500, leaving a subset of higher value purchases between \$500 and \$2,500. That subset of about 21,200 purchase orders valued at \$29.3 million represented about 41 percent of the purchase orders and nearly 85 percent of the dollar value of the total General and Industrial universe. The sample universe of 9,733 purchase orders valued at \$14 million accounts for about 19 percent of the total number of purchase orders and nearly 41 percent of the dollar value of the total General and Industrial universe. To ensure representation in our sample of NSNs that had single and multiple purchases, we further refined the higher dollar value subset by separating the purchase orders into two subgroups. The first contained purchase orders relating to NSN items having one, two, or three purchase orders and the second subgroup contained purchase orders relating to NSN items with four or more purchase orders during the 12 months represented by the data. Based on the review of data during the survey portion of the audit, we then stratified the two subgroups by using the ratio of the unit price General and Industrial paid BPA vendors for an item to the standard unit price DLA charged its customers. Purchase orders with a price ratio of 1.5 or higher were selected as the sample universe. We drew a simple random sample to select the purchase orders in each subgroup for a total of 120 purchase orders reviewed during our audit.

Based on the sample purchase orders, we estimated that between 2,930 and 5,280 of the 9,733 purchase orders in the sample universe would have had overcharges, valued between \$386,000 and \$1,942,000. The ranges are based on a 95 percent confidence level. The midpoint of the value range is \$1,164,000 and the number of purchase orders' midpoint is 4,105.

Use of Technical Assistance. Personnel in the Quantitative Methods Division, Office of the Assistant Inspector General for Auditing, provided technical support

for this audit. Operations Research Analysts developed the stratified random sample and made projections for potential monetary benefits for the portion of the universe used for the stratified sample.

Audit Type, Dates, and Standards. This economy and efficiency audit was performed from March through November 2000 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls considered necessary.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD. Further details are available on request.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of the DSCP management controls over the SASPS program. Specifically, we reviewed DSCP management controls for ensuring that prices paid for SASPS micro-purchases were fair and reasonable. We could not review management's self-evaluation applicable to those controls because no documentation was available.

Adequacy of Management Controls. We identified a material control weakness in that the SASPS did not compete micro-purchases among vendors with a BPA. DSCP officials identified SASPS as part of an assessable unit. However, in its evaluation of SASPS, DSCP officials did not identify the specific material management control weaknesses identified by the audit. Specifically, DSCP performed tests of the pricing of SASPS buys and found the controls to be adequate. However, DSCP could not provide documentation to support the attributes tested, extent of testing, and the results of the tests. Therefore, we could not determine why DSCP did not identify the material control weakness identified by the audit. We projected for the \$14 million sample universe included in our review that DSCP spent an estimated \$1.2 million on 4,105 SASPS purchases that could have been put to better use for a 1-year period. If DSCP does not improve management controls, DSCP could lose the opportunity to put \$7.2 million to better use during the 6-year Future Years Defense Program. A copy of the report will be provided to the senior official responsible for management controls in DLA.

Appendix B. Prior Coverage

During the last 5 years, the General Accounting Office has issued two audit reports and the Inspector General, DoD, has issued seven audit reports discussing prices for spare parts in the Acquisition Reform environment.

General Accounting Office

General Accounting Office, Report No. GAO-01-22 (OSD Case No. 2080), "Defense Acquisitions: Price Trends for the Defense Logistics Agency's Weapons Systems Parts," November 2000

General Accounting Office, Report No. NSIAD-99-90 (OSD Case No. 1808), "DoD Pricing of Commercial Items Needs Continued Emphasis," June 1999

Inspector General, DoD

Inspector General, DoD, Report No. D-2001-072, "Industrial Prime Vendor Program at the Naval Aviation Depot-North Island," March 5, 2001

Inspector General, DoD, Report No. D-2000-099, "Procurement of the Propeller Blade Heaters for the C-130 and P-3 Aircraft," March 8, 2000

Inspector General, DoD, Report No. D-2000-98, "Spare Parts and Logistics Support Procured on a Virtual Prime Vendor Contract," March 8, 2000

Inspector General, DoD, Report No. 99-217, "Sole-Source Commercial Spare Parts Procured on a Requirements Type Contract," July 21, 1999

Inspector General, DoD, Report No. 99-026, "Commercial Spare Parts Purchased on a Corporate Contract," October 30, 1998

Inspector General, DoD, Report No. 98-088, "Sole-Source Prices for Commercial Catalog and Noncommercial Spares Parts," March 11, 1998

Inspector General, DoD, Report No. 98-064, "Commercial and Noncommercial Sole-Source Items Procured on Contract N000383-93-G-M111," February 6, 1998

Appendix C. Selected Markups

The following 14 purchase orders from our sample of 120 SASPS purchase orders had a vendor markup of more than twice the 30 percent markup allowed by the terms of the BPA. The amount of overcharge was determined by calculating the allowable price per unit (vendor's unit cost plus the allowed 30 percent markup) and comparing it with the price the vendor charged DSCP.

Selected Overcharges of SASPS Purchases at DSCP							
<u>Item Description</u>	<u>Vendor Unit Cost*</u>	<u>Vendor Quantity</u>	<u>Unit Price Charged DSCP</u>	<u>DSCP Quantity</u>	<u>Total Value Of DSCP Purchase</u>	<u>Markup (percent)</u>	<u>Overcharge</u>
Pre-formed packing	\$ 2.50	180	\$ 4.08	180	\$ 734.40	63.2	\$ 149.40
Shear bolt	3.56	600	5.88	410	2,410.80	65.4	515.45
O-ring	1.02	578	1.70	578	982.60	66.7	216.17
Spiral wound gasket	22.07	66	36.90	24	885.60	67.2	197.02
Indicator light (assembly)	235.53	5	429.80	5	2,149.00	82.5	618.06
Plain seal	10.96	25	25.50	25	637.50	132.7	281.30
Plain seal	10.18	46	24.90	46	1,145.40	144.6	536.64
Material stacking pallet	274.00	2	699.00	2	1,398.00	155.1	685.60
Special shaped seal	90.00	5	250.00	5	1,250.00	177.8	665.00
Plain seal	8.29	142	24.75	40	990.00	198.6	558.92
Indicator light (assembly panel)	448.36	5	1,547.81	1	1,547.81	245.2	964.94
Body screw	0.48	400	2.10	400	840.00	334.8	588.84
Dust protection plug	0.03	6,000	0.25	5,285	1,321.25	698.7	1,106.20
Washroom sink	39.17	12	409.15	6	2,454.90	944.6	2,149.37

*Vendor unit costs were rounded to nearest cent. As a result, computations using unit costs may not equal the actual overcharges or percentages.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
Deputy Under Secretary of Defense (Logistics)
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Logistics Agency
Commander, Defense Supply Center Philadelphia

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

Defense Logistics Agency Comments



IN REPLY
REFER TO

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

FEB 20 2001

J-33

MEMORANDUM FOR DIRECTOR, CONTRACT MANAGEMENT DIRECTORATE,
DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Draft Audit Report "Buying Program of the Standard Automated Materiel Management System (SAMMS) Automated Small Purchase System (SASP): Defense Supply Center Philadelphia (DSCP)" (Project No. D2000LDF-0116)

Enclosed is the Defense Logistics Agency's response to the subject audit for your consideration. We concur in your finding and four of the five recommendations you made. Specifically, we recognize that we can introduce competition into the SAMMS Procurement by Electronic Data Exchange (SPEDE) System at DSCP, without jeopardizing the benefits of automating a large volume of low-dollar value procurements. In fact, we were in the process of assessing the cost/benefits of making SPEDE competitive prior to the audit. A Systems Change Request has been approved and funded to introduce competition into the DSCP SPEDE System by February 2002. By adding a competitive feature to SPEDE, we will be able to increase the threshold from \$2,500 to \$25,000, thereby increasing the volume of purchase request we can process through SPEDE, and ensuring competitive pricing.

While we concur in the finding recommendations related to the introduction of competition into the SPEDE system, we believe that your projection of savings is substantially overstated. It's overstated because it does not take into account refunds secured in the routine review of SPEDE awards, which are followed by requests for refunds when appropriate. A case-in-point is the procurement of six "Washroom sinks" which was the worst case of overcharging (\$2149 total) cited in Appendix B of your draft audit. DSCP negotiated a \$2142 refund from the contractor in June 2000. For the purpose of projecting future savings, this action should have been recorded as \$7, not \$2149. While your auditors initially identified this overcharge, DSCP routinely identifies overcharges and receives refunds. These refunds must be included in any projections of savings in future years, if the estimates are to be accurate.

We do not concur in your recommendation that DLA change the methodology used to compute vendor overcharges in the SPEDE System. The E-Z Quant Program we currently use was developed in consultation with the Defense Contract Audit Agency in 1992. While we are sometimes overcharged on individual low dollar value awards, E-Z-Quant provides a fair and effective means of protecting the Government's interests, obtaining refunds when appropriate, and removing contractors who repeatedly attempt to abuse the system.

With over 1 million procurement actions annually, DLA is continuously looking for ways to improve our procurement processes and oversight.

Thank you for the opportunity to comment on this draft report.

FRANK B. LOTTS
Deputy Director
Logistics Operations

Subject: Buying Program of the Standard Automated Materiel Management System
Automated Small Purchase System: Defense Supply Center Philadelphia,
Project No. D2000LD-0116

Finding: Vendors were not abiding by the terms of the blanket purchase agreement with the Defense Supply Center Philadelphia that constrained vendors to a 30 percent markup over vendor cost. The DSCP could have purchased items for \$19,809 less for 59 of the 120 purchase orders valued at \$167,156 in the sample. As a result, it is projected for the \$14 million subset of the universe included in the review that the DSCP spent an estimated \$1.2 million on 4,105 purchases that could have been put to better use for a 1-year period. (See page 3 of report).

DLA Comments: Partially Concur. The Standard Automated Materiel Management System (SAMMS) Automated Small Purchase System (SASPS) was developed and implemented to automate the procurement of high volume, low dollar value, non-complex spare parts. DLA pioneered the use of emerging technology with the implementation of SAMMS Procurement by Electronic Data Exchange (SPEDE), a sub-program within SAMMS, which further automated the Blanket Purchase Agreement (BPA) award process. These automated systems are used to make approximately 150,000 micro-purchases valued at \$93,044,708 annually from vendors who have signed BPAs with DLA to provide specific items. This represents 16 percent of the total number of contracting actions but only 2.2 percent of the total dollars issued by DLA on an annual basis. SPEDE was programmed to rotate awards to vendors who have signed up to provide specific items. Imbedded within the programming logic is a management control in compliance with DFARS 217.7504 that requires higher-level review for those proposed awards with an increase of price of 25 percent or more over the previous 12-month period. SPEDE halts automatic processing of these awards and refers them to a buyer for manual review. As DLA's mission has expanded to keep pace with increased Service operational tempo rates, our reliance upon automated systems to process lower dollar value requirements has been critical to our support for the warfighter. DLA has recognized that a programming change to SPEDE to enable competition could maintain the automation level envisioned when the system was developed while achieving better prices for these low dollar value, non-complex spare parts.

The DLA BPA Audit program was initiated to conduct post award reviews on BPA pricing for those awards processed through SPEDE. If, after conducting this analysis, price increases cannot be adequately explained, respective contractors are contacted to substantiate the price paid. Where prices cannot be supported, refunds are pursued. If satisfactory resolution is not accomplished, recommendations are made to remove respective contractors from the automated BPA systems and warnings of overpricing are disseminated to buyers. While we concur in the finding recommendations related to the introduction of competition into the SPEDE system, we believe that your projection of savings is substantially overstated because it does not take into consideration the refunds secured in the routine review of SPEDE awards under the DLA BPA Audit Program. A case in point is the procurement of six "Washroom Sinks" which was the worst case of overcharging (\$2, 149 total) cited in Appendix B of the draft audit report. DLA

negotiated a \$2,142 refund from the contractor in June 2000. For the purpose of projecting future savings, this action should have been recorded as \$7, not \$2,149. While your auditors initially identified this overcharge, DLA routinely identifies overcharges and receives refunds. For example, within the sample universe reviewed during the audit, DLA received refunds in the amount of \$45,536 from approximately 20 vendors. These refunds should be included in any projection of savings in future years.

Internal Management Control Weakness: Standard Automated Materiel Management System Automated Small Purchase System did not compete micro-purchases among vendors with a blanket purchase agreement. If DSCP does not improve management controls on micro-purchases, the DSCP would lose the opportunity to put \$7.2 million to better use over the 6-year Future Years Defense Program. (See page 15 of report).

Nonconcur.

Concur; weakness will be reported in the DLA Annual Statement of Assurance

Recommendations: The Director, Defense Logistics agency, in conjunction with the Commander, Defense Supply Center Philadelphia:

1. Implement competitive procurement procedures by replacing the electronic commerce interface of Standard Automated Materiel Management System Automated Small Purchase System with a system that competes requests for quotes with multiple vendors with blanket purchase agreements at all DLA supply centers.

DLA Comments: Concur. DLA was in the process of assessing the cost/benefits of making our current system competitive prior to the audit. A Systems Change Request has been approved and funded to replace the current version of the Standard Automated Materiel Management System (SAMMS) Automated Small Purchase System (SASPS) SAMMS Procurement by Electronic Data Exchange (SPEDE) with a competitive version called SPEDE Re-host. The re-host provides for competition among qualified Blanket Purchase Agreement vendors and increases the threshold for awards processed through SPEDE from \$2,500 to \$25,000, thus enabling a greater number of requisitions to be processed through the automated system while ensuring that those awards are made at reasonable prices.

Disposition:

- Action is ongoing. ECD: February 2002
 Action is considered complete.

2. Provide training to Standard Automated Materiel Management System Automated Small Purchase System buyers and develop a user's guide that provides information on how to use the capability of the system to redirect purchase orders to blanket purchase agreement vendors offering the best value.

DLA Comments: Concur. Buyers have received on-the-job training on how to utilize the SASPS/SPEDE system. Each buyer is aware of the capabilities of the system and has been utilizing the redirection of requests for quotation (RFQs) in instances of suspected overpricing, no quotes, or receipt of unacceptable quotes. Upon implementation of the SPEDE Re-host Systems Change Request, the capability to redirect RFQs in SASPS will become obsolete since each requisition will be competitively awarded. A user's guide for SASPS has been provided to each DLA Inventory Control Point (ICP) using SASPS.

Disposition:

- Action is ongoing. ECD:
 Action is considered complete.

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3. Change the methodology used by the Contract Integrity Office in computing vendor overcharges.

DLA Comments: Non-concur. The methodology used by DLA was developed in consultation with the Defense Contract Audit Agency (DCAA) in October 1992. DLA adopted DCAA's E-Z-Quant statistical sampling software package and operating procedures for conducting vendor audits. DCAA concurred in the methodology and determined it to be statistically sound. Using the E-Z-Quant program, all awards for a BPA vendor are entered and a statistical sample is derived. DLA performs cost analysis of the items in the sample to ensure that vendors are complying with the pricing terms of their BPA that allows for the cost of material plus no more than a 30 percent markup to cover general and administrative costs, overhead, profit, etc. The results of this analysis are then applied to the entire universe of awards made to that vendor under the BPA and a refund is requested if appropriate.

While DLA is always open to beneficial suggestions to continually improve internal audit programs, we non-concur in adopting the methodology recommended. The IG used a method that is not based on statistically sound practices. This was done by stratifying the sample and then choosing those awards over the 30 percent markup threshold that would result in the largest refund amounts and then calculating an individual overcharge on each separate order without considering those awards under the 30 percent ceiling.

Two key statistical errors in the methodology used by the IG were the "judgmental" selection of potentially overpriced awards and the misapplication of the stratification process. Results of a sample are only representative of the entire universe of SASPS awards when they are randomly chosen. Judgmental selection does not yield such a representative sample. In addition, when samples are stratified by any attribute (e.g. dollar value of awards), the results of this process are only true for the specific stratification level of the universe and not all awards of all dollar values. These two errors, along with using the standard unit price to conduct price analysis, result in an overstatement of SASPS potential overpricing. Therefore, the IG's suggested approach, in addition to being statistically flawed, would not be cost effective or as broadly based as the current SASPS audit method.

Disposition:

- () Action is ongoing. ECD:
(X) Action is considered complete.

4. Aggressively pursue collection of refunds due from vendors as the result of overpayments that exceeded markups allowed in blanket purchase agreements.

DLA Comments: Concur. DLA will continue to pursue refunds for overcharges in an aggressive manner within the terms of the Blanket Purchase Agreements. If satisfactory resolution is not accomplished, recommendations are made to remove vendors from SASPS and warnings of overpricing are disseminated to all buyers.

Disposition:

- () Action is ongoing. ECD:
- (X) Action is considered complete.

5. Develop performance measures and provide quarterly reports on the status of overpricing of Standard Automated Materiel Management System Automated Small Purchase System procurements for all supply centers.

DLA Comments: Concur. DLA routinely analyzes SASPS data for monitoring its automated BPA program and to track BPA vendor pricing and performance. Performance measures and quarterly reports on the status of SASPS overpricing will be developed. DLA has established a requirement for each ICP to have in place a Contract Quality Management Plan (CQMP). The purpose of the CQMP is to assure that each ICP has in place an effective management control plan for assuring contracting system controls and integrity and for continuous improvement of contract quality in all phases of the procurement process. DLA will include review of potential SASPS overpricing reports as part of future CQMP reviews. In addition, SASPS pricing is routinely reviewed during Procurement Management Reviews.

Disposition:

- () Action is ongoing. ECD:
- (X) Action is considered complete.

Audit Team Members

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