GAO

Report to the Chairman, Committee on Government Operations, House of Representatives

June 1993

## DEFENSE PROCUREMENT

# Programs for Considering Vendor's Past Performance in Awarding Contracts





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The Honorable John Conyers, Jr. Chairman, Committee on Government Operations House of Representatives

Dear Mr. Chairman:

As you requested, we reviewed Air Force Logistics Command (AFLC) and Defense Logistics Agency (DLA) programs for awarding contracts to vendors with superior quality and delivery histories, but not necessarily offering the lowest prices (hereafter called quality vendor programs). This report addresses (1) the origin of these programs, whether they were initiated in response to evidence demonstrating a significant quality problem in vendor performance, and what formal legal reviews were done on the programs; (2) the extent of their use, and how much they increased prices; (3) the programs' competitive impact on small businesses; and (4) whether pre-existing procurement practices could accomplish the same program goals. We will be reporting to you separately on several legal issues that we identified during our review.

#### Results in Brief

AFLC and DLA initiated their quality vendor programs in response to a 1986 recommendation by the President's Blue Ribbon Commission on Defense Management (Packard Commission) that called for the Department of Defense (DOD) to use more commercial-style competition emphasizing quality and established performance, as well as price, in awarding contracts. The programs were not initiated in response to specific evidence demonstrating significant quality problems in vendor performance; however, program officials said several studies had shown that such quality problems existed. The quality vendor programs are a reflection, in part, of growing recognition in government that past performance should be a factor in contractor selection. Program and legal officials told us that no formal reviews had been done to determine the legality of these programs because their legality was never in question.

Under the quality vendor programs we reviewed, the agencies typically awarded contracts to the lowest priced offeror. In a relatively few cases, however, the agencies paid price differentials for the higher priced offers of quality vendors. During fiscal years 1988 through 1992, AFLC awarded

<sup>&</sup>lt;sup>1</sup>As of July 1, 1992, the Air Force reorganized and AFLC became part of a new Air Force Material Command.

60 contracts to other than the lowest priced offeror under the quality vendor programs and paid an aggregate price differential of about \$140,807. During the same time period, DLA awarded 594 such contracts and paid an aggregate price differential of about \$258,272. The total value of these contractual actions represents a small fraction of 1 percent of the dollar value of all contracts awarded at AFLC and DLA during this period. AFLC and DLA officials said they plan to initiate new programs that will consider past performance in many more of their contract award decisions.

Our review indicated that the quality vendor programs generally have not limited the opportunity for small businesses as a group to compete. For example, at AFLC's San Antonio Air Logistics Center and DLA's Defense Construction Supply Center, the two buying centers we visited, all but 2 of the 192 contracts awarded with a price differential under the programs during fiscal years 1988 to 1992 went to small businesses. However, the Small Business Administration has taken the position that the quality vendor programs conflict with provisions of the Small Business Act. In contrast, DOD stated that the programs are consistent with the act. As indicated above, we will be reporting to you separately on this matter.

Use of source selection factors other than price was an authorized procurement practice before the quality vendor programs were developed. Basically, the quality vendor programs are efforts to simplify this practice and make it more usable for the relatively small dollar value procurements of spare and replacement parts that the programs are intended to cover. Another procurement practice has been required since long before the quality vendor programs were initiated: determining whether the apparent winner of a contract award is responsible—that is, capable of successfully performing the contract. However, this practice does not and is not intended to distinguish vendors with superior performance histories from other responsible offerors, a goal of the quality vendor programs.

#### Background

Under procurement law and government-wide regulations, the source selection evaluation factors that apply to a procurement and their relative importance are within the broad discretion of agency procurement officials. However, solicitations must state these factors and their relative importance.

According to AFLC and DLA regulations, quality vendor programs are intended to formalize the contracting officer's authority to exercise

business judgment in awarding contracts that historically have been awarded on the basis of price alone. Program regulations and solicitations (1) state that price is the primary source selection evaluation factor, but that offerors' past quality and delivery performance will also be considered, (2) recognize that responsible offerors' performance histories show varying degrees of quality and delivery performance, and (3) allow contracting officers to make awards to a quality vendor that is not the lowest-priced offeror, if this represents the best value to the government and the proposed price is no more than 20 percent higher than the lowest offer.

The similarly structured programs at AFLC and DLA require interested vendors to apply for designation as quality vendors by supply class.<sup>2</sup> Prospective program participants must have been awarded at least a minimum specified number and value of contracts in the applicable supply classes during a specified time period. They also must have met or exceeded specified delivery and quality levels on these and other contracts. Specific eligibility criteria differ between AFLC and DLA, but each program has quantitative and objective criteria as minimum standards. Appendix I describes these criteria in more detail.

#### Quality Vendor Programs Implement Packard Commission Recommendation

AFLC, after a concept test at the Oklahoma City Air Logistics Center in 1986, implemented its quality vendor program at all five of its Air Logistics Centers in November 1987. DLA's Defense Electronics Supply Center and Defense Industrial Supply Center tested a variant of the AFLC concept during 1987. DLA authorized four of its centers to implement quality vendor programs in December 1987.<sup>3</sup>

The AFLC and DLA centers started their programs in a few federal supply classes and gradually expanded the number of supply classes in the programs. By November 1992, the AFLC and DLA centers had incorporated all their supply classes into the program.

According to AFLC and DLA program staff, the primary impetus for their quality vendor programs was an April 1986 Packard Commission recommendation. The President established the Commission, in part,

<sup>&</sup>lt;sup>2</sup>A federal supply class is a general grouping of supply items purchased by the government. They include categories such as aircraft structural components and vehicular power transmission components.

<sup>&</sup>lt;sup>3</sup>The four centers consisted of the two where the concept was tested and the Defense Construction Supply Center and the Defense General Supply Center.

because public confidence in the defense acquisition system had been shaken by reports of grossly overpriced spare parts, test deficiencies, and cost and schedule overruns. Although the Commission analyzed such cases, it concluded that a diagnosis based solely on recognized deficiencies could only lead to "band-aid" treatments. For that reason, the Commission compared the defense acquisition system with other procurement systems in the government and the private sector, and based its recommendations on these evaluations.

The Commission's report stated that it was particularly important for DOD to focus on achieving more effective competition, modeled after the competitive procurement techniques used in industry. According to the report, these practices are intended to simultaneously achieve several objectives: attract the best qualified suppliers, validate product performance and quality, and secure the best price.

Program staff at AFLC and DLA told us that the Commission's recommendation and initiation of the quality vendor programs were consistent with (1) dod management officials' intent to implement total quality management, a systematic process of continuous improvement in which an organization focuses on satisfying its customers and (2) their agencies' intent to deal with quality problems identified by their field quality tests and by our office and the dod Office of the Inspector General. However, AFLC and DLA officials told us that the decisions to initiate the quality vendor programs were not based on specific evidence demonstrating significant quality problems in vendor performance on dod procurements.

The quality vendor programs are a reflection, in part, of growing recognition in government that past performance should be a factor in contractor selection. For example, in January 1993 the Office of Federal Procurement Policy issued a policy letter requiring consideration of past performance in all procurements over \$100,000.<sup>5</sup> Also, the General Services Administration (GSA) now provides for the evaluation of past performance when considering whether to exercise a contract option.<sup>6</sup> Moreover, in 1986, Congress required that quality be a consideration in all procurements in which price or cost is not the only factor to be considered.<sup>7</sup> Additionally,

<sup>&</sup>lt;sup>4</sup>A list of prior reports on this subject is included at the end of this report.

<sup>&</sup>lt;sup>5</sup>See the January 11, 1993, Federal Register (58 Fed. Reg. 3573).

<sup>&</sup>lt;sup>6</sup>See the December 17, 1992, Federal Register (57 Fed. Reg. 59939).

<sup>&</sup>lt;sup>7</sup>10 U.S.C.A. section 2305 (a)(3).

our office recognized the value of past performance in selecting contractors in the General Services transition report (GAO/OCG-93-28TR, Dec. 1992) and in General Services Administration: Actions Needed to Stop Buying Supplies from Poor-Performing Vendors (GAO/GGD-93-34, Jan. 11, 1993) in which we noted that GSA continued to award contracts to vendors that repeatedly supply defective or poor quality products or that were late with deliveries. We recommended that GSA develop more complete and usable data on vendors' capabilities and past performance and make effective use of that data in selecting contractors.<sup>8</sup>

Officials at AFLC and DLA legal offices and the Office of the Secretary of Defense told us that the legality of quality vendor programs was never in question, and therefore, no formal reviews of their legality had been undertaken. However, AFLC and DLA officials coordinated with their legal offices regarding their regulations for the programs.

Awards to Quality
Vendors Were Few
and Rarely Involved
Price Differentials,
but Planned Changes
May Increase the Use
of Past Performance
Information

Although AFLC and DLA have had quality vendor programs essentially in place for more than 5 years, relatively few program awards have been made to quality vendors and only a small portion of those involved price differentials. During fiscal years 1988 through 1992, the last full fiscal year for which we obtained such data:

- The five AFLC centers awarded an estimated 431,787 contracts, of which 2,345 (0.5 percent) were awarded to quality vendors in supply classes covered by the program.
- The four DLA centers awarded about 3.8 million contracts, of which 117,357 (3.1 percent) were awarded to quality vendors in program supply classes.
- Of these awards to quality vendors, only 60 contracts (2.6 percent) at AFLC and 594 (0.5 percent) at DLA were awarded with price differentials as a result of the quality vendor programs.

Of the \$43.5 billion in contracts the five AFLC centers awarded and the \$11.4 billion the four DLA centers awarded during this period, the total dollar value of contracts with price differentials was \$2.5 million (0.006 percent) at AFLC and \$4.3 million (0.04 percent) at DLA; the price differentials paid totaled \$140,807 at AFLC and \$258,272 at DLA.

Moreover, the number of quality vendors is quite small compared to the number of active vendors receiving contracts (the vendor base). For

<sup>&</sup>lt;sup>8</sup>This report is based, in part, on case studies of nine GSA contracts with seven contractors that were consistently poor performers. The problems occurred with two of the contractors even though they had received certificates of competency from the Small Business Administration.

example, at the end of fiscal year 1992, the San Antonio Air Logistics Center had 77 quality vendors out of a total vendor base of about 2,950, and the Defense Construction Supply Center had 248 quality vendors, out of a total vendor base of about 4,500.

Table 1 summarizes information on program awards to quality vendors, including awards with a price differential exceeding the lowest price offered.

#### Table 1: Program Awards, Fiscal Years 1988 Through 1992

Award information	AFLC	DLA
Total number of awards made at program buying centers	431,787ª	3,763,000
Number of awards to quality vendors in program supply classes	2,345	117,357
Number of awards with price differentials	60	594
Value of awards with price differentials	\$2,526,909	\$4,282,351
Value of price differentials paid	\$140,807	\$258,272

<sup>&</sup>lt;sup>a</sup>This is the total number of AFLC spare parts acquisitions, which is the extent of the program's coverage at AFLC.

#### Delivery Performance on Awards With Price Differentials

Our review of 36 contracts awarded with price differentials at the Defense Construction Supply Center and the San Antonio Air Logistics Center showed that (1) 22 met agency on-time delivery criteria, (2) 1 was delivered 2 months late, (3) 1 was not clearly determinable, and (4) 12 contracts were not yet due for delivery at the time we reviewed them.

A February 1992 Defense Construction Supply Center analysis of scheduled deliveries for 124 contracts it had awarded with price differentials showed that program contractors had met agency on-time delivery criteria for 114 (92 percent) of the contracts and had not for 6 (4.8 percent). The remaining four (3.2 percent) each had multiple shipments, some of which met the on-time delivery criteria and some of which did not. Comparable data was not available for all contract awards or all those made to the lowest bidders.

Of the price differential contracts we reviewed, no user had reported quality deficiencies attributable to the contractors. However, on one contract, the contracting officer granted waivers allowing rework for 50 of

the 970 units contracted for, and acceptance of 1 unit with a minor deviation.

#### Vendor Rating System May Expand Use of Performance History Information

DLA officials expect their quality vendor program to be replaced with a vendor rating system in calendar year 1993. AFLC is also planning to implement a vendor rating system in calendar year 1993, but officials expect it to coexist with their quality vendor program. Under the vendor rating systems, firms in the vendor base will receive ratings based on various factors which, like the quality vendor programs, are expected to include past quality and delivery performance. Unlike the quality vendor programs, however, the vendor rating systems are expected to compute quality and delivery ratings for offerors without their having to apply for quality vendor designation. Such ratings are to be (1) based on the past performance information available to the systems and (2) used in selecting the winning offerors in accordance with previously established evaluation criteria. Program officials at AFLC and DLA believe the vendor rating systems will affect many more award decisions than the quality vendor programs because the systems are to be applied to almost all competitively negotiated actions at DLA and all competitively negotiated actions over \$10,000 at AFLC.

#### No Evidence of Adverse Impact on Small Businesses

As previously mentioned, the Small Business Administration has taken the position that the quality vendor programs conflict with the certificate of competency provisions of the Small Business Act. However, we did not find evidence that small businesses as a group had been negatively impacted by the quality vendor programs.

Our review indicated that the quality vendor programs have not limited the ability of small businesses as a group to compete for awards. For example, at the two centers we visited, we found that almost all quality vendor program awards with price differentials went to small businesses. The San Antonio Air Logistics Center made 26 of its 27 price differential awards to small businesses, and Defense Construction Supply Center made 164 of its 165 awards with price differentials to small businesses.

<sup>&</sup>lt;sup>9</sup>The certificate of competency program empowers the Small Business Administration to certify to government contracting officers that particular small business concerns are responsible, therefore, they are eligible to receive and are considered capable of performing specific government contracts. Contracting officers trigger this process by determining and documenting that a small business lacks certain elements of responsibility. If the certificate is issued, the contracting officer must award the contract to the small business concern. See Federal Acquisition Regulation 19.601, et seq.

In addition, at the two centers the majority of firms qualifying as quality vendors were small businesses. According to agency statistics, at the end of fiscal year 1992, about 60 percent of the quality vendors at the San Antonio Air Logistics Center and about 83 percent at the Defense Construction Supply Center were small businesses. We also found no evidence in the 36 contracts we reviewed in depth that the programs had impeded competition. The number of offerors for these contracts ranged from 2 to 13 and averaged 6.4, about 95 percent of which were small businesses.

Another indication that quality vendor programs have not limited the ability of small businesses to compete has been the lack of complaints about this issue. For example, the directors of the Small and Disadvantaged Business offices at AFLC and DLA headquarters as well as at the two centers we visited told us they had neither received nor heard of complaints that the quality vendor programs at their agencies were limiting opportunities for competition. Similarly, representatives from the Small Business Administration at the two centers told us they had neither received nor heard of complaints about the quality vendor programs impeding competition.

These officials are responsible for enhancing small and disadvantaged businesses' opportunities at the buying offices, which includes performing various outreach type activities, as well as assisting the agencies in meeting their small and disadvantaged business buying goals. As a result, these officials are in frequent contact with their constituent businesses and should be in position to hear complaints if there are any.

### Impact on New Entrants Is Uncertain

You expressed concern that in designating quality vendors, the quality vendor programs could preclude other vendors that are new entrants to the marketplace or a particular supply class from being able to compete realistically and win contracts. That is, new entrants could be at a disadvantage because of their inability to meet the quality vendor program criteria, not having won previous awards. In light of this concern, DLA and AFLC regulations require contracting officers to consider, among other things, whether the low offeror is a new entrant prior to determining whether to award a contract to the low offeror or to a quality vendor at a higher price.

AFLC and DLA have disseminated supplemental information to contracting officials and potential offerors emphasizing that source selection decisions

in the quality vendor program are discretionary and that the entry of new suppliers into the supplier base is an important consideration. Most of the contracting officers we interviewed said they normally made contract awards to the lowest offeror, which included new entrants.

Statistical information is not available on the extent to which new entrants competed for awards, were considered, or were selected. The centers we visited did not collect such information. The primary way contracting officers identified new entrants was by obtaining contract history information; however, contracting officers generally obtained such information only for the vendor presenting the lowest priced offer and for quality vendors within the 20-percent range. If a new entrant was not the lowest offeror, the contracting officer may not have known that a new entrant submitted an offer.

#### The Quality Vendor Programs Use Two Pre-Existing Procurement Practices

The AFLC and DLA quality vendor programs incorporate the pre-existing procurement practices of (1) using source selection factors other than lowest price in making award decisions and (2) making responsibility determinations before awarding contracts. The programs attempt to streamline the first practice in an effort to simplify the process sufficiently to make it usable for the relatively small dollar value procurements for which the programs are intended. The second practice continues to be required for awards under these programs as it is for all contracts. Responsibility determinations alone, however, cannot and are not intended to accomplish the programs' goals of identifying contractors with superior, as opposed to acceptable, delivery and quality performance records and ensuring that consideration is given to awarding them contracts when in the best interest of the government.

Solicitations in the quality vendor program employ source selection factors other than price. The solicitations specify that price is the primary source selection factor, but that award can be made to a vendor appearing on a quality vendor list when this is in the best interest of the government, even though it is not the lowest offeror. To be included on this list, a contractor is required to submit an application that must be reviewed and approved by agency personnel independent of the contracting officer and the specific procurement.

Agency officials view this process, done independently of any solicitation, as a more practical way of taking nonprice factors into consideration than performing a more time-consuming source selection evaluation of each

offeror for such relatively small dollar value procurement actions. If source selection factors relating to performance history were tailored for each solicitation and vendor performance history were not independently reviewed in advance, the buying agency would need to make an analysis of historical performance for every offeror that has a reasonable chance to win each contract. Such analyses would require significant effort on the part of contracting officers, unless automated systems were used—as intended under the planned vendor rating systems. Agency officials told us that the efforts required to do such analyses would be excessive, especially in view of the small dollar value of the contracts involved.

At the Defense Construction Supply Center, fewer than 2 percent of the 264,000 contract actions awarded in fiscal year 1991 were over \$25,000, and most awards were under \$10,000. The largest contract awarded with a price differential in the program's history at the Defense Construction Supply Center was \$464,038, which included the exercise of options. The program at AFLC was limited to awards under \$10 million, but most program awards with a price differential were far smaller (under \$10,000). The largest contract awarded with a price differential at the San Antonio Air Logistics Center was \$418,870.

The agencies could not accomplish the objectives of the quality vendor programs through the responsibility determination process. The requirement for responsibility determinations is intended to enable contracting officers to avoid making awards to contractors having significant shortcomings that would impair successful contract completion. Quality vendor programs, however, attempt to identify superior vendors from among those competing for awards; many or all of the vendors may be responsible. The responsibility determination process is not intended to deal with such differences. Rather, it requires the contracting officer to assess a number of factors and determine whether or not a prospective contractor is capable of successfully performing the contract. These factors include having the necessary physical facilities and equipment, technical skills, and financial resources or the ability to obtain them, as well as a satisfactory on-time delivery and quality performance record. Further, a responsibility determination is made only for the apparent winning offeror and, therefore, could not accomplish the programs' goals of identifying contractors with superior delivery and quality performance records.

#### Scope and Methodology

For this report we obtained information from officials from the Secretary of Defense's Office of the General Counsel for Logistics, DOD's Office of the Inspector General, and the Office of Federal Procurement Policy in Washington, D.C.; AFLC Headquarters at Wright-Patterson Air Force Base, Ohio, and its San Antonio Air Logistics Center at Kelly Air Force Base, Texas; DLA Headquarters at Cameron Station, Virginia, and its Defense Construction Supply Center at Columbus, Ohio; and Small Business Administration Headquarters in Washington, D.C., and offices at Defense Construction Supply Center and San Antonio Air Logistics Center. These officials included quality vendor program representatives, contracting officials, agency small business representatives, competition advocates, and quality assurance and legal representatives.

We reviewed applicable laws, regulations, policies, program documentation, and aggregate program data reported by the agencies. We also examined contract files for 36 awards with price differentials, 24 at the Defense Construction Supply Center and 12 at the San Antonio Air Logistics Center; these awards were judgmentally selected at each of the locations, so that our sample included the awards that paid the largest price differentials and the most recent awards.

We conducted our work from November 1991 through April 1992 in accordance with generally accepted government auditing standards. We obtained updating information in February 1993. As requested, we did not obtain agency comments on this report that were fully coordinated within DOD. However, we discussed the results of our review with program officials from AFLC and DLA as well as the Air Force, Office of the Secretary of Defense, and Small Business Administration officials. They generally agreed with the information presented in the report. We have incorporated their specific comments or suggestions in the report, where appropriate.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time, we will send copies to the Secretary of Defense and to other interested congressional committees. Copies of the report will also be made available to others upon request.

Please contact me at (202) 512-4587 if you or your staff have any questions concerning this report. Major contributors to this report were Kevin M. Tansey of our National Security and International Affairs Division, and Rae Ann Sapp, George J. Buerger, and Neil S. Wickliffe of our Cincinnati Regional Office.

Sincerely yours,

Paul F. Math

Director, Acquisition, Policy,

Technology and Competitiveness Issues

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# Quality Vendor Program Eligibility Criteria as of September 1991

Criterion	AFLC centers	DLA centers
Experience	Vendor must have had at least three specific supply class contracts in three years totaling at least \$50,000.	Vendor must have had at least three specific supply class contracts in 1 year totaling at least \$10,000 at most centers and \$20,000 at the Defense Industrial Supply Center.
	In measuring delivery and quality success, the program considers contracts at a center within the specific supply class only.	In measuring delivery and quality success, the program considers contracts at a center regardless of supply class.
Quality	Success is measured by the percent of units delivered without quality deficiencies within the last 12 months.	Success is measured by the percent of line items delivered without quality deficiencies within the last 24 months at the Defense Construction Supply Center and 12 months at the other centers.
	Quality deficiencies are defined as Quality Deficiency Reports resulting from a vendor fault.	Quality deficiencies are defined as Quality Deficiency Reports and/or Reports of Deficiency resulting from vendor fault.
	In-plant quality system problems disqualify program applicants.	In-plant quality system problems, as well as several other factors such as debarment, disqualify program applicants.
	Minimum performance is one standard deviation better than a standard determined by statistical methods.	Minimum performance is 97 percent at the Defense Construction Supply Center and 99.5 percent at the other centers without Quality Deficiency Reports resulting from a vendor fault.
		Minimum performance is 95 percent at the Defense Construction Supply Center and 99 percent at the other centers without Reports of Deficiency.
Delivery	Success is measured by line items delivered or scheduled for delivery in the last 12 months.	Success is measured by line items delivered or scheduled for delivery in the last 12 months.
	Vendors must have a minimum 90 percent on-time delivery record.	Vendors must have a minimum 95 percent on-time delivery record.
	"On time" varies by center and can be up to 15 days after the scheduled delivery date.	"On time" means up to 29 days after the scheduled delivery date.

## Prior GAO and DOD Office of the Inspector General Reports on Defense Quality Assurance Issues and Defective Parts

DEFENSE PROCUREMENT: Qualification and Quality Requirements for Purchases of Critical Spare Parts (GAO/NSIAD-91-95, Mar. 25, 1991).

Nonconforming Products Procured by the Defense Industrial Supply Center (DOD/IG Report No. 90-113, Sept. 27, 1990).

Nonconforming Products in the Defense Supply System at Warner Robins Air Logistics Center (DOD/IG Report No. 89-065, Apr. 10, 1989).

PROCUREMENT: Department of Defense Quality Assurance Efforts (GAO/NSIAD-89-28FS, Nov. 2, 1988).

PROCUREMENT: Quality and Safety Problems with the Beretta M9 Handgun (GAO/NSIAD-88-213, Sept. 15, 1988).

Reimbursements Due From Contractors for Discrepant Material Deliveries to the Defense Logistics Agency (DOD/IG Report No. 88-183, July 15, 1988).

QUALITY ASSURANCE: Concerns About Four Navy Missile Systems (GAO/NSIAD-88-104, Mar. 24, 1988).

Follow-on Audit of Known but Unreported Defective Material (DOD/IG Report No. 87-083, Feb. 11, 1987).

QUALITY ASSURANCE: Efforts to Strengthen DOD's Program (GAO/NSIAD-87-33, Nov. 3, 1986).

Processing of Quality Deficiency Reports in the Defense Logistics Agency (DOD/IG Report No. 86-131, Aug. 28, 1986).

Defective Parts on the Navy's Light Airborne Multi-Purpose System MK III Program (DOD/IG Report No. 85-054, Dec. 17, 1984).

Procurement Quality Assurance of Material Receipts by Corpus Christi, Texas, Army Depot (DOD/IG Report No. 84-018, Dec. 7, 1983).



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