Audit Report

OFFICE OF THE INSPECTOR GENERAL

AWARD OF SECTION 8(a) PROGRAM CONSTRUCTION CONTRACTS BY THE DEFENSE CONSTRUCTION SUPPLY CENTER

Report No. 95-147

March 15, 1995

Department of Defense

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Acronyms

DCSC	Defense Construction Supply Center

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

March 15, 1995

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION AND TECHNOLOGY
DIRECTOR, DEFENSE LOGISTICS AGENCY
COMMANDER, DEFENSE CONSTRUCTION SUPPLY CENTER

SUBJECT: Audit Report on the Award of Section 8(a) Program Construction Contracts by the Defense Construction Supply Center (Report No. 95-147)

We are providing this final report for your review and comments. Congressman John R. Kasich requested the audit on behalf of a constituent who alleged that the Defense Construction Supply Center paid substantially more than fair market value to and gave preferential treatment to socially and economically disadvantaged small business firms. Comments on a draft of this report from the Defense Logistics Agency were considered in preparing this final report.

DoD Directive 7650.3 requires all audit recommendations to be resolved promptly. The Director, Office of Small and Disadvantaged Business Utilization, Office of the Under Secretary of Defense for Acquisition and Technology, did not respond to the draft report. Therefore, we request comments from him by May 15, 1995.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. James Kornides, Audit Program Director, or Mr. Stuart D. Dunnett, Audit Project Manager, at (614) 337-8009. The distribution of this report is listed in Appendix B. The audit team members are listed on the inside back cover.

David Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 95-147 **March 15, 1995**
(Project No. 4LE-5046)

AWARD OF SECTION 8(a) PROGRAM CONSTRUCTION CONTRACTS BY THE DEFENSE CONSTRUCTION SUPPLY CENTER

EXECUTIVE SUMMARY

Introduction. Congressman John R. Kasich requested the audit on behalf of a constituent who alleged that the socially and economically disadvantaged small business firm in the Section 8(a) Program that was awarded contract DLA710-93-0032, valued at $735,198, was paid substantially more than fair market value and received preferential treatment. The allegation was the second recent allegation concerning overall Defense Construction Supply Center policies on awarding construction industry projects using preferential contracting practices. Preferential contracting practices can be used to the extent necessary to achieve the goal established in United States Code, title 10, section 2323 (10 U.S.C. 2323), that 5 percent of all DoD procurement dollars be awarded to minority small business firms and institutions, but such use should not fall disproportionately on a particular industry segment.

Objective. The original audit objective was to evaluate the validity of the constituent's allegations that the firm that was awarded contract DLA710-93-0032 was paid an excessive amount and received preferential treatment. We expanded our objective to determine whether the Defense Construction Supply Center was in compliance with the criteria established by 10 U.S.C. 2323 when awarding construction industry contracts using preferential contracting practices. We also reviewed applicable internal controls.

Audit Results. We did not substantiate any improprieties in the award of contract DLA710-93-0032. However, contracts awarded from October 1, 1990, through June 30, 1994, to socially and economically disadvantaged small business firms in the construction industry (standard industrial classification codes 15 through 17) were disproportionate to awards in other industry segments. As a result, large business firms and other small business firms were excluded from construction industry contracts, and the opportunity to lower costs through competition was restricted.

Internal Controls. The audit identified material internal control weaknesses. Internal controls and the implementation of the DoD Internal Management Control Program were not effective to ensure that a particular industry segment did not bear a disproportionate share of the contract awards made to socially and economically disadvantaged small business firms using preferential contracting practices. Part I discusses the internal controls assessed, and Part II provides details of the weaknesses identified.

Potential Benefits of Audit. Increased competition will decrease costs; however, we could not quantify the potential monetary benefits.

Summary of Recommendations. We recommend that the Commander, Defense Construction Supply Center, establish procedures to evaluate contract award data by industry segment. We also recommend that the Director, Office of Small and Disadvantaged Business Utilization, Office of the Under Secretary of Defense for Acquisition and Technology, monitor the Defense Construction Supply Center procurement office to ensure that it limits the use of Section 8(a) Program contracts in standard industrial classification codes 15 through 17.

Management Comments. The Principal Deputy Director of the Defense Logistics Agency concurred with the recommendation. However, the Principal Deputy Director nonconcurred with the finding, stating that the Commander, Defense Construction Supply Center, did not award a disproportionate share of contracts to a Section 8(a) Program firm. The Office of the Under Secretary of Defense for Acquisition and Technology did not respond to the draft of this report. A full discussion of management comments and audit responses is in Part II, and the complete text of management comments is in Part IV.

Audit Response. We request that the Office of the Under Secretary of Defense for Acquisition and Technology provide comments on the final report by May 15, 1995.

Table of Contents

This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Part I - Introduction

Background

Congressman John R. Kasich requested the audit on behalf of a constituent who alleged the $735,198 that the Defense Construction Supply Center (DCSC) awarded on contract DLA710-93-0032 for the installation and repair of a sprinkler system was substantially more than fair market value. The constituent also alleged that DCSC gave preferential treatment to the firm awarded the contract. This was the second recent allegation concerning overall DCSC practices on awarding a disproportionate share of construction industry contracts to socially and economically disadvantaged small business firms, as defined in United States Code, title 15, section 637 (15 U.S.C. 637), Small Business Administration Section 8(a) Program, using preferential contracting practices.

Preferential contracting practices, such as sole-source procurement, are authorized to achieve the goals of the Section 8(a) Program and 10 U.S.C. 2323. The goal of 10 U.S.C. 2323 is that 5 percent of all DoD procurement dollars be awarded to minority small business firms and institutions, but not awarded disproportionately to a particular industry segment.

Objective

The original audit objective was to evaluate the validity of the constituent's allegation that DCSC paid excessive amounts and gave preferential treatment to the firm that was awarded contract DLA710-93-0032. We expanded our audit objective to determine whether DCSC was in compliance with the criteria established by 10 U.S.C. 2323 when awarding construction industry contracts using the preferential contracting practices. We also reviewed applicable internal controls.

Scope and Methodology

We reviewed the contractor selection process and fair market price determination, including Government estimates, used by DCSC in awarding contract DLA710-93-0032. We expanded the audit scope to determine whether DCSC was in compliance with 10 U.S.C. 2323, because the specific allegation was related to a recent DoD Hotline allegation concerning the DCSC practice of awarding a disproportionate share of construction industry contracts to firms under the Section 8(a) Program using preferential contracting practices.

Using the Defense Logistics Agency Contracting Action Reporting System, we obtained specific data on contract awards in the construction industry: standard industrial classification code 15 (building construction), code 16 (construction other than building), and code 17 (special trade construction). We also obtained data on contract awards in the other standard industrial classification codes. We did not review the general or application controls of the Defense Logistics Agency Contracting Action Reporting System pertaining to the data on contract awards or assess the reasonableness of the Government estimates. We examined the 95 construction contracts, valued at $27.1 million, that DCSC awarded from October 1, 1990, through June 30, 1994.

We did not use computer-processed data or statistical sampling procedures to conduct this audit.

This economy and efficiency audit was made from May through November 1994, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Organizations visited or contacted during the audit are listed in Appendix A.

Internal Controls

Controls Assessed. We evaluated internal control techniques, such as written policies and procedures, applicable management information systems, actions taken in response to a FY 1993 DoD Hotline Investigation Report, and the DoD Internal Management Control Program related to controls to ensure an equitable distribution among industry segments of contract awards to socially and economically disadvantaged small business firms.

Internal Control Weaknesses. The audit identified material internal control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Controls were not effective to ensure that a particular industry segment did not bear a disproportionate share of the contract awards made to socially and economically disadvantaged small business firms using preferential contracting practices. The DoD Internal Management Control Program at DCSC did not detect the internal control weaknesses, because DCSC had not begun conducting internal control reviews on contract awards.

The recommendations, if implemented, will assist in correcting the reported weaknesses. No quantifiable monetary benefits are associated with correcting the internal control weakness.

A copy of the final report will be provided to the senior officials responsible for internal controls in the Office of the Secretary of Defense and the Defense Logistics Agency.

Prior Audits and Other Reviews

General Accounting Office Report No. GAO/NSIAD-93-167 (OSD Case No. 94-01), "Minority Contracting: DoD's Reporting Does Not Address Legislative Goal," July 27, 1993, stated that 10 U.S.C. 2323 requires DoD to report on its progress toward meeting the overall 5-percent goal of minority contracting. Instead of reporting on the overall goal, DoD reported on three separate goals in FYs 1991 and 1992 (prime contracts with minority small business firms, subcontracts with such firms, and prime contracts with minority colleges and institutions). The General Accounting Office also reported that DoD used preferential contracting practices in about 20 percent of the contracts awarded to minority small business firms.

The report questioned the extent to which preferential contracting practices were required after FY 1993 because DoD exceeded the 5-percent goal in FY 1992, although the awards using preferential practices were excluded. Officials at the DoD Office of Small and Disadvantaged Business Utilization agreed with the findings and said that future reports to Congress would highlight DoD performance against the overall goal. However, they did not agree that preferential contracting practices should be evaluated or curtailed.

DoD Hotline Investigation Report No. 93-T53211-93060, [Untitled], August 31, 1993, summarized the results of a Defense Logistics Agency investigation made in response to an allegation made through the DoD Hotline. The allegation was that DCSC paid excessive amounts on four construction industry contracts. All four contracts were awarded on a sole-source basis to socially and economically disadvantaged small business firms in the Section 8(a) Program at prices that exceeded the original Government estimate.

The report provided substantial evidence that three of the contracts were awarded at prices above fair market value. DCSC personnel significantly increased the Government estimates that were intended to approximate fair market value during negotiations with contractors, but the rationale for the upward revisions was not adequately explained. DCSC agreed and stated that it would develop procedures to ensure that any changes to the original Government estimates were justified and fully documented.

Other Matters of Interest

We did not substantiate any improprieties in the contractor selection process or fair market price determination used by DCSC to award contract DLA710-93-0032. DCSC awarded the sole-source contract on September 30, 1993, to a socially and economically disadvantaged small business firm.

Although DCSC solicited only one Section 8(a) Program firm, that exception to full and open competition was authorized by the regulations implementing the Section 8(a) Program. An independent Government estimate supported the award price of $735,198, and no documentation disputed the reasonableness of the estimate.

Part II - Finding and Recommendations

Construction Contracts

DCSC awarded a disproportionate share (74 percent of the contracts and 97 percent of the funds) of the $27.1 million in construction industry contracts it issued from October 1, 1990, through June 30, 1994, to socially and economically disadvantaged small business firms in the Section 8(a) Program. (DCSC awarded 94 percent of the Section 8(a) Program contracts sole-source). DCSC achieved the high percentages by establishing a practice of using less than full and open competition to award Section 8(a) Program contracts in the construction industry. The conditions occurred because DCSC relied extensively on the construction industry to help achieve the 5-percent goal established by 10 U.S.C. 2323, and DCSC did not have procedures to evaluate contract award data by industry segment to ensure an equitable distribution of contracts awarded to socially and economically disadvantaged small business firms. As a result, large business firms and other small business firms were excluded from construction industry contracts, and opportunities to achieve price reductions through competition were severely restricted.

Background

Preferential Contracting Practices. The overall DoD procurement policy is to place a fair percentage of contracts with both small business firms and socially and economically disadvantaged small business firms. Socially and economically disadvantaged small business firms are defined in 15 U.S.C. 637 as firms that are owned by designated minorities. The Federal Acquisition Regulation establishes industry categories and size standards for each industry category. Business firms that are smaller than the assigned size category are considered small business firms for Federal procurement purposes. The Federal Acquisition Regulation also requires that contracting officers promote full and open competition in the acquisition process by providing all responsible sources an opportunity to compete for Government contracts. However, both 10 U.S.C. 2323 and 15 U.S.C. 637 grant exceptions to full and open competition.

United States Code, Title 10, Section 2323. In 10 U.S.C 2323, Congress established a goal that an amount equal to 5 percent of all DoD procurement dollars obligated be awarded as contracts or subcontracts to minority small business firms, historically black colleges and universities, and minority institutions. Preferential contracting practices can be used to the extent necessary to attain the 5-percent goal, but that use should not fall disproportionately on a particular industry segment.

United States Code, Title 15, Section 637. Congress established the Small Business Administration Section 8(a) Program in 15 U.S.C 637. The goal of the Section 8(a) Program is to increase the participation of socially and economically disadvantaged small business firms in Government acquisitions.

Small business firm owners with designated racial and social characteristics can elect to participate in the Section 8(a) Program and get access to Government contracts that they might otherwise not have received through full and open competition. Congress authorized DoD contracting organizations to use less than full and open competition procedures and to give preference to socially and economically disadvantaged small business firms in the Small Business Administration Section 8(a) Program and pay a price not exceeding fair market price by 10 percent. DoD contracting organizations can set aside acquisitions for award to the Small Business Administration, which negotiates with and subcontracts work to firms qualified under the Section 8(a) Program. Small Business Administration approval is required before a DoD contracting organization may compete contracts valued at less than $3 million among Section 8(a) Program firms.

Legislative Intent on Using Preferential Contracting Practices. House of Representatives Report No. 102-527, "National Defense Authorization Act for Fiscal Year 1993," October 3, 1992, provides the legislative history on 10 U.S.C. 2323. The report states that Congress neither mandated nor desired that the Section 8(a) Program be used to unfairly exclude nondisadvantaged firms from obtaining Government contracts. Thus, large and other small business firms should not be excluded in the award of contracts, but allowed to compete for a fair percentage of Government contracts.

Contract Awards in the Construction Industry

DCSC awarded a disproportionate share of the construction industry contracts* it issued to socially and economically disadvantaged small business firms in the Section 8(a) Program. From October 1, 1990, through June 30, 1994, DCSC awarded 95 construction industry contracts, valued at about $27.1 million. DCSC awarded 71 of the 95 contracts (74 percent), valued at $26.3 million (97 percent), to Section 8(a) Program firms. Further, 67 of the 71 contracts awarded to Section 8(a) Program firms, valued at about $15.4 million, were sole source.

While the regulations that implement the Section 8(a) Program allowed DCSC to use less than full and open competition procedures (approval from the Small Business Administration is required before DCSC can compete a Section 8(a) Program contract valued at less than $3 million), the DCSC use of the procedures excluded large business firms and virtually all nondisadvantaged small business firms from construction industry contracts. The condition occurred because DCSC:

*The construction industry consists of standard industrial classification codes 15 (building construction), 16 (construction other than building), and 17 (special trade construction).

o relied extensively on the construction industry to help meet established goals, and

o did not have procedures to evaluate contract award data by industry segment to ensure equitable distribution of contracts among various types of businesses.

DCSC Practice to Rely Extensively on Construction Industry. DCSC established an unwritten practice to rely extensively on the construction industry to achieve the 5-percent goal established in 10 U.S.C. 2323 and the increased participation goal in 15 U.S.C. 637. While such action appears to be laudatory, reliance on preferential contracting practices to award contracts in one industry segment is contrary to United States Code, which states that attainment of the 5-percent goal should not fall disproportionately on a particular industry segment. Further, extensive use of sole-source contracts reduces the opportunity for large business firms and other small business firms to compete and achieve price reductions.

DCSC personnel informed us that they relied on the construction industry to meet the goals because they believed that finding suitable Section 8(a) Program firms was more difficult in the procurement of commodities and other services. They also stated that the Small Business Administration could delay contract awards if DCSC did not use the recommended Section 8(a) Program firms.

Accordingly, if the Small Business Administration determined that a socially and economically disadvantaged small business firm in the Section 8(a) Program was qualified and available for a construction project, DCSC did not solicit offers from other qualified small business firms.

Full and Open Competition. DCSC limited opportunities to achieve price reductions through competition by electing to place the majority of the construction industry contracts it awarded in the Section 8(a) Program. Figure 1 shows that of the 71 Section 8(a) Program contracts, DCSC awarded 67 (94 percent), valued at $15.4 million, sole source.

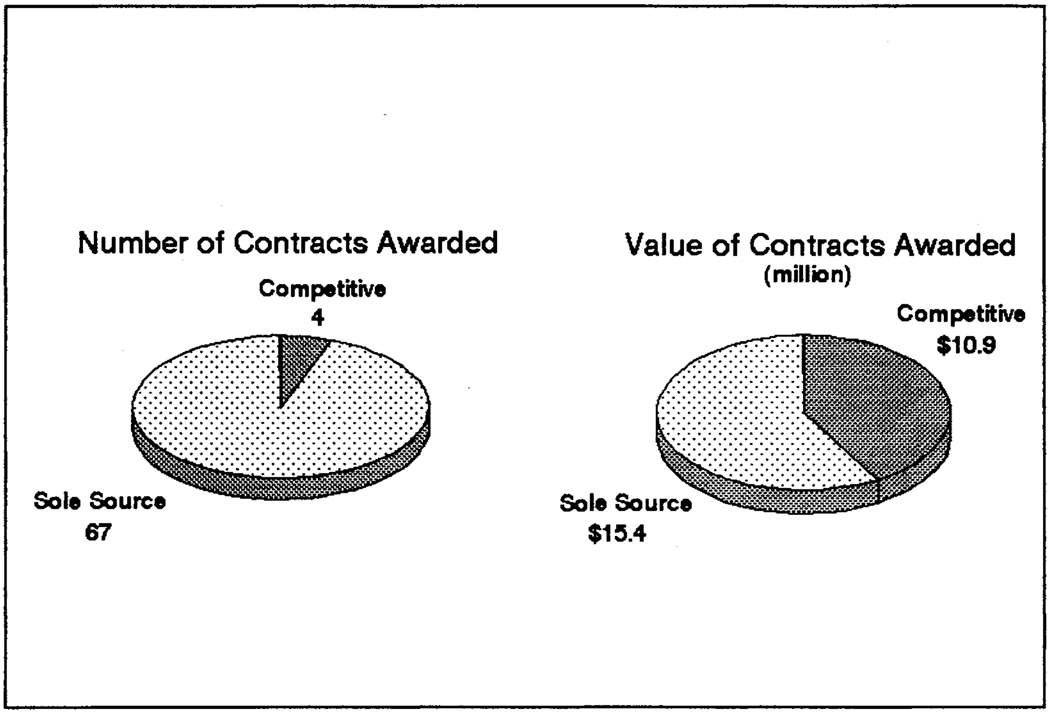

Figure 1. Section 8(a) Program Construction Industry Contracts Awarded Sole Source

We could not determine whether the 67 sole-source contracts represented the price achievable through full and open competition. According to the Defense Federal Acquisition Regulation, competition saves the Government an average of 25 percent more than sole-source contracts. The Federal Acquisition Regulation requires that Section 8(a) Program contracts not be awarded above fair market value.

Government Estimates. DCSC relied primarily on Government estimates to establish the fair market value for the 67 sole-source contracts. Estimates are difficult to validate independently because site conditions vary and other factors make them highly subjective. For example, the award of contract DLA710-93-0032 did not involve competition and, accordingly, we could not determine whether the Government award price of $735,198 represented the price attainable by the Government if the construction services were purchased on a fully competitive basis. When DCSC awarded a competitive contract for a sprinkler installation and repair project on larger (more square footage) but similar facilities, the winning bid was about $1.7 million, representing about 40 percent of the $4.2 million Government estimate. DCSC personnel could not explain the significant difference between the Government estimate and award price. The Government estimate on both projects was made by the same architectural engineering firm.

Distribution of Contract Awards by Industry Segment. DCSC did not have procedures to evaluate contract awards by industry segment to ensure that contracts were equitably awarded to Section 8(a) Program firms and non-disadvantaged firms among industry segments. DCSC management maintained a management information system that had the capability to provide upper level DCSC management with the information needed to readily identify the distribution of contracts. Specifically, the Defense Logistics Agency Contracting Action Reporting System contained the capability to provide information on the types of firms awarded contracts. However, DCSC did not develop procedures to use the system to evaluate contract data by industry segment. As a result, DCSC awarded a disproportionate share of contracts in the construction industry to socially and economically disadvantaged small business firms. As previously indicated, of the $27.1 million in contracts awarded by DCSC to construction industry firms, $26.3 million (97 percent) was awarded to small disadvantaged firms. In comparison, as shown in Figure 2, the DCSC procurement office awarded $47 million (about 2 percent) of the $2.4 billion of contracts in all other industry segments to small disadvantaged firms.

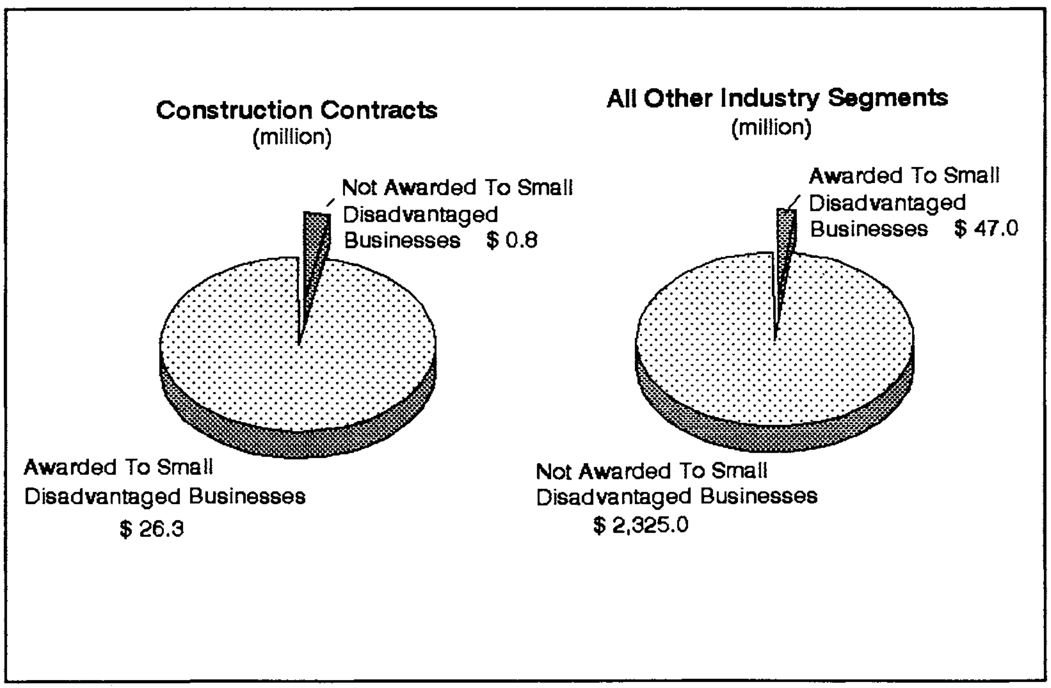

Figure 2. Construction Industry Contracts Compared to Other Contracts Awarded to Small Disadvantaged Business Firms

The contracts awarded in the construction industry to small disadvantaged firms were disproportionate relative to other industry segments.

Policy to Limit Preferential Practices. Defense Acquisition Circular 91-06, May 27, 1994, requires the Director, Office of Small and Disadvantaged Business Utilization, Office of the Under Secretary of Defense for Acquisition and Technology, to limit a contracting organization's use of preferential contracting practices. Limitations are to be set when the practices are used disproportionately in a particular industry segment to achieve the 5-percent goal established by 10 U.S.C. 2323.

Congress intended that contract awards to small disadvantaged firms be integrated among all industry segments. Although a DoD policy on preferential contracting practices was not officially published until 1994, DCSC had a responsibility to take the action needed to ensure that there was balance in the distribution of its contracts to small disadvantaged firms. DCSC officials indicated that there had been no guidance on use of preferential contracting practices at the DoD level until Circular 91-06 was published in 1994. They indicated the circular has clarified the policies that must be followed.

DCSC needs to establish procedures to evaluate contract award data by industry segment. That action would allow DCSC to identify industry segments in which more contract awards should be made to Section 8(a) Program firms, and to identify segments that are receiving a disproportionate share of the awards.

Additionally, because our review showed that DCSC awarded a disproportionate share of contracts in the construction industry, we believe that the Director, Office of Small and Disadvantaged Business Utilization, Office of the Under Secretary of Defense for Acquisition and Technology, should monitor DCSC to ensure DCSC procurement offices limit the use of Section 8(a) Program contracts in the construction industry.

Management Comments on the Finding and Internal Controls, and Audit Response

DLA Comment on Preferential Contracting Practices. The Principal Deputy Director of the Defense Logistics Agency nonconcurred with the finding and indicated that the audit report erroneously causes the reader to conclude that DCSC was awarding a disproportionate share of contracts to Section 8(a) Program firms. He indicated that DCSC should increase its awards with Section 8(a) Program firms and other small disadvantaged business firms because DCSC has never attained the 5-percent small disadvantaged business goal. He also indicated that the DCSC Section 8(a) Program awards were awarded on a sole-source basis, in total compliance with legislation and regulations and in consonance with the Small Business Administration, which has purview over the Section 8(a) Program on a Government-wide basis. The Principal Deputy Director added that the report ignored construction dollars awarded by the U.S. Army Corps of Engineers (for DCSC requirements). He indicated that he is not aware of authorization available to DCSC to provide a 10-percent preference on Section 8(a) Program awards, and is not aware of any instance where DCSC knowingly made awards in excess of fair market price. Accordingly, he disagreed that the finding portrayed an internal management control weakness. For the full text of DLA comments, see Part IV.

Audit Response: We agree with DLA that DCSC can and should do its share to ensure that an equitable portion of contracts are awarded to Section 8(a) Program firms. However, as indicated in this report, the DLA contract awards to small disadvantaged businesses in the construction industry are disproportionate to awards in other industries and preclude the efficiencies that can be gained in that industry through competition, because most Section 8(a) Program contracts are awarded sole source. We believe that DCSC should take action to correct the imbalance we detected by concentrating its Section 8(a) Program contracting efforts in the nonconstruction industries, in its attempt to reach the goal of 5 percent.

Contracts awarded by the U.S. Army Corps of Engineers were not included in the scope of this audit. It is possible that the Corps' procurement offices awarded a more proportionate share of construction contracts to small disadvantaged businesses. However, that was not true of the DCSC procurement office.

We noted the Principal Deputy Director's comment regarding our wording, "give a 10-percent preference to socially and economically disadvantaged small business firms," and have changed the final report to clarify the intent of our statement. With regard to the comment that he was unaware of any instances where DCSC awarded contract prices above fair market value, the report referenced a previous DLA Hotline investigation that provided substantial evidence that three Section 8(a) Program contracts were awarded at prices above the fair market value established through Government estimates.

We continue to believe that the DCSC procurement office needs to bolster internal controls to ensure that no one industry segment receives a predominant share of Section 8(a) Program contracts. Such effort would increase the probability of competition in all industries and increase the opportunity for DCSC to achieve price reductions.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Commander, Defense Construction Supply Center, establish procedures to evaluate contract award data by industry segment to ensure a more equitable distribution of contract awards to socially and economically disadvantaged small business firms.

Management Comments. The Principal Deputy Director of the Defense Logistics Agency concurred and stated that DCSC will start publishing a quarterly report showing awards to small and disadvantaged businesses and other contractors for each Standard Industrial Code and Federal Supply Class. The first report should be issued in April 1995.

2. We recommend that the Director, Office of Small and Disadvantaged Business Utilization, Office of the Under Secretary of Defense for Acquisition and Technology, monitor the Defense Construction Supply Center procurement office to ensure that it limit the use of Section 8(a) Program contracts in standard industrial classification codes 15 through 17.

Management Comments. The Office of the Under Secretary of Defense for Acquisition and Technology did not respond to the draft of this report.

Audit Response. We request that the Office of the Under Secretary of Defense for Acquisition and Technology provide comments on the final report.

Part III - Additional Information

Appendix A. Organizations Visited or Contacted

Department of Defense

Office of the Under Secretary of Defense for Acquisition and Technology, Washington, DC
Office of the Director, Defense Procurement, Washington, DC

Other Defense Organizations

Headquarters, Defense Logistics Agency, Alexandria, VA
Defense Construction Supply Center, Columbus, OH

Non-Defense Federal Organizations

Small Business Administration, Columbus, OH

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Under Secretary of Defense (Comptroller)
Deputy Under Secretary of Defense (Acquisition Reform)
Director, Defense Procurement
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Department of the Army

Auditor General, Department of the Army

Department of the Navy

Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
  Commander, Defense Construction Supply Center
Director, National Security Agency
Inspector General, Central Imagery Office
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange

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House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

Congressman John R. Kasich, U.S. House of Representatives

Part IV - Management Comments

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

26 JAN 1995

IN REPLY REFER TO

DDAI

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: OIG Draft Report on the Award of Section 8 (a) Program Construction Contracts by the Defense Construction Supply Center (Project No. 4LE-5046)

This is in response to your 7 November 1994 request.

Jacqueline G. Bryant

JACQUELINE G. BRYANT
Chief, Internal Review Office

2 Enclosures

cc:
AQAU
DCSC-R

TYPE OF REPORT: Audit

PURPOSE OF INPUT: Initial Position

AUDIT TITLE & NO: Award of Section 8(A) Program Construction Contracts by the DCSC Project No. 4LE-5046

FINDING: DCSC awarded a disproportionate share (74 percent of the contracts and 97 percent of the funds) of the $27.1 million in construction industry contracts it issued from October 1, 1990, through June 30, 1994, to socially and economically disadvantaged small business firms in the Section 8(a) Program. (DCSC awarded 94 percent of the Section 8(a) Program contracts sole-source). DCSC achieved the high percentages by establishing a practice of using less than full and open competition to award Section 8(a) Program contracts in the construction industry. The conditions occurred because DCSC relied extensively on the construction industry to achieve the 5-percent goal established by 10 U.S.C. 2323, and DCSC did not have procedures to evaluate contract award data by industry segment to ensure an equitable distribution of contracts awarded to socially and economically disadvantaged small business firms. As a result, large business firms and other small business firms were excluded from construction industry contracts, and opportunities to achieve price reductions through competition were severely restricted.

DLA COMMENTS: Nonconcur with the finding. Overall the audit report distorts the facts concerning the use of the 8(a) Program at DCSC to achieve the 5% SDB goal mandated by 10 U.S.C. 2323. The report constantly confuses and commingles these two similar, but separate and distinct pieces of legislation. It should be noted that the 8(a) legislation is applicable Federal government wide, and predates the DoD legislation (10 U.S.C. 2323) by more than 20 years. The audit report erroneously causes the reader to conclude that DCSC was awarding a disproportionate share of contracts to 8(a) firms. To the contrary, it could be argued that DCSC should increase its awards with 8(a) and other SDB firms since DCSC has never attained the 5% SDB goal. Like-wise, the report suggests that these 8(a) awards were made contrary to the rules governing competition because they were awarded on a sole source basis. The fact that they were awarded on a sole source basis is, however, in total compliance with the enabling 8(a) legislation and implementing regulations and in consonance with the Small Business Administration which has purview of the 8(a) program on a government wide basis.

Final Report Reference

For the construction efforts going on at the DCSC complex, the audit report ignored those construction dollars awarded by the USA Corps of Engineers for DCSC requirements under Job Ordering Contracts to firms other than 8(a) firms. Examples would include the $65 million awarded on DACA27-93-C-0124 to P.J. Dick, Inc., and the $10.3 million award on DACA27-94-C-0066 for the construction of the 83rd ARCOM Center, and many others. These additional dollars awarded to non 8(a) firms must be considered when evaluating the allegation that 8(a) firms are receiving a disproportionate amount of DCSC construction awards.

On page 9 of the audit report it is stated, "Congress authorized DoD contracting organizations to use less than full and open competition procedures and to give a 10% preference to socially and economically disadvantaged business firms in the Small Business Administration Section 8(a) Program." We are not aware of any such authorization available to DCSC to provide a 10% preference on 8(a) awards. Section 921 (b)(2) of P.L. 99-661 prohibits 8(a) contract awards to exceed the fair market price. However, P.L. 99-661, Section 1207, provides authorization to place awards with SDBs using less than full and open competition and to pay a price not exceed-ing fair market cost by more than 10%. DoD has implemented this authority at DFARS 219.502-2-70 and 219.70. We are not aware of any instance where DCSC has knowingly made 8(a) awards in excess of the fair market price. Consequently, we do not agree that any of the findings discussed portray an internal management control weakness. Revised

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur
( ) Concur; however weakness is not considered material
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance

ACTION OFFICER: Patricia Cleveland/AQAU
PSE REVIEW/APPROVAL: Anthony J. Kuders, Deputy Director, AQAU, 23 Jan 95
CORDINATION: Nick McHenry, AQPLB, 25 Jan 95
Bob Morrison, AQPLD, 25 Jan 95
E. Sanchez, FOE, 24 Jan 95
D. Stumpf, DDAI, 25 Jan 95
Bryant, DDAI, 25 Jan 95

DLA APPROVAL: Lawrence P. Farrell, Jr.

TYPE OF REPORT: Audit

PURPOSE OF INPUT: Initial Position

AUDIT TITLE & NO: Award of Section 8(A) Program Construction Contracts by the DCSC (Project No. 3LE-0032)

RECOMMENDATION: Recommend that the Commander, Defense Construction Supply Center, establish procedures to evaluate contract award data by industry segment to ensure a more equitable distribution of contract awards to socially and economically disadvantaged small business firms.

DLA COMMENTS: Concur with above recommendation. DCSC will publish a report quarterly showing the total amount of dollars awarded to Small and Disadvantaged Business (SDB) concerns compared to the total dollars awarded for each Standard Industrial Classification (SIC) code and Federal Supply Class (FSC). Anticipated completion date for first report is April 1995.

The Executive Director, Procurement, and Director, Small and Disadvantaged Business Utilization, DLA, will monitor the DCSC procurement office to ensure that DCSC effectively utilizes Section 8 (a) contracts in SIC codes 15 and 17.

DISPOSITION:
(X) Action is Ongoing. Estimated completion Date: April 1995
( ) Action is Considered Complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur
( ) Concur; however weakness is not considered material
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance

MONETARY BENEFITS:
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

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DLA APPROVAL:

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