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Office of Inspector General  
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## **SPECIAL REPORT**

# **MAS PRICING PRACTICES: IS FSS OBSERVING REGULATORY PROVISIONS REGARDING PRICING?**

Jointly prepared by the  
Office of Audits and the Office of Counsel

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# TABLE OF CONTENTS

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<b>EXECUTIVE SUMMARY</b>	<b>1</b>
<b>FINDINGS</b>	<b>5</b>
<b>Finding 1:</b> The Federal Supply Service Is Not Consistently Negotiating Most-Favored Customer Pricing	<b>5</b>
Background	<b>5</b>
Review Scope and Findings: Price Negotiations Under Two of Three Multiple Award Schedules Examined Do Not Consistently Achieve Most-Favored Customer Pricing	<b>7</b>
<b>Finding 2:</b> Many Multiple Award Schedule Contract Extensions Are Accomplished Without Adequate Price Analysis	<b>28</b>
Background	<b>28</b>
Review Scope and Findings: Extensions Accomplished with Very Little Negotiation or Price Analysis	<b>30</b>
<b>Finding 3:</b> Preaward Audits Are Not Being Used Effectively to Negotiate Better Multiple Award Schedule Prices	<b>32</b>
Background	<b>33</b>
Findings: Preaward Audits Requested on MAS Contract Actions Have Decreased Significantly in Recent Years	<b>33</b>
Recommended Actions	<b>37</b>
<b>APPENDICES</b>	
Objectives, Scope and Methodology	<b>A-1</b>
Prior General Accounting Office Reviews of Multiple Award Schedule Pricing	<b>B-1</b>

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# EXECUTIVE SUMMARY

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## **FSS Is Not Following Regulatory Pricing Requirements in Negotiating MAS Contracts**

### Program Growth

GSA's Multiple Award Schedule (MAS) contracting program has grown significantly in recent years. For a variety of reasons, including ease of use, it has become one of the major vehicles through which Government agencies purchase commercial products and services. Since fiscal year 1997, the MAS program has doubled in terms of appropriated dollars spent by agencies procuring products and services. In fiscal year 1997, the MAS program generated \$5.6 billion in sales; in fiscal year 2000, sales under the program had grown to \$13.6 billion.

Our Office is concerned that, as the MAS program has grown, certain program fundamentals -- including pricing objectives and other pricing tools -- have been marginalized. These fundamentals, which are set out by regulation, include the mandate for most-favored customer pricing, the requirement to perform meaningful price analysis when awarding or extending contracts, and the use of preaward audits to assist in negotiating contracts.

### MAS Pricing Fundamentals

- ◆ **Most-Favored Customer (MFC) Pricing** – MFC pricing ensures that MAS contract pricing captures the entire Government's volume purchasing power, rather than leaving numerous agencies to negotiate individual deals -- with necessarily reduced bargaining power -- on their own. The MFC concept harnesses the federal Government's collective buying power for pricing purposes, and is the *raison d'être* of the MAS program.

**Price Analysis** – Price analysis is the key substantive step a contracting officer (CO) performs for the purpose of arriving at a fair and reasonable price, a legally-mandated standard for government procurement. Various methods can be used to perform a price analysis. For MAS contracts, because of the program's goals and structure, the most feasible and effective price analysis method is to compare a vendor's prices to the Government with its prices to its other customers. Price analyses must be meaningful and vigorous for all significant contract actions, including contract extensions, if GSA hopes to achieve good pricing under MAS contracts.

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## **EXECUTIVE SUMMARY** (Continued)

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- ◆ **Preaward Audits** – Audits performed of a vendor’s proposal before a contract is awarded or a major contract action is effected are crucial to obtaining good MAS pricing. Preaward audits are the main tool by which a CO can be assured that a vendor’s pricing is as represented; such audits also provide COs with additional details -- and important associated bargaining leverage -- regarding a vendor’s pricing and sales practices in anticipation of negotiations. In light of the virtual elimination of postaward audits by GSA in 1997, these preaward audits are one of the Government’s sole remaining protections against overpricing.

### *GSA Needs to Refocus COs on MAS Pricing Fundamentals*

Our review examined how well COs are adhering to these three MAS pricing fundamentals which are set out in regulation. Generally, our reviews of selected contract negotiations found that COs are not consistently negotiating MFC pricing on MAS contracts. We also determined that COs performed inadequate price analyses on the majority of contract extensions reviewed. Finally, we noted a precipitous drop over a 10-year period in the number of preaward audits conducted by GSA of MAS contracts even as MAS sales skyrocketed.

### *Obtaining MFC Pricing*

We reviewed contract negotiations under three MAS schedules (copiers, information technology, and office furniture) to determine whether COs were successfully negotiating for MFC pricing. These contracts represented \$7.4 billion in expected purchases. Our results indicated --

- ◆ Of 11 copier contracts reviewed, COs achieved MFC pricing in only 1 negotiation;
- ◆ Of 14 information technology (IT) contracts reviewed, COs achieved MFC pricing in 4 negotiations, and failed to achieve MFC pricing in 6 negotiations; we were not able to determine whether MFC pricing was achieved in the remaining 4 negotiations; and

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## **EXECUTIVE SUMMARY** (Continued)

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- ◆ Of 6 office furniture contracts reviewed, COs achieved MFC pricing in 5 negotiations. In 1 of the 5 where MFC was achieved, the vendor offered MFC to begin with.

The reasons for COs' failure to negotiate MFC pricing involved a failure to leverage the Government's purchasing power, as well as other negotiations shortcomings. Specifically, COs --

- ◆ failed to target commercial pricing at a level commensurate with Government sales; indeed, in some cases the Government was by far the largest purchaser yet the CO failed to achieve even the better commercial pricing associated with customers who bought less than the Government;
- ◆ rather than quantifying the value of any differing terms and conditions of more favorable commercial pricing, COs rejected the better commercial pricing as a negotiation objective; and
- ◆ too readily accepted vendors' unsubstantiated or inaccurate information regarding prices or pricing practices.

Preaward audits of the contracts we reviewed recommended cost avoidances of \$309.6 million. COs actually negotiated only \$18.2 million -- or 5.9% -- of this amount in savings through pricing improvements under these contracts. On the photocopier contracts, one of three schedules reviewed, COs sustained only \$3.8 million -- or about 2% -- of \$199 million in cost avoidances recommended.

### *Price Analysis*

The review also examined the quality of price analyses COs were performing on MAS contract extensions for 80 MAS contracts. Forty-four of the 80 contracts reviewed were extended without a meaningful or vigorous price analysis. In these 44 cases, we found no contract documentation indicating a CO had asked for updated pricing information (or obtained a statement that pricing had not changed since initial award), performed market research or requested a preaward audit to evaluate the offer.

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## EXECUTIVE SUMMARY (Continued)

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For example --

- ◆ written representations regarding whether a contractor's pricing had changed since initial award were ineffective; in one instance a contractor simply noted that it "agree[d] to the modification"; in another instance, a contractor made a *telephonic* representation that its prices had not changed to the CO; and
- ◆ price analyses actually performed were not careful or vigorous; in one instance, price analyses for extensions on three different carpet contracts were embodied in an identical one page form document; the CO's reasoning justifying the extension included that the contractor was agreeable to extending at current pricing.

We believe many of these MAS contracts were extended on a *pro forma* basis-- without a meaningful price analysis action to compare offered pricing to pricing in the commercial market. It appears, from available documentation, that FSS was more concerned with awarding contracts and keeping continuous contract coverage, than with scrutinizing pricing.

### *Use of Prewards*

In the final segment of our review, we examined the use of preaward audits to evaluate offers for significant MAS contract actions. In FY 1990, 211 preaward audits were performed on MAS proposals. As the MAS program has increased significantly in terms of sales generated, the number of MAS preaward audits requested by COs has dropped precipitously. In fiscal year 1996, the MAS program generated \$4.1 billion in sales. That same year, 94 preaward audits were requested and performed on MAS proposals, covering \$2,320,439,644 in contract sales. In FY 2000, a year during which MAS sales amounted to \$13.6 billion, COs requested just 23 preaward audits. The audited preaward contracts constituted \$694,281,664 in sales -- approximately 5% of total MAS contract sales for that fiscal year.

In our view, preaward audits are a valuable tool for COs to use in negotiating MFC pricing on MAS contracts. Although GSA formally stated, in the context of the 1997 Commercial Items GSAR rulemaking, that it would emphasize the use of preawards, to date it has taken insufficient measures to integrate this tool into the contracting process.

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# FINDINGS

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## **Finding 1: The Federal Supply Service Is Not Consistently Negotiating Most-Favored Customer Pricing**

Our review indicates that FSS is not consistently negotiating most-favored customer (MFC) prices on Multiple Award Schedule contracts, especially on the information technology (IT) and photocopier schedules we reviewed. This occurred because FSS does not insist on leveraging fully the Government's aggregate buying power, and because it often fails to evaluate and quantify differences between better commercial pricing and schedule terms and conditions. We note this occurred despite contracting officers' (COs) having access to audit reports or audit information identifying better MFC pricing.<sup>1</sup>

### **BACKGROUND**

#### *Program Basics*

The Multiple Award Schedule (MAS) Program provides customer agencies with a simplified process to purchase small quantities of commonly-used commercial products and services at prices associated with volume buying. In FY 2000, the MAS program generated over \$13.6 billion in sales through approximately 6,316 contracts covering 110 different commodity schedules,<sup>2</sup> with products ranging from office furniture to scientific equipment to IT services.

#### *MAS Negotiations and the Most-Favored Customer Negotiation Objective*

Price negotiations under MAS contracts are based on vendors' commercial prices. Offerors are required to provide as key parts of the MAS proposal a list of commercial products they offer GSA under each special item number (SIN), their commercial price lists for the products, and information (via the GSA-prescribed Commercial Sales Practices Format (CSPF)) regarding the prices or discounts at which they sell the products commercially. GSA COs use this

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<sup>1</sup> This review was based on MAS contracts negotiated in the 1998-99 time period, the last substantial set of contracts subject to preaward audits. Appendix A describes in more detail the specific objectives, scope and methodology of this review.

<sup>2</sup> This excludes the schedules run by the Department of Veterans Affairs under a delegation from GSA.

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## **FINDINGS** (Continued)

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commercial pricing and discount information to negotiate MFC pricing.<sup>3</sup> MFC pricing represents fair and reasonable pricing for MAS contracts.<sup>4</sup> GSA has defined MFC pricing by regulation as pricing that is equal to the best prices an offeror gives any commercial customer, terms and conditions considered, and has committed itself to obtain this pricing. 48 C.F.R. § 538.270(a). MFC pricing -- a touchstone of the MAS program -- is based on the fundamental premise that the federal Government is one customer and that it therefore should be entitled to prices that are commensurate with its collective or aggregated purchasing power.<sup>5</sup>

The MFC pricing strategy, however, is flexible. It recognizes that in certain instances valid reasons exist as to why the Government would not be entitled to an offeror's MFC pricing, including chiefly where the MFC commercial pricing involves differing terms and conditions. For example, the General Services Acquisition Regulation (GSAR) stipulates that an offeror's MFC commercial pricing may relate to customers who perform certain value-added functions for the offeror that GSA is not able or willing to perform. 48 C.F.R. § 538.270(c). In such instances, negotiations policy dictates that the pricing objective or target remain the same, but that key differences are quantified and taken into account in negotiations.

### *GSA's Role in Negotiating MAS Pricing*

In describing MAS ordering procedures, the Federal Acquisition Regulation (FAR) states that GSA "has already determined the prices of items under schedule contracts to be fair and reasonable." 48 C.F.R. § 8.404. This regulatory pricing statement is echoed by GSA in its *GSA FSS Owner's Manual* (2000) literature to federal orderers marketing the MAS procurement vehicle. In a pricing-related section of this manual on page 14, GSA states that it "negotiates competitive contracts with commercial partners who give us the same or better discounts than their best commercial customers." In this

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<sup>3</sup> MAS contract awards do not involve head-to-head competition between vendors; instead the GSA CO awards to multiple vendors, and bases contract pricing on the vendor's prices to its commercial customers.

<sup>4</sup> Fair and reasonable prices are required to be obtained for all negotiated contracts. 48 C.F.R. § 15.4. As applied to MAS contracts, one type of negotiated contract, the fair and reasonable mandate requires that COs obtain MFC pricing. 48 C.F.R. §§ 538.270, 538.271.

<sup>5</sup> The Government Accounting Office (GAO) has also noted that GSA should target MFC pricing. GAO, Multiple Award Schedule Contracting – Changes Needed in Negotiation Objectives and Data Requirements, GAO/GGD 93-123 (1993). In addition, GAO has noted various pricing problems within the MAS program. See Appendix B.



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## **FINDINGS** (Continued)

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manner, GSA assures ordering agencies of good pricing, and encourages use of MAS schedules.

### **REVIEW SCOPE AND FINDINGS: PRICE NEGOTIATIONS UNDER TWO OF THREE MULTIPLE AWARD SCHEDULES DO NOT CONSISTENTLY ACHIEVE MOST FAVORED CUSTOMER PRICING**

Our Office conducted a review of contract negotiations in 1998-1999 for three MAS schedules, including contracts under the photocopier, information technology (IT), and office and household furniture MAS schedules. This review revealed that COs are not consistently pursuing and attaining MFC pricing. Results vary by contract and schedule, with more problems appearing on the IT and photocopier schedules, especially for large dollar or more complex procurements. Consistent with the regulations, we categorized a negotiation as having achieved MFC -- even if the price negotiated was not the actual best discount or price -- as long as differing terms or conditions were considered and valued by the CO.

We have reported the results of negotiations on a schedule-by-schedule basis below. We have also included two more detailed examples of contract negotiations which illustrate our core finding that COs do not achieve MFC pricing because they do not always take into account the negotiating leverage provided by the buying power of the Government's total estimated sales.

#### **Results of Negotiations by Schedule**

	<b>MFC Achieved</b>	<b>MFC Not Achieved</b>	<b>Unable to Determine if MFC Achieved</b>	<b>Total Sales \$ for Contracts</b>	<b>Total Contracts</b>
Photocopier Contracts*	1 ½	9 ½	0	<b>\$1.4 Billion</b>	11
IT Contracts	4	6	4	<b>\$5.9 Billion</b>	14
Office Furniture Contracts	5	1	0	<b>\$138.8 Million</b>	6
<b>Total Contracts</b>	<b>10½</b>	<b>16 ½</b>	<b>4</b>	<b>\$7.4 Billion</b>	<b>31</b>

\*For one of the photocopier contract negotiations listed, the CO achieved MFC for one SIN, but did not achieve MFC for the other SIN.

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## **FINDINGS** (Continued)

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### A. Photocopier MAS Negotiations

#### Scope of Review

Our Office reviewed negotiations for 11 MAS contract extensions under schedule FSC Group 36, Part IV for, among other products, the purchase of photocopier machines, machine maintenance and the lease of machines. The extensions were for the period October 1, 1998 through September 30, 2001.<sup>6</sup> Total estimated purchases under the 11 GSA contracts for the extension periods totaled approximately \$1.4 billion. Historically, these 11 contracts represented over 95% of sales under this schedule.

Our review included examining preaward audits of the proposals,<sup>7</sup> records of discussions with the COs regarding negotiations, and key negotiations documents, including chiefly the Price Negotiation Memoranda (PNMs).<sup>8</sup> It should be noted that 10 of the 11 preaward audits of these photocopier extensions were qualified because the vendors did not provide all of the information necessary to ensure a full, unimpeded audit scope. Common scope impairments encountered during the audits included refusals to provide requested information, and provision of unsupported data, incomplete information, or databases which did not allow exception pricing to be readily detected. For example, one vendor who proposed to sell the Government copier rentals and maintenance, did not provide for review any rental sales transactions and only a limited number of maintenance sales transactions; sales of these transactions represented about 47 percent of GSA transactions for a calendar year being audited.

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<sup>6</sup> These extensions were the second set of extensions for these copier contracts. The original contracts were awarded for the period 1993 to 1996. The contracts were extended once until 1998, and again for the period from October 1998 to September 2001.

<sup>7</sup> Preaward audits review vendors' MAS proposal pricing information to determine whether the information is current, accurate and complete. The audits are conducted before award of a contract, and are provided to COs for their use in negotiating prices during contract negotiations. The audits typically recommend "cost avoidances" which indicate and quantify areas where better pricing or terms could be negotiated. Auditors are also available to assist the CO at negotiations, or to work with the CO on a consulting basis to evaluate vendor positions or submissions during negotiations.

<sup>8</sup> A PNM is the primary document by which a CO memorializes contract negotiations – including pricing aspects. The FAR requires that PNMs be prepared and specifies their contents, including a summary of the vendor's proposal, a discussion of any field pricing assistance or audit recommendations, and a statement of the Government's negotiating position. 48 C.F.R. § 15.406-3.

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## **FINDINGS** (Continued)

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Because the contracts expired September 30, 1998, FSS set a deadline for the conclusion of negotiations and for contract award of August 31, 1998. Most of the preaward audits were completed within a preagreed to 90 day period, and were provided to the COs by August in advance of negotiations.<sup>9</sup> Although historically auditors have routinely been asked to participate in negotiations, the auditors who performed these audits did not participate in negotiations, nor were they generally asked by COs to assist on a consultative basis during negotiations.

### *Copier Review Results: MFC Pricing Generally Not Achieved*

For each of the 11 contract extensions, we analyzed negotiations to determine whether the COs targeted and successfully negotiated MFC pricing for the top two SINS under each contract.<sup>10</sup> The COs targeted MFC pricing in all 11 negotiations, including one where the vendor's initial proposal offered the Government MFC up front. However, COs were only successful in actually negotiating MFC pricing in two instances: in one negotiation for one of the two top SINS examined, and in another negotiation where the vendor offered MFC pricing at the start of negotiations.

Our review indicates that COs accepted various vendor-provided reasons for why GSA was not entitled to MFC pricing on 10 copier contract negotiations. These arguments generally related to differences between the MAS vehicle and the better commercial pricing that -- in the vendors' view -- meant that the pricing was not comparable. When presented with these arguments, COs in many cases abandoned the MFC commercial pricing objective, and instead chose other less favorable commercial pricing to serve as the basis for price negotiations. For the most part, the COs did not quantify or assign values to the differing terms and conditions.<sup>11</sup>

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<sup>9</sup> FSS advised the contractors of the proposed extension actions, and related preaward audits, in approximately March 1998.

<sup>10</sup> This report does not point out instances where a vendor *failed to disclose* its MFC pricing in a proposal. For purposes of this discussion, we start with the MFC, whether it was properly disclosed in the proposal or identified through the audit.

<sup>11</sup> As we have stated, GSA's price negotiations policy requires that MFC remain the negotiation objective, but that COs quantify potential differences and take them into account. The policy does not require the elimination of the commercial pricing as the basis for negotiations because different terms and conditions may adhere. 48 C.F.R. § 538.270.

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## **FINDINGS** (Continued)

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### The Preaward Audits

Preaward audits for each of the 11 negotiations reviewed and verified vendors' proposals, and highlighted vendors' MFC pricing for the COs' use in negotiations. These audits found that, for 9 of the proposals and for one SIN on the 10<sup>th</sup> proposal, vendors provided other customers, including in particular state or local government customers and national or major accounts, with better pricing than they offered the Government on the top two SINS under the MAS proposal.<sup>12</sup>

### Photocopier Negotiations

The following discussion isolates the reasons, based on our review, that caused the COs to move from MFC pricing. Because many of the extension negotiations involved negotiations for more than one SIN, several reasons may exist for each of the negotiations discussed here.

- In 7 negotiations, the documents indicate that COs moved from the MFC objective because of vendor arguments that better commercial pricing (mostly to national account or state and local government customers) involved customers who purchased or were committed to purchase in quantities over the MAS maximum order amount.<sup>13</sup> However, in most of these instances, federal agencies, over the MAS contract's term, purchased quantities that far exceeded those of the customers receiving the more favorable pricing. For price negotiations purposes, the paramount consideration should be the federal Government's expected volume of sales compared to the volume of sales -- over the same time period -- of the more favored customer; the maximum order is relevant largely only to the pricing of individual federal orders.<sup>14</sup>

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<sup>12</sup> The top two SINS vary by contract, and can include copier purchase, copier maintenance, and copier leasing.

<sup>13</sup> This better pricing's related terms and conditions were sometimes reflected in written agreements.

<sup>14</sup> The maximum order (MO) term is a MAS contract provision, typically set in terms of a dollar amount, that designates the order size at which agencies considering making a MAS buy are required to seek additional price discounts or reductions from vendors. 48 C.F.R. § 8.404. Also, certain types of commercial pricing arrangements, involving definite quantity contracts providing for single orders that are larger than the designated MAS MO level, are exempt from the operation of the standard MAS price reduction clause. 48 C.F.R. § 552.238-75.

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## **FINDINGS** (Continued)

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- In 5 negotiations, the vendor argued that better pricing both to states and to commercial (major account) customers was not comparable to a MAS contract because the better pricing involved more competition. In 4 of these negotiations, vendors characterized better pricing as involving single award state contracts where direct head-to-head competition was involved between suppliers to obtain the contract. In the remaining negotiation, the competition involved was described in a very loose sense; the vendor argued that the better pricing was necessary to obtain the favored customers' business. The vendor described this better pricing as arising from "competitive situations." However, pricing under state contracts, even those that are awarded using head-to-head competition, are good market indicators, especially where the federal Government buys comparable amounts under the MAS vehicle. Also, better commercial pricing resulting from competition or "competitive situations" is exactly what GSA COs should be considering and negotiating for. The MAS program is premised on and driven by competitive forces in the commercial marketplace. The documents indicate that the CO accepted the vendors' argument in each of the 5 negotiations.
- In 4 negotiations, the documents indicate that general negotiation failures occurred. In one negotiation for one SIN, the CO generally failed to address or note any of the better MFC pricing the vendor had disclosed. In the second negotiation, the CO acknowledged in general terms certain better commercial pricing afforded a dealer, but did not negotiate for it citing various general functions that the dealer performed. The negotiations documents do not reflect that the CO assigned any values to or examined these functions as required by the MFC regulations. In the third negotiation, a vendor argued that it did not offer certain better dealer MFC pricing in a "widespread" manner, and so would not extend it to the Government. The CO appeared not to negotiate for this better pricing on that basis. In the fourth negotiation, the CO -- instead of negotiating a better MAS basic discount based on the vendor's disclosed MFC pricing -- kept the same basic discount as previously negotiated and extracted a promise from the vendor that MAS customers, at the end of the year, would be guaranteed a specific discount at least as good as that of a particular favored state customer. However, that state customer, practically speaking, was receiving much better than the specific discount percentage designated by the CO because of constant promotional discounts it received in addition to the basic discount. Because the vendor gave frequent additional promotional discounts, the percentage discount the CO used was too low to be effective as a price benchmark vis-à-vis the vendor's other customers.

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## **FINDINGS** (Continued)

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- In 3 negotiations, vendors argued -- and COs accepted -- that GSA was not entitled to MFC pricing because the better prices were determined using other types of evaluation or contracting methods and so were inherently non-comparable to MAS pricing. These different pricing methods often involved a per month or period charge for a combination of products including a copier together with supplies or consumables. We did not find evidence in any of these negotiations that the COs attempted to break down the components of the better commercial price in order to perform a comparison with proposed MAS pricing, nor were the auditors asked to perform such a comparison.
- In 2 negotiations, we noted that the COs moved from the MFC objective when vendors argued that better commercial and state pricing was not comparable to MAS because the federal Government under MAS purchased in individual orders of one and two products, whereas the customers afforded better pricing purchased in larger order quantities. These vendors, impliedly or explicitly, argued that they incurred additional significant administrative or transactional costs in connection with the MAS orders, and could not afford to extend GSA the same pricing. In one case, the vendor specifically argued that it could not extend better state maintenance pricing to the federal Government under MAS, because the state administered the contract through a single office, whereas MAS maintenance sales would be expected to be spread throughout the United States. In this context, we note that auditors can do an analysis of the geographic concentration of MAS sales to determine whether these sales -- like state purchases -- are concentrated in a few discrete areas and so are comparable to state sales. In this instance, it does not appear that the CO asked the vendor about the concentration of MAS sales, nor did the CO ask the auditors to perform such an analysis.
- In 2 negotiations, for both SINs, vendors argued -- and the COs accepted -- that GSA was not comparable to MFC pricing extended to a national account customer and a state customer because those customers bought entire systems or product bundles, or because the customers bought copier machines together with maintenance and supplies. The CO did not separate out the product groups in negotiations in order to conduct a price comparison with MAS products.

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## **FINDINGS** (Continued)

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- In 1 negotiation, the CO moved from the MFC pricing objective -- a permanent up-front discount over the life of the contract -- in exchange for vendor commitments to extend temporary promotional pricing on a few models to GSA under the MAS vehicle for an additional limited two-month time period. An up-front discount, which extends to all models over the contract's entire term, is generally more advantageous for the federal Government than temporary discounts on particular models.
- In 1 negotiation, a vendor argued that antitrust laws restricting the vendor's ability to dictate prices at which its dealers sold to end-user third parties somehow prevented the vendor from extending GSA similar better pricing. The CO appeared to have moved from the MFC objective based on this rationale. We note that the vendor's ability to control its dealers' pricing is irrelevant to the fact of the existence of better pricing.

### ***Case Study: Vendor A's Copier Contract Negotiations***

One of the 11 contract negotiations was conducted with Vendor A for a proposal to extend its current GSA MAS contract for the purchase, lease, rental and maintenance of copier equipment, as well as for related supplies. The extension was for a 3-year period, and Vendor A was among the top 10 vendors, measured by estimated MAS sales, under the particular schedule.

The audit revealed that a variety of customers received better pricing than the pricing offered to GSA. The audit also revealed that MFC pricing was to two sets of Vendor A's customers: certain state government customers and certain commercial customers under a particular formal program. The following chart illustrates better pricing on select copier models. It also reflects resulting overpayments by Government customers over the term of the MAS contract extension. Generally, Vendor A offered GSA pricing that was 20-89% higher than its MFC pricing.

<b>GSA Sales Rank</b>	<b>Model</b>	<b>Percentage Best Price Is Lower Than GSA Price</b>	<b>Estimated Overpayment for GSA Purchases</b>
1	Model A	17.0%	\$4,644,000
5	Model B	29.6%	\$5,019,120
7	Model C	25.1%	\$4,165,200
13	Model D	47.2%	\$3,864,240

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## **FINDINGS** (Continued)

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The CO discussed the majority of the better prices identified by the audit in negotiations with Vendor A. However, the CO did not succeed in negotiating this MFC pricing.<sup>15</sup> Negotiations documents reflect that the CO accepted, without corroboration or substantiation, various explanations as to why GSA was not entitled to the better MFC pricing that was proffered by Vendor A.

First, as to the better state pricing, Vendor A argued that such pricing was not comparable to GSA because it involved single award contracts to one supplier awarded using direct competition, or because state contracts were priced using a total cost approach evaluation method which folded in supply prices to the price of the copier equipment itself. The CO appeared to accept this reasoning, and did not ask the auditor, for example, to attempt a comparison of the better state combined pricing to GSA pricing.

As to the significantly better commercial pricing involving Vendor A's formal sales program, Vendor A argued that the pricing was not comparable to GSA as it involved "dollar thresholds" that exceeded the GSA contract's maximum order. The audit disclosed that the dollar thresholds were not binding and Vendor A, by its own admission, extended the pricing "without the need for a firm commitment." In addition, the audit noted that the federal Government's purchase volume under the MAS contract far exceeded that of the customers receiving better pricing under this program.

If the CO were to have negotiated MFC pricing as identified in the audit, the resulting cost savings would have amounted to approximately 15% of the total dollars spent under the contract during the three-year extension period. Contracting personnel actually negotiated improved prices over Vendor A's proposal amounting to only 1% of the cost avoidances recommended. We note that during negotiations for Vendor A's base contract in 1993, contracting officials sustained 72% of the amount recommended through negotiating better pricing.

### *Overpricing Impact*

The failure to negotiate MFC pricing on the photocopier contracts resulted in Government purchasers paying higher prices for the products and services.

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<sup>15</sup> FSS management officials set a one-week deadline for conducting negotiations for this contract extension. In comparison, negotiations for this vendor's base contract in 1993 took over three months for a single product line.



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## FINDINGS (Continued)

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**Example #1:** On a best-selling model under the GSA contract, one major vendor offered commercial customers pricing on copier purchases that was 17% lower than the GSA negotiated price. This equated to a GSA price that was \$1,720 more than the price the vendor gave these commercial customers on each machine. Over the 3-year contract extension period, the Government will have paid \$4.6 million more for this product than a commercial customer.<sup>16</sup>

**Example #2:** Another major vendor offered state and local customers a price for purchase of a copier system (copier together with an accessory) that was \$5,582 less than its price to GSA. Over only 1 year, the Government will have paid \$3.896 million dollars more for purchases of this copier system than the favored state customer.

Had the COs on all the copier contract negotiations succeeded in negotiating MFC pricing -- as identified in each related audit report -- better pricing would have resulted in \$199 million in costs saved on contract purchases.<sup>17</sup> COs actually sustained or achieved only \$3.8 million of \$199 million -- or slightly less than 2% -- by making price improvements through negotiations under the contracts. In contrast, for FY 90 through FY 97 on contracts under the copier schedules, COs sustained -- or actually saved -- 71.4% of the amounts recommended by preaward audits through negotiating better pricing. Nothing has changed in the audit approach or methodology that would account for the difference in rates of cost avoidances sustained between the prior and more recent contracts.

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<sup>16</sup> This overpayment figure assumes the Government would continue to purchase the machine at the same rate during the 3-year extension period as it had purchased over a 5-month period under the base contract.

<sup>17</sup> This savings number is calculated using the estimated sales expected under the GSA contracts for the three-year extension period.

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## **FINDINGS** (Continued)

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### **Photocopier Contracts -- Comparison of Negotiated Savings for Current vs. Prior Contracts**

	<b>TOTAL ESTIMATED CONTRACT VALUE</b>	<b>AUDIT RECOMMENDED COST AVOIDANCE</b>	<b>ACTUAL NEGOTIATED SAVINGS</b>	<b>PERCENTAGE OF COST AVOIDANCE CO SUSTAINED AT NEGOTIATIONS</b>
FY 90-97 Contracts	\$1,998,045,139	\$186,651,408	\$133,291,445	71.4 %
FY 98-99 Contracts	\$1,400,970,622	\$ 198,963,281	\$3,819,407	1.91 %

#### **B. Information Technology MAS Contract Negotiations**

##### *Scope of Review*

Our Office reviewed 14 contract actions under FSC Group 70, for the purchase of various IT items, including software, hardware, and IT services. The estimated sales under these contracts totaled more than \$5.9 billion. The negotiations took place generally in late 1998. We reviewed preaward audits of these contract actions,<sup>18</sup> contract documentation, including mainly the PNM, and any records of discussions with the COs regarding the results of negotiations. We had attended and assisted in 2 sets of negotiations at the COs' request. Although auditors tried to adhere to the 30 day agency-set deadline for conducting preaward audits, audits generally took significantly longer to complete in large part because vendors were resistant to providing their pricing practices in full, or because vendor-provided data was unusable. In all the contract actions, the auditors provided the COs with audit findings before the start of negotiations.

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<sup>18</sup> We had originally planned to audit 16 contract actions, but were unable to do so because two vendors refused to provide GSA with their pricing information. In one instance, an IT services vendor offered to provide GSA only with commercial pricing information from expired contracts. The contract involved estimated sales of \$71 million. In the second case, on a proposed contract with expected sales of well over \$100 million, another IT services vendor refused to provide the GSA CO any commercial pricing information. In both cases, we understand FSS ultimately awarded contracts to the vendors; we do not know whether FSS eventually received adequate pricing information from the two vendors.

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## **FINDINGS** (Continued)

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### *IT Extensions Review Results: MFC Pricing Not Negotiated in Most Instances*

The preaward audits generally found better pricing to a variety of customers, including commercial customers, state and local governments, and other non-MAS federal customers, on the 14 contracts audited.

Of the 14 contract actions reviewed, the CO achieved MFC pricing, or pricing that appeared substantially equivalent to MFC pricing, in 4 of these actions.<sup>19</sup> In 6 contract actions, we determined that MFC was not achieved by the COs. In the remaining 4 negotiations, we could not determine whether MFC was achieved because vendors provided only limited commercial pricing information reflecting their pricing to commercial customers.<sup>20</sup> The following discussion describes each of the contract actions, with emphasis on the results of negotiations.<sup>21</sup>

#### **MFC Achieved**

On 4 of 14 contract actions, the CO negotiated MFC pricing, or pricing substantially as favorable as MFC pricing.

- In the first contract action, which involved a 5-year contract extension for IT services, the vendor offered MFC pricing, and the pricing was verified as being MFC by the audit. The CO accepted this pricing as the GSA price. There were no significant audit impairments in the audit of this vendor's proposal. That is, the audit examined the full range of the vendor's commercial pricing.
- In the second negotiation, a CO was negotiating pricing for a 5-year extension on a contract for the sale of software and other items. The audit found that the vendor/reseller gave a single state customer on average a 12% better discount than it was proposing to give GSA. In this connection, the audit found that federal Government MAS users historically purchased

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<sup>19</sup> On 1 of these 4 negotiations, the vendor offered MFC pricing up front.

<sup>20</sup> More minor audit impairments occurred in other contract actions, including for those negotiations which we categorized as achieving MFC.

<sup>21</sup> We categorized a negotiation as having achieved MFC – even if the price was not the actual best discount or price – as long as differing terms or conditions were considered and valued by the CO. Also, in contrast to the furniture and copier contract reviews, we were unable to determine whether the COs targeted MFC pricing under the IT negotiations. For these contracts, contract documentation was generally weaker and, in many cases, did not reflect specific prenegotiation objectives.

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## **FINDINGS** (Continued)

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as much as the MFC state customer. The company, however, argued that it could not extend this state discount to GSA because the manufacturer dictated the better state price, no other customer received that discount, and the manufacturer represented that it would not extend other customers that discount. Although the CO did not negotiate the state price, he was able to negotiate a significantly better GSA price, which was equal to any other of the vendor's most-favored customers.

- A third negotiation involved a proposal for a 5-year base contract for the sale of laptops to the federal Government under the MAS vehicle. The audit found that the vendor gave its dealers better prices than GSA, and that the magnitude of the better markups was unjustified in part. That is, the audit found that several of the claimed dealer functions -- mostly having to do with additional administrative costs to make MAS-specific sales -- were not actual expenses incurred. The CO succeeded in negotiating a significant reduction in this markup almost to the MFC-point recommended by the audit.
- The fourth negotiation also succeeded in achieving MFC pricing. The contract action was for a 3-year extension of a contract to sell GSA IT hardware and related maintenance. The audit found that the pricing proposal was accurate, and that the GSA pricing was MFC, considering terms and conditions.<sup>22</sup> Per the audit's recommendation, the GSA CO realigned the basis of award customer from one reseller to a group of 5 resellers that had become over time the MFC customers.

### **Unable to Determine Whether MFC Achieved**

In our review, we were not able to determine whether the CO achieved MFC pricing in 4 of the 14 MAS negotiations. This was due in large part to the vendors' provision of limited or unreliable commercial pricing information to GSA during negotiations.

- The first negotiation involved a proposal to extend a contract, chiefly for the purchase of software, for a 5-year period. The audit concluded that GSA pricing was fair and reasonable as compared to a limited number - 2% - of other similar software sales made by the vendor. Ninety-eight percent of the

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<sup>22</sup> A price differential existed between the better-priced resellers and GSA that represented reseller functions, such as marketing activities and technical support -- all performed with dedicated staff.

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## **FINDINGS** (Continued)

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vendor's sales, however, were for a different type of software license not offered under the GSA contract. The audit recommended that GSA consider adding this more commercial type of license. The CO attempted to add the more commercial license, but was unsuccessful. The CO merely extended the contract, with its then existing products, at those terms and conditions.

- In the second contract action, the CO was negotiating a 33-month extension of a MAS contract for the sale of IT hardware and software. The audit found that the company gave better pricing to various state and local government customers that averaged 5% better than GSA's. We were not able to determine the quality of the pricing actually negotiated for two reasons. First, the vendor gave GSA only limited pricing information relating to its dealers and distributors; it failed to provide information on actual rebates it paid to these customers. Second, instead of negotiating pricing for the extension at that time, the CO extended the contract at existing pricing for a period of 11 months. After these 11 months, the CO negotiated a new contract.<sup>23</sup> We did not review the later negotiations; nor was an audit performed of the vendor's proposal at that later time.
- The third contract action was a negotiation for a 3-year contract extension for predominantly IT consulting services. The vendor's refusal to provide complete and reliable pricing information prevented the audit from evaluating the offered pricing. The vendor did not provide any fundamental supporting documentation, such as payroll registers, to allow the auditors to evaluate its commercial service rates and to compare them to the GSA-offered rates. The vendor also provided commercial rate information only on what it represented to be its top 24 customers' rates, without any assurance that the information in fact related to its top 24 customers. Ultimately, the CO could not make a price reasonableness analysis, and did not award the contract at that time.<sup>24</sup>

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<sup>23</sup> We have conflicting information from FSS regarding the nature of this later contract action. One CO stated that a new contract was negotiated. Another CO noted that several of the vendor's contracts were combined at that later date through a modification.

<sup>24</sup> About four months later, the CO conducted a price analysis using a prior labor rate analysis done of the vendor by the Defense Contract Audit Agency. The CO also compared the GSA-offered pricing to Blanket Purchase Agreement (BPA) pricing the vendor had entered into. The CO then awarded the contract. We did not review that later negotiation and contract award to determine the quality of the pricing achieved. BPAs are agreements typically negotiated with vendors under existing MAS contracts for large, definite quantities of items or services.

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## **FINDINGS** (Continued)

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- The fourth contract action involved a 3-year extension of a contract for the purchase of IT hardware and other items. The audit found, among other things, many instances of nonstandard pricing, constituting about 16% of the vendor's total sales. The audit recommended that the CO increase the GSA contract's basic discount, include state and local customers in the basis of award category, and establish a firm threshold for nonstandard discounts which would automatically trigger the price reduction clause.<sup>25</sup> We could not determine whether the CO realigned the basis of award customer or renegotiated pricing, largely because the PNM for this contract was lost. We also note that the vendor refused to provide any pricing information related to its sales to federal resellers and other federal agencies.

### **MFC Not Achieved**

In 6 of the 14 negotiations we reviewed, we were able to determine that COs were not generally successful in achieving MFC pricing. We have described the negotiations below, with emphasis on the pricing results.

- The first negotiation involved a review of a proposal for a 5-year extension of a contract for the sale of IT hardware and other items. The audit found that the vendor generally gave its best commercial customers an average discount that was significantly better than it gave GSA. Specifically, 25% of the company's sales to its top commercial customers were at discounts of 25% or higher; GSA's basic up-front discount was 7.5%. Despite the fact that federal Government MAS users in the previous year purchased more products from the vendor than these top commercial customers combined, the CO was unable to negotiate the same up-front discount given to these commercial customers. This appears to have been in part because the CO did not view MAS users as being one customer, and so did not leverage the total MAS contract sales. The CO negotiated no significant up-front improved basic discount, and instead negotiated a feature involving special pricing on a limited set of product configurations.

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<sup>25</sup> The basis of award customer represents the commercial customer that GSA will align itself with for purposes of negotiating pricing, and defines the price reductions that a vendor will be obligated to extend to the Government during the contract's term.

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## **FINDINGS** (Continued)

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- The second contract action involved a negotiation for a 3-year extension of a contract for the sale of IT hardware and other items. The vendor was a dealer and a subsidiary of a major company, and sold exclusively to the Government. The vendor did not provide commercial sales pricing data for review (it had solely Government sales), and did not provide any pricing information from its manufacturers for purposes of the CO performing a price reasonableness analysis.<sup>26</sup> Based on the very limited information available, the audit was able to determine that the vendor charged other non-MAS Government customers 2% less markup on a variety of purchases. Overall, the audit recommended that the CO not extend the contract, because the vendor's pricing information was insufficient for negotiations. The CO appears to have done a general market survey to justify awarding the vendor the extension at the preexisting prices; there is no evidence that the CO tried to negotiate better markups for proposed prices. The CO argued that attempting to negotiate a better markup for GSA would "stifle competition" because it would somehow discourage the vendor's salespersons from extending better pricing on specific non-MAS Government orders.
- The third negotiation involved a proposal for a 3-year extension for a contract for the sale of hardware and software. The audit found that the vendor gave better pricing -- by on average 6% -- to its non-MAS Government customers and to Government resellers on the top 10 GSA selling products. The CO extended the contract at the then current pricing without negotiating better pricing. The CO instead used GSA Advantage and compared GSA offered pricing to other vendors' MAS pricing in order to conduct a price reasonableness analysis and to make award.
- Under the fourth contract, the CO negotiated pricing on a proposal for a 5-year base contract for the sale of software, training services, and IT services. The audit found that the vendor gave better pricing to national account end-users of 8 to 12.5%, depending on the product or service. On two of the three SINS examined, the CO failed to achieve MFC, although she negotiated pricing that was better than initially offered. On the training services SIN,<sup>27</sup>

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<sup>26</sup> The vendor subsidiary argued that it had no commercial sales, and that it was not obligated to provide pricing relating to commercial sales made by its affiliates or its parent, although this was arguably the only existing meaningful pricing information. GSA regulations provide that if a vendor is a dealer without commercial sales to the public, the vendor must arrange for its manufacturers to provide its pricing information to GSA so a price reasonableness determination can be made. 48 C.F.R. § 515.408(5).

<sup>27</sup> Sales under this SIN represented only 7.9% of estimated sales under the contract.

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## **FINDINGS** (Continued)

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it appears the CO was able to substantially achieve MFC -- although she was not able to negotiate the best absolute commercial discount. The better commercial training pricing appears to have required the commercial customer to prepay amounts of over \$1 million. GSA contract customers cannot prepay for such services.

- The fifth contract involved a 3-year extension for the sale of IT services. The vendor only supplied GSA with pricing information related to certain other Government contracts. It did not provide GSA with its Government and commercial contract pricing arising from certain cost-plus type contracts; this missing information constituted approximately 58% of its total sales. Nonetheless, the audit found that for one labor category the vendor gave non-MAS Government customers from \$3 to \$30 per hour better rates than it gave GSA under the MAS contract, and that it improperly included a cost component in another of its labor categories. The CO negotiated only a \$16 dollar improvement in the first labor category, and noted, as justification for not achieving the full \$30 improvement, the vendor's unsubstantiated argument that the \$30 better price recommended by the audit was an average differential, not an "actual amount." The CO was, however, able to negotiate out the total value of the improper cost component on the second labor rate.
- In the sixth contract action, a 3½ year extension for IT hardware items and IT services, the vendor gave better pricing on hardware items to commercial customers on 10 of the top 15 models which sold most under the GSA contract. For IT services, the vendor gave other federal agencies significantly lower rates than what they proposed for GSA under the MAS. Although the CO was able to negotiate some improvements in the prices offered for hardware items, the CO did not negotiate the better commercial customer prices. For IT services, the CO was not able to negotiate the better federal Government pricing.<sup>28</sup>

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<sup>28</sup> The vendor had asserted that the better federal pricing for IT services was not comparable to GSA, because GSA required vendor employees to perform any ordered work while work under the better-priced federal contracts could be performed by cheaper non-vendor labor.



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## **FINDINGS** (Continued)

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### ***Case Study: Vendor X's IT Contract Negotiations***

One of the 14 IT contract negotiations was conducted with Vendor X. The action was for a 5-year extension for, among other items, IT hardware. MAS sales under the extension were estimated to exceed hundreds of millions of dollars. Vendor X offered GSA a 7.5% basic discount -- the same basic discount on its base contract -- on the principal group of hardware products under the contract. The audit found that Vendor X's pricing to the audit-identified top commercial end-user customers was significantly better than what was offered GSA. Twenty-five percent of the sales to this top customer class were made at a discount of 25% or higher. GSA's estimated sales under the contract exceeded those of the top commercial end-user customers combined.

During negotiations, Vendor X argued that it could not improve its basic discount for a variety of generalized reasons, including that selling to federal customers involved competition, that federal orderers bought "less rich configurations," that Vendor X incurred more internal costs to sell to and manage federal orders, and that it would be difficult, if not impossible, to sell through small business federal resellers (and thus support small business programs) if Vendor X was forced to increase the basic GSA discount.

The CO accepted the same basic discount as offered -- 7.5%. In addition to this basic discount, the CO negotiated a promotional discount on certain upgradable configurations. For these promotional systems, if the savings yielded from sales of these systems did not equal 3% of total non-BPA<sup>29</sup> MAS sales over the course of a year, Vendor X would provide the Government with coupons representing the difference. Finally, Vendor X also agreed that at year's end it would ensure that the margin it made on MAS sales would be comparable to the margin it made on sales to a set of customers it represented were its top customers who received its best pricing. The vendor agreed to rebate any difference in cash to GSA.<sup>30</sup>

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<sup>29</sup> Blanket purchase agreements (BPAs) are typically negotiated by an individual agency and a MAS vendor for large quantities of fixed-amounts of items or services. See footnote 24.

<sup>30</sup>For the last two years, Vendor X has represented to GSA that it owed GSA nothing on account of the year end margin comparison feature. To date, GSA has not chosen to verify these assertions.

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## **FINDINGS** (Continued)

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In our view, the CO did not target or negotiate MFC on this extension. Generally, the reason appeared to be in part GSA's failure to insist on leveraging its collective purchasing power.

We could not calculate the cost avoidances achieved by the contracting officials in this negotiation because the contracting officials did not negotiate any improved up-front discount; as noted above, the officials instead negotiated a coupon feature (relating to the promotional systems) and a rebate feature. Any cost savings calculations achieved from these features would be dependent on future commercial and GSA sales.

### Overpricing Impact

The failure to negotiate MFC pricing on these IT contracts resulted in MAS users paying higher prices for the products and services.

**Example #1:** One major distributor of IT products sold its top 10 GSA-selling models to commercial customers at an average price that was 6% better than the price at which it sold under the MAS contract. Over the contract extension's term, the Government will have paid \$39,900,000 more for these products.

**Example #2:** Another vendor, an IT services provider, was found to be providing a certain technical skill category it offered to GSA to its non-MAS federal Government customers at a rate per hour that was from \$3-\$30 better than the rate it gave GSA under the MAS vehicle. Over the contract extension term, the Government will have paid over \$800,000 more for the services provided.

We were able to calculate cost avoidances actually sustained by COs in negotiations for only 6 of the 14 IT contracts reviewed. For the remainder, PNMs and other relevant documentation were not available. The audits recommended cost avoidances of \$98.7 million for these 6 contracts. The total cost avoidances actually achieved by COs during negotiations on these 6 contracts amounted to about \$10.8 million -- or approximately 10.9% of the amount recommended. In contrast, for FY 90 through FY 97, COs sustained -- or achieved -- 49.7% of cost avoidances recommended in preawards performed of IT contracts through negotiating better pricing. Again, we do not know of any variables relating to audit methodology or approach which could account for the significant difference in the costs sustained rates between the prior and more recent IT contracts.

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## **FINDINGS** (Continued)

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### **Negotiated Savings Comparison for Prior vs. Current IT Contracts<sup>31</sup>**

	TOTAL ESTIMATED CONTRACT VALUE	AUDIT RECOMMENDED COST AVOIDANCE	ACTUAL NEGOTIATED SAVINGS	PERCENTAGE OF COST AVOIDANCE CO SUSTAINED AT NEGOTIATIONS
FY 90-97 Contracts	\$ 1,386,689,052	\$187,329,553	\$ 93,161,992	49.7 %
FY 98-99 Contracts	\$ 2,084,000,000	\$ 98,700,000	\$ 10,780,000	10.9%

#### C. Office Furniture MAS Contract Negotiations

##### Scope of Review

Our Office reviewed 6 contract negotiations under FSC Groups 71 I H and 71 III J for the purchase of office and household furniture, filing cabinets, and office storage units. Five of the contract actions were five-year extensions and one action was for a new basic contract. As part of our review, we examined preaward audits of the proposals, key negotiations documents including the PNM, and any records of discussions with the COs regarding the results of negotiations.<sup>32</sup> The total estimated sales under the MAS contracts for the periods of the contract actions reviewed totaled \$138,831,736. Pursuant to agency policy, we generally performed these audits within 30 days. The audits were performed during the period from May 1998 through September 1998.

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<sup>31</sup> The chart statistics for FY 98-99 contracts encompass only 6 of the 14 contracts we reviewed. We were not able to obtain cost avoidances sustained figures for the remaining contracts.

<sup>32</sup> Our auditors were not asked to participate in or assist at negotiations, although they were consulted with at some points.

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## **FINDINGS** (Continued)

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### The Preaward Audits

Our Office performed preaward audits of the proposals to verify the pricing disclosures and to determine MFC pricing. The audits found that one of the vendors offered GSA MFC pricing up front in their initial proposal. On the other 5 proposals, the audits found that vendors gave better pricing (constituting MFC pricing) to other customers.

#### *Furniture Review Results: MFC Pricing Largely Achieved*

For the five furniture contracts reviewed where MFC was not offered up front, the CO in each negotiation set MFC pricing -- as set out by the audit -- as the negotiation objective. COs succeeded in negotiating the best discount or MFC price on 4 of the 5 contracts. The following discussion describes each of the 5 furniture contract negotiations, with emphasis on the results of negotiations.<sup>33</sup>

#### **MFC Achieved**

- In the first negotiation, the audit found that the vendor, a furniture manufacturer, gave its commercial customers 10% discounts on product purchases if the customers bought at least \$100,000 worth of product over a year. GSA did not get an equivalent discount on product orders under the existing contract, nor was it offered this discount in negotiations for the new follow-on contract. The CO was able to negotiate an equivalent discount for products under the new follow-on contract.<sup>34</sup>
- In the second negotiation, the audit disclosed that the vendor gave three commercial customers a 2% rebate on furniture purchases. In addition, the audit found that one of these customers got an additional concession -- an incentive rebate -- of up to 2.5%. The vendor did not offer GSA these rebates. In negotiations, the CO was able to negotiate equivalent discounts for products under the schedule contract.
- In the third negotiation, a company argued that GSA was not entitled to better pricing (2.7% better than the GSA offer) offered a single reseller customer because that reseller sold only to Government customers and

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<sup>33</sup> We did not describe the one negotiation where MFC was offered to begin with.

<sup>34</sup> The audit also determined that the company gave an additional 4% rebate to its customers. The company represented that it had discontinued this 4% rebate. Recently, we learned through a self-reported price reduction by the company that it had reinstated the 4% rebate.

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## **FINDINGS** (Continued)

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added certain services – including design – to the products they purchased from the offeror. In addition, the company argued that this better customer passed on any better discount differential to the Government end-user it serviced. The CO consulted with the auditor to determine whether the vendor's claims were generally substantiated by the audit. The CO subsequently accepted these arguments.

- In the fourth negotiation, when a CO brought the audit-identified better dealer pricing to the vendor's attention, the vendor did not dispute these better commercial prices, but instead assured the CO that it would no longer extend such pricing in the future. Specifically, the company represented that it had put in place a system to ensure that such better pricing would not occur in the future. The CO accepted this assurance, and did not negotiate the better pricing, although the CO did succeed in negotiating a 1% basic discount better than the vendor initially offered. Assuming the company's system to stop the aberrant better pricing was effective, GSA would have succeeded, for the most part, in negotiating MFC.

### **MFC Not Achieved**

In this negotiation, a vendor argued that better pricing to resellers detected by an audit was not effectively better because the vendor sold to these customers from a higher-priced price list. The CO accepted this proposition, and failed to negotiate a better discount. Meaningful CO follow up with the auditor would have shown that the pricing was in fact better pricing, because the auditor had compared net pricing and had taken the differing price lists into account.

### ***Overpricing Impact***

The failure to negotiate MFC pricing on one furniture contract resulted in Government purchasers paying higher prices for the covered products. For this contract, the audit found that the vendor gave a commercial customer pricing on furniture products that was on average 8.6% better than they offered GSA. Over the term of the extension, the Government will have paid approximately \$6.4 million more for these products than the commercial customer. The total cost avoidances recommended by the audit reports for all 6 furniture contracts were \$12,859,578. The total cost avoidances actually obtained by the COs through negotiating pricing improvements were \$3,631,173, or 28% of the amount recommended. We do not have sufficient information to compare this rate to historical costs sustained by COs on prior negotiations for contracts on the same schedules.

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## **FINDINGS** (Continued)

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### **Finding 2: Many Multiple Award Schedule Contract Extensions Are Accomplished Without Adequate Price Analysis**

Our Office reviewed 80 MAS contract extensions to determine the quality of price analysis performed by the COs. Out of the 80 extensions reviewed, we determined that 44 involved inadequate price analyses.

Various legal authorities and GSA guidance mandate that COs conduct price analyses on contract actions. Conducting vigorous price analyses on MAS extensions is particularly crucial given that commercial and market pricing likely will have changed significantly during the multiyear duration of a MAS contract.

#### **BACKGROUND**

##### *Price Analysis Requirements*

GSA extended the terms of many contracts through modifications in the 1996-2000 time period.<sup>35</sup> For example, in 1998 through early 1999, GSA extended approximately 1,100 MAS contracts under the IT schedules in this manner.

A variety of regulatory and other provisions address the price analysis that should be performed when MAS contracts are extended through modifications or options exercise. These authorities, as a general matter, require that the CO at the time of extension determine that prices are fair and reasonable. This mandate, as applied to the MAS program, requires that MFC pricing should be preserved or achieved.

First, the FAR mandates that COs determine that prices are fair and reasonable on negotiated contract actions, such as MAS, by conducting price analyses. 48 C.F.R. § 15.404-1(a). Appropriate methods include conducting market surveys, conducting market research, comparing pricing to other offers, and soliciting additional pricing information. 48 C.F.R. § 15.404-1(b)(2).<sup>36</sup> With respect to option extensions specifically, the FAR, at 48 C.F.R. § 17.207), echoes the general requirement that pricing is one of the chief factors to be

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<sup>35</sup> FSS was not able to determine the exact number of extensions occurring during this time period.

<sup>36</sup> The FAR also contains accompanying related documentation requirements for these analyses. 48 C.F.R. § 15.406-3.

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## **FINDINGS** (Continued)

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considered when determining whether to exercise an option. The FAR also suggests that field pricing assistance, including audits, is appropriate where the buying activity has inadequate information to determine a fair and reasonable price. 48 C.F.R. § 15.404-2.

The GSAR also speaks to price reasonableness on MAS extension actions. The GSAR, at 48 C.F.R. § 517.207(c), provides specific guidance on option extensions, specifically noting the CO's duty to determine fair and reasonable pricing. As we noted earlier in the report, the fair and reasonable mandate, in the context of MAS contracts, connotes obtaining MFC pricing.

A variety of GSA guidance documents specifically address price analyses on MAS extensions, and the role of preaward pricing audits in the process. First, GSA guidance to COs notes the importance of making a fair and reasonable determination for MAS extensions. Specifically, GSA guidance notes that option pricing is not automatically considered fair and reasonable -- at the time of option exercise -- and directs COs to evaluate contract pricing and conduct a price analysis to ensure that the option prices "continue to allow Government customers to receive the best price available to the contractor's most favored customers." This guidance provides that, among other methods, the CO should conduct market research or a market survey and document the file to show that option pricing is fair and reasonable.<sup>37</sup> The guidance also requires that a contract option price analysis memorandum and negotiation memorandum be prepared. Additional GSA guidance also notes that COs should consider obtaining preaward audits to help in determining price reasonableness for major modifications, including large dollar extensions.

In accordance with these established policies, a third set of recently-issued GSA guidance, relating to Evergreen contracting, notes that before extending, a CO must get a statement from the vendor that its commercial pricing policies and the basis of award customer remain the same, or in the absence of such a statement, obtain updated pricing information. In addition to obtaining this statement or the updated pricing information, the Evergreen guidance authorizes the CO to conduct a market survey, and to request preaward audits -- especially on older contracts or large contract extensions (those where the estimated sales over the 5-year extension period are expected to be over \$25 million).

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<sup>37</sup> This guidance provides that, at a minimum, the file must include "documentation of the analysis performed and rationale used to determine that exercise of the option was in the best interest of the Government."

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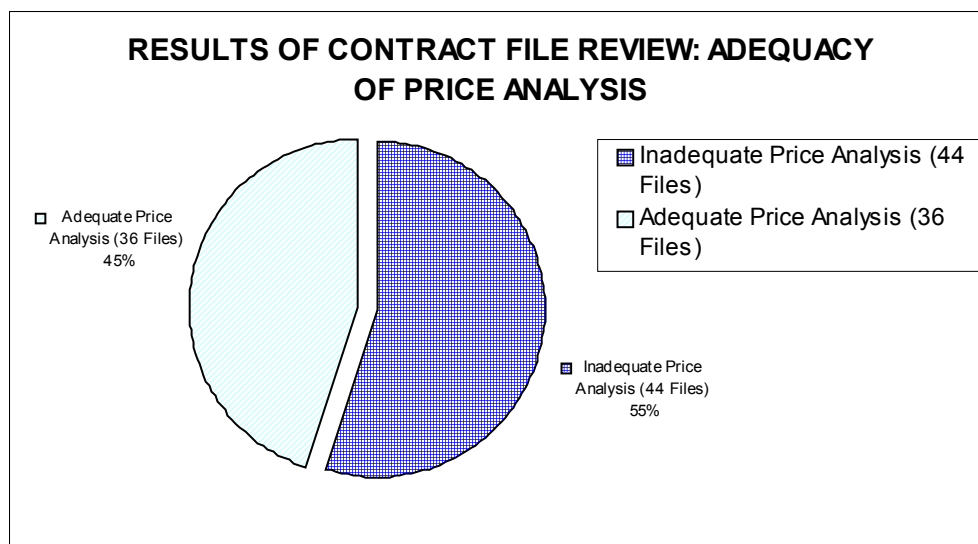
# FINDINGS (Continued)

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## REVIEW SCOPE AND FINDINGS: EXTENSIONS ACCOMPLISHED WITH VERY LITTLE NEGOTIATION OR PRICE ANALYSIS

In order to determine the extent and nature of the price analysis performed in connection with each contract extension action, we reviewed contract files and, in some cases, discussed the extension actions with the COs. We concluded that an extension action was inadequate -- from a price analysis perspective -- if from our review it appeared that the CO did not perform at least one of the following actions: conduct a documented market survey; request updated pricing information from the vendor or obtain an effective, clear contractor statement that its pricing information as disclosed at award had not changed; or request a preaward audit. Where a file did not include documentation reflecting any of these price analysis actions, we categorized the extension as inadequate.

COs performed inadequate price analyses on a significant number of the contract extensions we reviewed. Of the 80 extensions we reviewed, 44 were effected with an inadequate price analysis; only 36 included documentation reflecting an adequate price analysis. In most of the latter contract actions classified as adequate, the files reflect that the price analysis was based solely on a contractor statement that its pricing information as disclosed at award had not changed. A few of the extensions also included preaward audits of the contract actions.





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## **FINDINGS** (Continued)

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### *Examples of Ineffective Vendor Statements Regarding Price Changes*

In many instances where we found an inadequate price analysis, the contractor statements regarding commercial pricing that were obtained were unclear or ineffective. The GSA COs accepted these statements and awarded the extensions. Specifically, vendors are required to provide the CO with a statement that their commercial pricing remains as previously disclosed and that the basis of award customer that GSA is aligned with has remained unchanged. If a vendor's commercial pricing has changed, the vendor should provide new pricing information. In a significant number of contract extensions we reviewed, these statements were deficient. In some cases, the statements were unclear in that they did not refer to changes in the vendors' commercial pricing but rather to the vendors' pricing and terms extended to GSA. In others, the vendor statements failed to make any representation regarding changes in their commercial pricing, noting rather that the vendor "accepted" the modification extending the MAS contract term. We note that GSA does not have readily-available model language for COs to use in preparing these extension modifications.

**Example #1:** One vendor who sold scientific equipment to GSA provided a letter responding to GSA's transmission of a modification request; the vendor failed to make any representation in the letter about changes in their commercial pricing. In the summary letter, the vendor noted only that it "agree[d] to the modification" to extend the contract.

**Example #2:** A carpet vendor's MAS contract was extended when a CO obtained a telephonic representation from the vendor's representative that its "business practices have not changed since initial negotiations."

### *Examples of Ineffective or Undocumented Price Reasonableness Analyses*

Many of the contract extensions we reviewed had little or no information in the contract file that reflected COs' performance of a price analysis.

- For example, under one schedule for carpet, we found three extension actions where the rationale for extending each one was documented with an identical one-page form document. There was no additional extension-related documentation, such as a contractor statement or market survey, reflecting a price analysis in the contract file. The one-page document, furthermore, generally noted that the vendor was agreeable to extending its GSA contracts at the current pricing it offers. The document went on to

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## **FINDINGS** (Continued)

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note that no price negotiation would be attempted because GSA sales have not exceeded the estimated amount. Finally, the document noted that pricing could be considered to be fair and reasonable because GSA would not allow the vendor a standard price escalation. No evidence exists that the CO performed a meaningful price analysis, or even considered the individual vendor's pricing in extending the contract.

- In another example, a contract extension for photocopier machines, maintenance, accessories, and supplies, the CO documented the extension action with a summary and unsupported one page justification. The justification is a fairly conclusory document that notes that the option exercise was in accordance with the FAR because there is an existing Government need, and because maintaining continuous coverage was paramount. We note that an equally important FAR-mandated consideration is that prices be fair and reasonable. As for price analysis, the document noted that an "informal analysis" of prices indicated that the option price was the "lowest price." The file and the document, however, do not contain any documents or information reflecting the existence or extent of the informal analysis. The justification also noted that extending the contract pricing was more favorable than awarding a new contract because of Department of Labor-provided prevailing wage rates. We note that the contract was primarily for the sale of non-service related products.

### **Finding 3: Preaward Audits Are Not Being Used Effectively to Negotiate Better Multiple Award Schedule Prices**

The number of preaward audits requested for MAS contract actions has decreased significantly in recent years, even as total sales under MAS contracts have increased dramatically. Requesting and effectively using preaward audits can significantly enhance the pricing achieved on MAS contracts. In our view, failing to effectively use preawards can inhibit COs' ability to obtain MFC pricing. In the seven years prior to adoption of the 1997 GSAR rule relating to MAS and commercial items acquisitions, COs used audit-developed information to lower MAS prices by over \$618 million.

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# **FINDINGS** (Continued)

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## **BACKGROUND**

Preaward audits review vendors' MAS proposals in order to determine whether the pricing information provided is current, accurate, and complete, and to identify MFC pricing. Preaward audits are provided to COs in advance of negotiations in order to assist the COs in negotiating favorable pricing for the Government. The audits typically recommend cost avoidances, which indicate and quantify areas, including price and terms or conditions, where better pricing or terms could be negotiated.

In 1997, GSA revamped the rules governing commercial items acquisition and the MAS program. As part of these regulatory changes, GSA eliminated in practice postaward pricing audits, which were viewed by vendors as being unduly burdensome and not in keeping with commercial practice.<sup>38</sup> However, GSA specifically renewed its focus on preaward audits, noting that it expected "to shift its emphasis to use of preaward audits of information submitted in support of price negotiations." 62 Fed. Reg. 44518 (August 21, 1997).

The FAR, as well as GSA guidance to COs, notes the usefulness of preaward audits of MAS contract actions, especially on complex or large dollar buys. 48 C.F.R. § 15.404-1 (field pricing assistance on proposals).

### **FINDINGS: PREAWARD AUDITS REQUESTED ON MAS CONTRACT ACTIONS HAVE DECREASED SIGNIFICANTLY IN RECENT YEARS**

The number of preaward audits that have been requested in recent years have decreased significantly.<sup>39</sup> The following chart reflects that in fiscal year 1990, 211 preaward audits were conducted. In fiscal year 1997, the year the final GSAR rule emphasizing preaward audits was issued, only 8 preawards were requested and conducted. In fiscal year 2000, 23 preawards were requested and conducted.

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<sup>38</sup> We maintained then, and continue to maintain, that there is evidence in commercial practice for audit clauses generally. See Procurement Reform and the MAS Program, GSA and VA OIGs (July 1995); Anthology of Commercial Terms and Conditions, GSA FSS Acquisition Management Center (July 1996).

<sup>39</sup> Preawards are generally only conducted upon the request of the contracting officer.

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# **FINDINGS** (Continued)

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## **Decrease in Preaward Audits Over Time**

<b>FISCAL YEAR</b>	<b>NUMBER OF PREAWARD AUDITS CONDUCTED</b>	<b>DOLLARS AUDITED *</b>	<b>PERCENTAGE OF MAS PROGRAM DOLLARS COVERED</b>
1990	211	\$ 3,309,961,437	-
1991	201	\$ 3,154,778,830	-
1992	130	\$ 1,261,565,667	-
1993	120	\$ 3,046,533,069	-
1994	126	\$ 1,131,456,202	-
1995	154	\$ 1,343,371,143	33%
1996	94	\$ 2,320,439,644	56%
1997	8	\$ 171,059,500	3%
1998	28	\$ 2,027,818,714	26%
1999	24	\$ 4,689,128,680	45%
2000	23	\$ 694,281,664	5%
	<b>TOTALS</b>	<b>\$ 23,150,394,550</b>	<b>25%</b>

\*The dollars audited column reflects only the SINS actually reviewed by the audit. This amount is generally less than the total estimated sales under the entire contract.

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## **FINDINGS** (Continued)

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### **Trends in Negotiated Savings From Preaward Audits**

<b>FISCAL YEAR</b>	<b>RECOMMENDED COST SAVINGS</b>	<b>ACTUAL NEGOTIATED COST SAVINGS</b>	<b>PERCENTAGE OF RECOMMENDED COST SAVINGS SUSTAINED</b>
1990	\$ 138,777,708	\$ 79,742,726	57%
1991	\$ 187,094,501	\$ 122,308,686	65%
1992	\$ 124,137,170	\$ 60,356,628	49%
1993	\$ 291,625,692	\$ 167,116,990	57%
1994	\$ 77,224,478	\$ 38,343,749	50%
1995	\$ 71,689,451	\$ 38,523,448	54%
1996	\$ 310,075,891	\$ 174,688,370	56%
1997	\$ 21,957,166	\$ 17,262,310	79%
1998	\$ 262,001,309	\$ 8,392,666	3%
1999	\$ 333,111,462	\$ 18,285,220	5%
2000	\$ 271,126,449	\$ 54,750,510	20%*
	<b>\$ 2,088,821,277</b>	<b>\$ 779,771,303</b>	<b>37%</b>

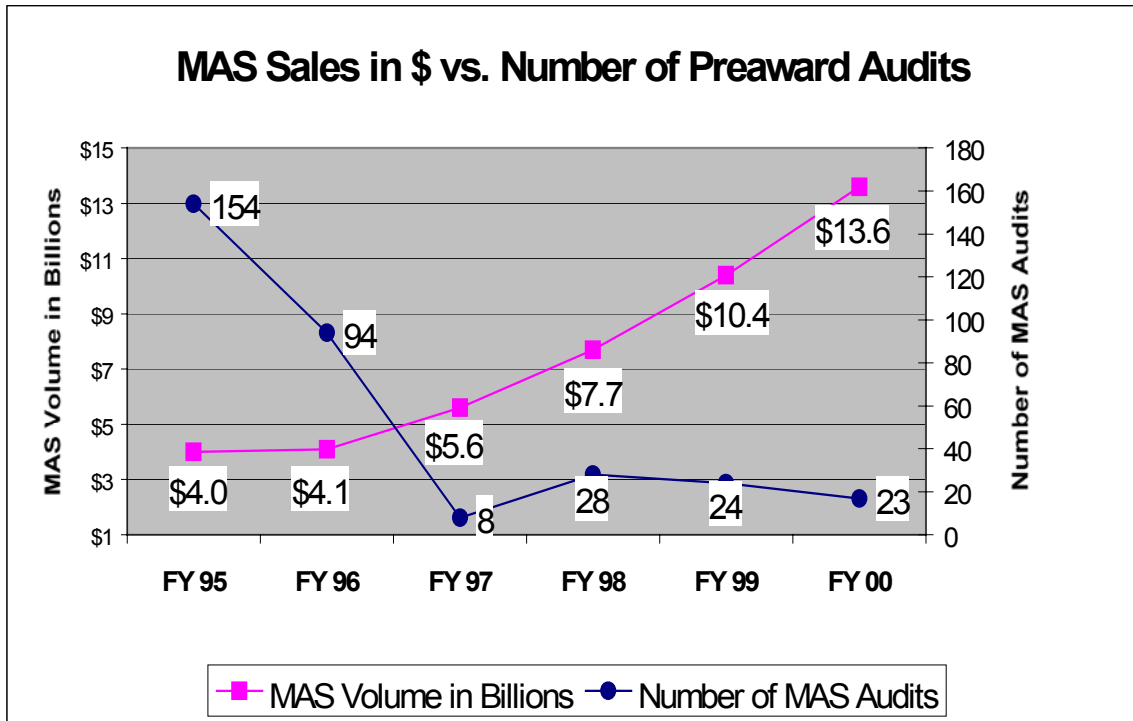
\*This rate reflects the actual sustained cost avoidances from only 3 audits.

Over roughly the same time period (FY 90-FY 97), sales under MAS contracts have increased significantly. In fiscal year 1995, the MAS program generated \$4 billion in sales; in fiscal year 1997, MAS program sales increased to about \$5.6 billion. In fiscal year 2000, sales under the program had increased further to \$13.6 billion.

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## FINDINGS (Continued)

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Also, during the 4-year time period from fiscal year 1997 through fiscal year 2000, preaward audits were performed on only 83 contract actions. In the 4-year period prior to this, preaward audits were performed on 494 MAS actions. These 494 audits resulted in over \$418 million in actual cost savings resulting from improved price negotiations by COs.

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## RECOMMENDED ACTIONS

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The recommended actions listed below address each of the findings outlined in the body of the report.

### ***Finding 1: FSS Is Not Consistently Negotiating Most-Favored Customer Pricing***

#### **Actions --**

- ❖ FSS should reemphasize to COs the regulatory requirement that MAS negotiations are premised on obtaining MFC pricing. COs should be required to note in price negotiation memoranda whether MFC was obtained, and if not, to justify why award is nonetheless in the Government's best interest.
- ❖ FSS should institutionally emphasize the requirement to treat the Government as one customer (leverage total purchasing power) when negotiating MAS contracts.
- ❖ FSS should institute pricing performance measures for MAS contracts.
- ❖ FSS should conduct periodic reviews focusing on the quality of MAS negotiations.

### ***Finding 2: Many MAS Contract Extensions Are Accomplished Without Adequate Price Analysis***

#### **Actions --**

- ❖ FSS should clarify, consolidate, and emphasize guidance on extensions, specifically addressing price analysis methods.
- ❖ FSS should provide training on extensions for COs.
- ❖ FSS should incorporate guidance on pricing MAS extensions into the GSAR.
- ❖ FSS should draft standardized updating representations for companies to submit for extensions.

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## **RECOMMENDED ACTIONS** (Continued)

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***Finding 3: Preaward Audits Are Not Being Used Effectively to Negotiate Better MAS Prices***

**Actions --**

- ❖ FSS should issue guidance (Acquisition Letters, Procurement Information Bulletins) for using preawards to COs. Existing guidance should be reaffirmed, with special emphasis on specifying particular situations/contract actions in which preawards should be requested.
- ❖ FSS should request more preaward audits, in accordance with this revised guidance.



# APPENDICES

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# Appendix A – Objectives, Scope and Methodology

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The Office of Audits and the Office of Counsel to the Inspector General jointly accomplished the work performed in conjunction with this review.

The primary objective of this review was to determine whether FSS is observing certain pricing-related regulatory provisions relating to negotiating MAS contracts.

To achieve this review objective, we first examined the current state of MAS contract negotiations. We reviewed negotiations for 31 MAS contracts from three of GSA's top-selling schedules, including photocopiers (11 contracts), information technology (14 contracts), and furniture (6 contracts). The total estimated dollar value of the contracts reviewed exceeded \$7.4 billion. The review was based on MAS contracts negotiated and awarded in the 1998-99 time period. Our review included examining preaward audits of the proposals, records of discussions with the contracting officers regarding negotiations, and key negotiation documents, including chiefly the price negotiation memoranda. We held interviews/discussions with FSS procurement officials and acquisition center directors and contracting officers concerning MAS negotiation objectives, price analysis, data requirements and other related issues. We also interviewed certain federal procurement officials at NIH, the Department of Veterans Affairs and NASA to discuss competing procurement vehicles. Further, we interviewed state procurement officials from Massachusetts, Pennsylvania, Texas, Washington, and Utah, to discuss state procurement methods.

For the second part of our review, we analyzed 80 MAS contract extensions to determine whether contracting officers had performed adequate price analyses of vendors' offers. We initially reviewed the award of 67 contract extensions covering 9 schedules. We then performed a supplemental review 18 months later of an additional 13 contract extensions from 5 different schedules. These reviews included an examination of the contract files and, in some cases, discussions with the responsible contracting officials. We determined whether this documentation met regulatory and other requirements dictating price analysis steps when MAS contracts are extended through modifications or through options exercise.

Finally, we examined the number of preaward audits requested by FSS for MAS contract actions for the period FY 90 through FY 00, in light of the MAS program's growth over the same time period.

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## Appendix B – Prior General Accounting Office Reviews of MAS Pricing

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In past years, GAO has reviewed the MAS program, including specifically its negotiation and pricing aspects, and emphasized that GSA COs should be seeking to obtain MFC pricing. Specifically, GAO has stated that MAS negotiations should always "start with the best discount given to any of the vendor's customers but that GSA must consider legitimate differences in terms and conditions" which are identified and valued by the offeror when negotiating the GSA price. GAO, Multiple Award Schedule Contracting -- Changes Needed in Negotiation Objectives and Data Requirements, GAO/GGD 93-123 (August 1993). Prior GAO audit reports had also noted pricing problems within the MAS schedules program. GAO, Federal Supply Service Not Buying Goods at Lowest Possible Price, GAO/PSAD-77-69.



SEP 24 2001

MEMORANDUM FOR DANIEL R. LEVINSON  
INSPECTOR GENERAL (J)

FROM:

DONNA D. BENNETT  
COMMISSIONER (F) (FPP)

SUBJECT:

OIG Special Report, "MAS Pricing Practices:  
Is FSS Observing Regulatory Provisions  
Regarding Pricing," dated August 24, 2001

Thank you for providing the opportunity to comment on the Office of Inspector General (OIG) Special Report, "MAS Pricing Practices: Is FSS Observing Regulatory Provisions Regarding Pricing?", dated August 24, 2001. The OIG reported three findings:

1. Most-favored customer pricing is not consistently negotiated;
2. Contracts are being extended without adequate price analysis; and
3. Preaward audits aren't being used effectively to negotiate better pricing.

The Federal Supply Service (FSS) response to these findings is attached.

The report asserted that the most-favored customer (MFC) concept is the *raison d'être* of the MAS program. Volume-based pricing is one of several key benefits of the program. Additional benefits include:

- ✓ Provides dramatic time-savings over other procurement methods
- ✓ Provides rapid introduction of new technology, services and products
- ✓ Allows customers to ask for spot-price reductions
- ✓ Minimizes the use of acquisition staff
- ✓ Minimizes duplication for both government and industry

The audits conducted by the OIG that served as a basis for the Special Report were performed on 31 of the 6000+ contracts that were negotiated during the period 1998-1999. Since the 1998-1999 timeframe, GSA has implemented many of the OIG's recommendations (training, directives, performance measures and contract reviews), resulting in improvements in the quality of MAS contracts, price negotiations, and the acquisition workforce.

GSA has conducted onsite training seminars for its acquisition personnel, established training requirements, established a MAS helpdesk, and issued additional pricing guidance in the form of policy directives. GSA continues to educate its workforce in all areas of acquisition -- including price analysis. We are in the process of contracting for an interactive web-based training tool to assist in the training of acquisition personnel and to provide a desk-top helpdesk. This tool, in conjunction with a dedicated helpdesk, the ongoing training seminars and mandated training, has/will continue to improve our operations.

A more recent OIG report acknowledged improvements in MAS contracting. See Inspector General audit report entitled "Limited Audit of Federal Supply Service's Contracting for Services Under Multiple Award Schedule Contracts" (A000897/F/3/V01002), dated January 9, 2001. The main focus of this limited audit was to determine whether FSS awarded MAS service contracts in accordance with Federal Acquisition Regulations. Based on contract file reviews, customer agency task order reviews, interviews of contracting officers and customer agency personnel, and interviews of various state contracting officials, it was reported that FSS' contracting officers are establishing fair and reasonable prices and that FSS is taking steps to improve internal controls over the negotiation, award and administration of services contracts. The report concluded that "no additional audit work is necessary or any recommendations are required."

Implementing performance measures throughout FSS is a continuing effort. A contract review process for significant contract actions has been developed and will be implemented this year. Customer surveys will include questions as to their satisfaction with MAS pricing. Additional guidance, particularly on services under MAS, will be issued in October 2001.

FSS agrees that preaward audits are a valuable tool to achieving a fair and reasonable price. During the past year all copier offers valued at over \$1 million were submitted for audit, as were some information technology and furniture offers. FSS desires to work closely with the OIG to identify and improve audit support processes to ensure requests for audit assistance are processed timely and resources are available to support MAS negotiations. FSS looks forward to working with you to develop preaward audit guidance.

Attachment

cc:

Eugene L. Waszily (JA)



FSS DETAILED COMMENTS ON THE OIG'S SPECIAL REPORT,  
"MAS PRICING PRACTICES: IS FSS OBSERVING REGULATORY  
PROVISIONS REGARDING PRICING," DATED AUGUST 24, 2001

FSS' comments on specific areas of OIG concern are addressed below:

**Findings 1 and 2 (Most-Favored Customer Pricing is not Consistently Negotiated and Contracts are Being Extended Without Adequate Price Analysis):**

Negotiation of most-favored customer (MFC) is an objective. The MAS Pricing Policy recognizes that MFC will not be achieved in every instance. Applicable regulations state that the terms and conditions of commercial sales vary and there may be legitimate reasons why the best price is not achieved. It is MAS policy to:

- ✓ Identify the offeror's most favored customer (these are the individuals or entities that get the best price, discounts, and/or concessions, regardless of selling terms and conditions).
- ✓ Compare commercial terms and conditions to those of the MAS solicitation.
- ✓ Seek and evaluate relevant information that warrant differentials between most-favored customer pricing and those offered to the Government.
- ✓ Seek to obtain the offeror's best price, discounts, concessions, terms and conditions, i.e., the price given to the most favored customer under similar selling terms and conditions.

We are very concerned that in several examples in which extensive price analyses were performed, the OIG substituted their judgment over the Contracting Officer's.

**Finding 1 - Most Favored Customer Pricing is not Consistently Negotiated (Photocopier MAS Negotiations):**

The report's comments were based on 11 MAS contract extensions under FSC Group 36, Part IV in 1998. The report does not mention the current round of new contract negotiations underway under this schedule, and the degree of audit support sought and provided in support of these negotiations.

Besides being dated, the report fails to reflect the findings of a review of the contract files conducted by the FSS Acquisition Management Center (FCO), dated June 21, 1999. These findings were forwarded to the Assistant Inspector General for Auditing (JA) from the FSS Assistant Commissioner for Acquisition (FC) in the attached memorandum. The FCO review found that the auditors did not account for differences in commercial terms and conditions. Neither the audit reports nor the negotiators made price adjustments to compensate for such differences.

The summary figures provided in the report show, when the initial contract was audited, a 9% cost avoidance was recommended. When the same contract was audited for the extension period, the auditors recommended a 14.2% cost avoidance. The audit reports did not identify any broad changes in market conditions or in the contractor's marketing strategies.

**Finding 2 - Contracts Are Being Extended Without Adequate Price Analysis (IT Extension Negotiations):**

Generally, our review indicates that the Information Technology Acquisition Center (FCI) did extensive price analysis in these negotiations. Under the subsection, "Unable to determine whether MFC achieved," the auditor cited instances where the contract was not awarded until better terms could be achieved, in another the CO awarded a more limited extension to increase pressure on the contractor to provide better pricing, and in the third case the contract was not awarded, because price reasonableness could not be determined.

Under the second bullet on page 19, the OIG states, "The vendor did not provide any fundamental supporting documentation, such as payroll registers, to allow the auditor to evaluate its commercial service rates ..." Under the MAS program, cost analysis is performed when there are too few sales to use as a basis for price analysis and it is determined that cost analysis is the only reasonable method of determining price reasonableness. When evaluating a commercial rate, it is more appropriate to evaluate rates actually received rather than payroll registers.

Under the first bullet on page 20, the auditor recommended, "that the CO... include state and local customers in the basis of award category..." This is a reference to GSAM 538.272 MAS price reductions, which states that "the offeror's customer or category of customers on which the contract award was predicated." The fact that "customer or category of customer" is singular is a significant part of this GSAM cite and the Price Reduction Clause, GSAM 52.238-75. The OIG's recommendations run contrary to the concept of a singular MFC as the basis of negotiations and the designated customer. The CO cannot arbitrarily increase the range of customers or category of customers. The category of customers is defined by the negotiations.

**Finding 3 – Preaward Audits Aren't Being Used Effectively to Negotiate Better Pricing:**

The actual relationship between schedule dollars and dollars audited does not compare apples to apples. Dollars audited reflect estimated contract values while program dollars reflect actual dollars. A substantial portion of the rapid growth in the MAS program has come from new schedules for services. These schedules have grown substantially faster than anticipated at the time of initial contract awards.



**OIG Recommendations and FSS Actions:**

The OIG recommended that FSS focus on training, directives, performance measures, reviews, and preaward audits. FSS has already implemented many of the OIG recommendations.

- ✓ The Office of Acquisition Management conducted onsite training seminars for its acquisition centers during calendar year 2000. Training included the process and procedures for evaluating the commercial sales practice sheet and sales information; pricing issues; prenegotiation memorandums; as well as other topics. We also instituted a Multiple Award Schedule helpdesk number to assist customers, industry AND acquisition personnel.
- ✓ GSA revised its occupational certification program for contract specialists and established training requirements as required by the implementation of the Office of Federal Procurement Policy Letter 97-1, Procurement System Education, Training and Experience Requirements for Acquisition Personnel.
- ✓ In the last year the Logistics Management Institute (LMI) has assisted FSS in developing a performance management system. As part of this effort, a team was formed to develop performance measures for the commercial acquisition business line, of which the schedules program is a part. The OIG attended the team meetings. The team discussed the mechanics of how savings under schedules could be measured. Suggestions included measuring the discounts GSA negotiates from commercial pricelists. Discussion also included the importance of overall quality, not just price, as well a terms and conditions and customer satisfaction. Also, the discount GSA negotiates is only part of the picture; it does not take into consideration the additional discounts agencies obtain. FSS plans to include questions on price in future customer surveys.
- ✓ FSS has implemented the OIG's recommendations to emphasize the regulatory requirements of the MAS program: for example, the acquisition letter on evergreen contracts, procurement information bulletin on exercising options, etc. Actions like this will continue.
- ✓ FSS is in the process of implementing a contract review process whereby significant acquisitions are reviewed to ensure that FSS is awarding quality contracts. The review process will improve the quality of contract negotiations and awards (and emphasize pricing outcomes); provide more effective on-the-job training of contract negotiators; and encourage adoption of innovative negotiation strategies.





FCO/PAT

June 21, 1999

MEMORANDUM FOR EUGENE L. WASZILY  
ASSISTANT INSPECTOR GENERAL  
FOR AUDITING (JA)

FROM: WILLIAM N. GORMLEY /s/  
ASSISTANT COMMISSIONER  
OFFICE OF ACQUISITION (FC)

SUBJECT: Office and Scientific Equipment Center Use of IG Audits  
During Class 36 MAS Extensions Negotiations

The Office of Acquisition Management (FCO) reviewed the eleven, pre-award audit reports and subsequent negotiations documentation on the audits, in support of negotiations of three year extension of contracts under the 36 IV multiple award schedule. The estimated value of the extension of each contract audited was substantial. In all but two audits, the reports had concluded that the prices as proposed were not fair and reasonable.

In evaluating the Office and Scientific Equipment Center's (FCG) response to the audit, it is understood that the audit recommendations were advisory and do not set negotiation objectives. The negotiation documentation reviewed indicated that negotiators reviewed and considered the audit reports. Supplemental information in the contracts files revealed, that in most instances, the negotiator discussed the audit report findings with the cognizant Office of Audits (JA) auditor. In the majority of cases where the audit reports recommended improvements, negotiations resulted in improved prices or terms. Copies of the negotiation memoranda were provided to the IG Office of Audits.

A common thread, found throughout the JA audit reports and FCG negotiation documentation, was comparisons with commercial contracts with different terms and conditions. Neither the audit reports nor the negotiators made price adjustments to compensate for the differences, as directed in the GSAR policy. The audit reports cited the commercial practice as the negotiation target without considering differences. The negotiators totally excluded from comparisons commercial agreements, for relatively minor differences, or differences which should have been addressed through price adjustments. (See Attachment 1)

Page 1 of 2



Another practice found was the auditors considering each commercial contract as a commercial sales practice. In the Commercial Sales Practices format (CSP) instructions calls only for the disclosure of "commercial policies or standard practices." Instances of a single contracts or only an instance of better pricing on a specific model, does not necessarily represent a contractor's commercial practice.

The issue of the LTOP lease rate was discussed in all the audits, comparing the lowest available LTOP rate to other offerors. In one instance this resulted in a lowering of the proposed rates. Neither the auditors nor the negotiators attempted to compare the proposed rates with then current market rates.

During discussions with contracting personnel, it was found that there is a widely held belief that because the Price Reduction Clause now permits agencies to negotiate better prices on a per order basis, the MAS most favored customer objective must consider each commercial competitive situation as if it were equivalent to a vendor offering a comparable special discount to a FSS customer, rather than being used to negotiate the schedule price.

The overall conclusion is that the audit results were considered in setting the negotiations objectives. Had the GSAR pricing policy of evaluating differences, rather than accepting or rejecting comparables been followed, improvements in the contract pricing may have been achieved.

The following remedial actions are being taken: FCO will issue a Procurement Information Bulletin and present additional training to the centers on proper techniques for evaluating differences between commercial contracts and multiple award schedule contracts. FCG is instructing their specialist and contracting officers to rigorously enforce the GSAR pricing instruction in evaluate requests for modifications applicable to these contracts, and not to give undue influence to the results of previous negotiation results.

2 Attachements



## ATTACHMENT 1: Examples of Not Evaluating Differences

Page 1 of 2

### NEGOTIATORS:

1. One PNM cited the IFF as a reason to exclude a commercial contract from consideration. The applicable consideration for IFF is well established.
2. There is a wide perception that competitive state contracts are not to be considered in evaluating offers. This is inconsistent with our historical pricing practices and a recent PIB which cited state contracts are good market indicators. Reasons for differences included the limited geographical area; however, this reason was applied to states including California, Utah, Hawaii, and Washington that include some of the remotest areas in the country. Another reason given was a single award; however, many promises of single awards were illusory.
3. Several commercial contracts were excluded because of the evaluation system used to award them: total product cost (a modified life cycle cost). Rather than excluding the contract, similar evaluations should have been run using GSA pricing, which would demonstrate that our prices are or are not reasonable. (see also auditors)
4. Commercial contracts were eliminated because they were over the MO, even when they were for estimated quantities over time; therefore, MO are not applicable.
5. Commercial contracts were excluded because they included a "lock" on buying supplies or maintenance. In the instance of maintenance, it can reasonably be assumed that most purchasers of copier machines will purchase the maintenance, as that is the standard practice. If that is too broad an assumption, under MAS contracts, vendors can offer superior combination pricing when a customer agrees to purchase with maintenance; therefore, the commercial contracts were not out of scope.
6. When confronted with the issue of rentals including supplies as compared to the normal schedule rental without supplies, the negotiators did not adjust the rental rate for the cost of supplies. Estimates of copies per unit of supply are available either from the vendors, trade publications or center engineers. This figures can be used to adjust rentals including supplies to MAS conditions (see also auditors below)
7. Rental plans were excluded based on the period of payment: quarterly in advance in lieu of monthly post pay. This is a relatively easy adjustment using the Excel spreadsheet to calculate the value of money over the three month period.

### AUDITORS:

1. The audit reports were inconsistent in their evaluations of rental plans and maintenance plans with fixed monthly charges. There is only two ways to

## ATTACHMENT 1: Examples of Not Evaluating Differences

Page 2 of 2

reasonably compare these plans: (1) either both the monthly base and the per copy charge must be better, or (2) use reasonable estimates of actual customer usage. Information on estimates of customer usage are available from the industry publications, from FSS experience with the cost per copy program or FSS technical personnel. In the one audit where this was done (MITA), the FSS prices appear reasonable compare to the commercial plans. Adjustments could have been made for usage of supplies as stated in #4 under negotiators.

2. Comparisons of rental plans including supplies should have been to the contracts Cost per Copy or Flat Rate plans, as more comparable than rentals.
3. Comparison to dealer pricing was made without consideration of dealer functions.

FCG AUDITS	PNM DISCUSSED AUDIT FINDINGS		SPECIALIST DISCUSSED WITH AUDITOR		NEGOTIATIONS RESULTED IN IMPROVEMEN	
1 ABM	N/A	NO	NO	NO		
2 CANON	YES	YES	YES	YES		
3 DANKA	YES	YES	YES	YES		
4 KONICA	YES	YES	YES	YES		
5 MINOLTA	YES	YES	YES	YES		
6 MITA	YES	YES	YES	NO		
7 OCE	YES	YES	YES	NO		
8 RICOH	YES	YES	YES	YES		
9 SAVIN	YES	YES	YES	YES		
10 SHARP	YES	YES	YES	YES		
11 XEROX	YES	YES	YES	NO		



COMMENTS:									
1	ABM	Audit found no questionable commercial sales practices. Renewal was at present terms.	OK						
2	CANON	Audit disclosed new class of dealer (GMAS II) with substantial increases in discount over current dealer. Higher dealer discounts permits dealers to offer much better prices than MAS prices CO stated GMAS II sales were "hard orders" over MO therefore not a basis for negotiation CO cited Canon's inability to control dealer pricing to dismiss instances of dealers providing better discounts							
		P/A appraisal: The MO issue is not relevant to dealer pricing, as we should give dealer credit for stocking (buying in quantity) in our dealer functions. The issue of Canon's ability to control dealers is irrelevant, if FSS based their dealer function mark-up on the true dealer costs then the margins would not allow such substantial undercutting of the FSS pricing.							
		Issue B: Audit disclosed state government get much better prices on purchase and rental than offered FSS on similar copiers CO did not address directly; however, the sales to states were through dealers, not Canon direct; therefore, previous comments apply.							
		P/A appraisal: State government comparisons are a legitimate price analysis technique, see PIB 98-15. Arguments made that State government contracts are more competitive or limited in scope are not; may explain minor variations in discounts; however, very large variations need substantial justifications or comparable price reductions.							
3	DANKA	Audit found two maintenance contracts that received better pricing than FSS							
4	KONICA	Auditor found dealer were receiving improved discount since award CO negotiated comparable discount improvements for FSS							
		Issue B: Auditor rental and maintenance plans with supplies receive better pricing than FSS rental w/o supplies							
5	MINOLTA	Audit cited 19 commercial and state customers as examples of agreements that received better prices on purchase than GSA, Co reviewed each commercial contract and determined whether or not the terms were consistent enough with the MAS to be a valid comparison, then either rejected the comparison or used it during negotiations.							
		P/A Appraisal: The CO should have looked beyond the technicalities of the offer to address the apparently significant price differences. The basis for several decisions to exclude were not clear. The information provided in the evaluation of rental was insufficient to determine a low price at all usage							



6	MITA	Issue A	Dealers get higher discounts than award and was not reported to FSS
		Issue B	CO position that dealer were not the designated MFC therefore this is not relevant Auditor found some specific commercial and state agreements that receive better pricing than MAS CO stated that the evaluation terms were not comparable. Mita offered the Government 40 and 43 percent, depending on the model which increased the permanent discount to 46 to 48 percent.
7	OCE	P/A Appraisal:	The auditor's analysis indicates most FSS rental programs are more favorable normal volumes. The Boy Scouts receiving dealer discounts alone is not sufficient to establish that this pricing represents a pricing practice within the meaning of the CSP Instructions.
		Issue A	Two commercial customers receive better discounts than FSS, OCE has a Discount Floor Price better than that offered FSS. The auditor found that very low prices were given in association with trade-ins. CO stated that auditor did not consider the GSA floor price which is between 18-20 better than the prices the auditor compared to. Trade-ins are not considered as part of the MAS any price reduction as a result of a trade-in is considered open market.
		Issue B	OCE has a dealer, IKON, that receives better discounts than FSS.
8	RICOH	Issue A	OCE established that IKON is a larger customer than FSS, plus it has dealer functions. Ricoh has national account customers who routinely receive better pricing than FSS.
		P/A Appraisal:	CO accepted explanation for the differences in contract types The CO should have looked beyond the technicalities of the offer to address the apparently significant price differences.
		Issue B:	Auditor found that FSS rental prices including supplies were higher than commercial customer pricing excluding supplies. CO stated that the inclusion of supplies was too great a different to make to prices comparable
		P/A Appraisal:	The data supplied in appendix B does not support the auditor's contention. With one exception the cost per copy charge on rentals with supplies was higher than the GSA price without supplies. As the cost of supplies only impacts the cost per copy aspect of a rental, the fact is that FSS rental prices without supplies are lower than with supplies. Much more analysis is necessary to determine which pricing is in fact superior.
9	SAVIN		Auditor found the CO should restate the existing relationship. CO concurred. Additional price reductions were negotiated.
10	SHARP	Issue	National accounts and state governments receive better pricing than MAS CO established that given the existing special promotions the MAS pricing is superior to the states Sharp agreed to special terms, beyond the price reduction clause, that if FSS will never be more

11	XEROX		than California or Ohio, the two most favored states.		
	Issue A	Xerox has a state contracts with prices substantially better than MAS.			
			CO held that because total cost of ownership awards based on a different method of evaluation they cannot be compared to schedule pricing		
	P/A Appraisal:	Total cost of ownership is a preferred price analysis method in the Government as well as in states; To compare schedule prices to Total costs methods requires additional analysis of the combined cost of machines, maintenance and supplies. Only on this basis can a decision be made on price comparability. This analysis should have been done.			
	issue B	Minimum Achieved Pricing plan offers better prices than provided on MAS.			
	P/A Appraisal:	The ceiling was not very significant when it could be reached with two machines and was less than 1% of the Government volume. Xerox should offer this program to GSA under similar terms.			
	Issue C	Maintenance and supplies are offer at better prices to national accounts.			
		CO: some orders were over the MO, and combination of products between SINS is not permitted under the schedule.			
	P/A Appraisal:	Most of the better supply prices listed were to very large distributors who would not be considered comparable to MAS end use customer. Comparison with maintenance prices does not include number of copies included; therefore price comparisons cannot be evaluated.			





U.S. GENERAL SERVICES ADMINISTRATION  
Office of Inspector General

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OCT 12 2001

MEMORANDUM FOR DONNA D. BENNETT  
COMMISSIONER  
FEDERAL SUPPLY SERVICE (F)

FROM: DANIEL R. LEVINSON *Daniel R. Levinson*  
INSPECTOR GENERAL (J)

SUBJECT: FSS Response to OIG Special Report on Multiple Award  
Schedule Pricing Practices

From reading the Federal Supply Service (FSS) response to the Special Report on Multiple Award Schedule (MAS) pricing practices issued by our office on August 24, 2001, it is clear that the issues we raise have been given substantial attention by FSS officials. It is also clear the two organizations remain apart in our views of current Multiple Award Schedule (MAS) procurement practices and precisely, what, if anything needs to be addressed to enhance program pricing activities. We are pleased that the FSS Commissioner has expressed an open willingness to explore and resolve the issues in contention. We welcome that opportunity.

The FSS response to our Special Report highlights many of the efforts taken in recent years to enhance the MAS program. We note particularly FSS's proposals to institute certain types of contract review procedures, under which significant acquisitions would undergo a review process to ensure FSS is awarding quality contracts. While we acknowledge these efforts and commend FSS for making improvements, we also note that most endeavors cited are only tangentially linked to the three major issues in the Special Report. Absent from FSS actions to date, and one of the recommendations contained in the Special Report, is the development of a performance measure to assess the effectiveness of pricing efforts on MAS contracts.

Our report is centered on the need for FSS to more consistently apply available means to achieve contract pricing in line with the most-favored customer (MFC) concept. We do not take issue with the MAS program, which clearly provides Federal customers and taxpayers significant benefits, many of which are enumerated in the FSS response. Nevertheless, we believe that MFC is, as we state in the report, a touchstone of the MAS program and is the means by which FSS can most effectively aggregate the purchasing power of the Government and achieve volume pricing.



With that said, we do not disagree with FSS's characterization of MAS pricing policy as stated in the response to Findings 1 and 2. MFC is a negotiation objective and because of differing terms and conditions, there may be legitimate reasons why the best price cannot be achieved. In the Special Report, we categorized a particular negotiation as having achieved MFC – even if the price negotiated was not the actual best discount or price – as long as the differing terms or conditions were considered and valued by the contracting officer. In most of the negotiations in which we found MFC had not been achieved, the failure was that contracting officers would simply reject a commercial customer when faced with differing terms and conditions rather than evaluate and quantify them. That this is contrary to GSA policy is also noted in the June 1999 FCO review that is attached to the FSS response. That FCO review, which was reviewed and considered for the Special Report, specifically states that “the negotiators totally excluded from comparisons commercial agreements, for relatively minor differences, or differences which should have been addressed through price adjustments.” This finding is also at the heart of our Special Report.

In addition to these general comments, we also wanted to bring the Commissioner's attention to the following particular points raised in the FSS response:

- FSS responds that the Special Report is based on analysis of only “31 of the 6000+ [MAS] contracts that were negotiated during the 1998-1999 timeframe.” We note that, while the MAS program has well over 6000 contracts in place, a large majority of the purchase dollars flowing through the program are concentrated in a few hundred contracts held by an even smaller number of vendors. Our sample of 31 contracts that formed the basis for our first finding (the second finding covered 80 contracts) had an estimated sales volume of \$7.4 billion. As stated in the Special Report, our review was based on MAS contracts negotiated in the 1998-1999 time period, because they were the last substantial set of contracts subject to preaward audit until this most recent round of copier contracts.
- In its response, FSS agrees that preaward audits are a valuable tool to achieving a fair and reasonable price and then notes that, in the past year, all copier offers valued at over \$1 million were submitted for audit, as well as some information technology and furniture offers. We point out that it is not sufficient to simply submit an offer for preaward audit; that audit also needs to be supported and used effectively in negotiations to form pricing decisions. The recent round of preawards on the copier contracts has, in fact, only served to reinforce the concerns we raised in the Special Report regarding negotiations quality. While we are not in a position to



comment at this time across-the-board on every negotiation and any resulting price impact, as the contracts were all very recently awarded, we are aware – as is FSS – of several instances of vendor recalcitrance in providing audit-requested information; insufficient support by contracting officials in obtaining that information; and FSS ultimately deciding to award contracts without benefit of the preaward audits that were in progress.

- In its response to Finding 3 on using preawards effectively, FSS takes issue with a chart that notes the decreasing number of preawards from FY 1990 through FY 2000 and also gives the dollars audited for each of those years as well as the percentage of MAS program dollars covered. We agree that the percentage of MAS program dollars covered by audit may be impacted somewhat in any given year in which the actual purchases of services greatly exceed estimates at the time of award (or extension). Nevertheless, the trend noted of dramatically decreasing numbers of preawards and dollars audited holds true and serves to support our overall conclusion that preawards are not being requested or effectively used. Another chart on page 36 of the Special Report graphically illustrates the sharp drop in numbers of preawards against the exponential growth of MAS sales dollars in the same time period.

The issues we discuss in our Special Report center on three areas: FSS is not consistently achieving MAS pricing; many contract extensions we reviewed lack adequate price analysis; and preaward audits are not being used effectively to negotiate better pricing. While FSS has clearly made changes in many areas, fundamentally these three issues remain unaddressed in any comprehensive or meaningful fashion. We would be happy to work with FSS in any review or other efforts it may undertake on these issues. We believe that the MAS program generally is a very effective vehicle for Government purchases of commonly used products and services, which can and should achieve significant savings for the taxpayer. Our principal goal with this report is to help insure that it continues to do that.