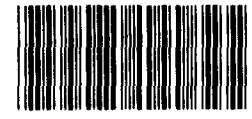


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Testimony



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General Services Administration's Management  
of FTS 2000

Statement of  
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the Comptroller General

Before the  
Subcommittee on Legislation and National Security  
Committee on Government Operations  
House of Representatives



Mr. Chairman and Members of the Subcommittee:

I am pleased to participate in the Subcommittee's hearings on the FTS 2000 government-wide telecommunications program.

Mr. Chairman, as you know, FTS 2000 is the largest ADP and telecommunications procurement ever attempted on the civil side of the federal government. Much has been accomplished since the contracts were awarded in December 1988. Transition from the old and expensive FTS system was completed in June 1990, 18 months ahead of schedule, and FTS 2000 now has over 1.1 million users for its switched voice service. As a result, the government is saving nearly \$178 million a year compared to the old FTS system.

However, we are concerned about certain aspects of FTS 2000.

Specifically,

- GSA's agreement with Sprint to assign Navy traffic to Sprint, in return for price reductions, may not be in the government's best interests;
- Further, based on our estimates, the assignment of Navy traffic to Sprint will not result in a 60/40 revenue allocation;
- While GSA is effectively enforcing mandatory use, in some cases complying with mandatory use can cost

agencies more for FTS 2000 services than they would pay for a separate contract;

-- We are concerned about the magnitude of costs GSA allocates to the FTS 2000 program;

-- AT&T and Sprint appear to be exceeding their FTS 2000 subcontracting goals for small and small disadvantaged businesses; however, because some large subcontractors did not provide plans for further subcontracting, it is not clear whether maximum practicable opportunity has been afforded such businesses.

GSA's Failure to Enforce FTS 2000 Price

Caps Led to the Reassignment of Navy Traffic

From AT&T to Sprint

I would like to first turn my attention to GSA's efforts to enforce contractually-mandated price caps on the two vendors, and how these efforts led to the reassignment of Navy traffic from AT&T to Sprint.

Section B.1.2 of the FTS 2000 contracts required that vendors' prices be no higher than publicly available prices and that any vendor overcharges be refunded to GSA.

In the fall of 1989, GSA notified both vendors that they were exceeding the price caps and asked that they lower their prices. Both vendors contested GSA's implementation of the price cap provision.

The dispute continued for nearly a year, until September 1990, when GSA acted to enforce B.1.2. GSA notified both vendors that they were violating section B.1.2 and were liable for overcharging the government. AT&T was told that it owed approximately \$167,000 for February 1990, and was directed to reduce its prices accordingly. Sprint was told that it owed approximately \$706,000 for February 1990, and was also directed to reduce its prices. GSA added that a further analysis would be performed and that additional charges might be made against their accounts.

Sprint vigorously protested GSA's attempted price cap enforcement directly to GSA management, and GSA immediately withdrew the enforcement letter it had sent to Sprint. Subsequently, in an attempt to resolve the dispute, GSA began to negotiate with Sprint over the implementation of B.1.2 and other contract administration issues.

Then, on October 15, 1990, GSA and Sprint signed a memorandum of understanding. In the MOU, GSA agreed to assign an agency worth \$20 million in switched voice revenue to Sprint, in return for a

volume discount from Sprint worth tens of millions of dollars over 2 years. Sprint specifically asked for Navy to be assigned to it and argued it needed the additional traffic in order to maintain its revenue allocation. A proposed contract modification reassigning Navy to Sprint was sent to AT&T, but AT&T refused to sign it. Three days later, on October 18, 1990, GSA issued a unilateral modification assigning Navy to Sprint. GSA and Sprint also agreed to develop a mutually acceptable index that would be used to determine a price cap for switched voice service.

Overall, this action may not have been in the best interests of the government.

There is no question that the agreement contains some definite pluses for the government:

- With Sprint's increased volume discounts, the government should save millions of dollars over 2 years; and,
- The government now has an agreed-upon methodology to enforce price caps on Sprint.

However, GSA's concessions to Sprint, whose prices are higher than AT&T's, were costly and disruptive:

- The government waived its right to enforce section B.1.2 until the end of the fourth year of the contract, giving up any chance to collect possible overcharging from December 8, 1988 through December 7, 1992.
  
- In conducting secret negotiations with Sprint, GSA has lost credibility with AT&T. AT&T was not told about the MOU until four months after the document was signed. Further, AT&T asserts that GSA did not give it an opportunity to offer a better volume discount than Sprint.
  
- GSA unsuccessfully spent an entire year trying to enforce section B.1.2, paying contractors to develop a price cap methodology that was eventually discarded.
  
- Finally, we believe the assignment of Navy will not contribute to achieving a 60/40 revenue split.

The switched voice index agreed upon by GSA and Sprint will remain in effect through December 7, 1992, the end of the initial contract period. Before the end of this period, during recompetition, GSA can renegotiate the entire contract including this agreement. Currently, GSA and AT&T are coming close to reaching an agreement regarding a price cap index for AT&T's prices. Over the next year and a half GSA can develop a fair and

equitable methodology for enforcing FTS 2000 price caps on both vendors, for all services. GSA should give this matter its full attention, to ensure that the government pays competitive prices for FTS 2000 services.

GSA's Assignment of Navy Will Not  
Result in a 60/40 Revenue Split

Let me now turn to GSA's management of the 60/40 revenue split, and how it is affected by the MOU I described previously.

In developing the network split, GSA used 1986 traffic tapes from the earlier FTS network and assumed that the offerors would bid nearly equal prices--thus generating a 60/40 revenue split. However, after the contracts were awarded, GSA realized that the significant disparity in the vendors' prices would initially result in an approximate 50/50 revenue split. GSA then decided to use unassigned agencies, taking into account contractors' prices, to move towards a 60/40 revenue split. In our view, given the fact that the initial contract prices were accepted, GSA's initial strategy for managing the 60/40 split was reasonable.

In a February 8, 1990, letter to both vendors, GSA laid out its basic strategy for managing the assignment of unassigned agencies. First, small agencies would be assigned only when

service orders were imminent, to retain flexibility. Second, GSA would evaluate the data collected from the unassigned agencies and improve potential traffic and revenue estimates. Both vendors continued to express concern over the status of unassigned agencies, particularly the Department of Defense and the Postal Service. However, we believe that GSA's cautious approach was proper--it would have been unreasonable for GSA to bow to vendor pressure and assign any unassigned agency to a vendor before it had enough data to make an informed decision.

GSA's commitment to a 60/40 revenue split was further demonstrated in May 1990, when GSA issued a contract modification assigning the three military services to AT&T with a \$60 million cap. Sprint would be assigned traffic where redundancy in the network was needed. However, Sprint protested this modification and requested a contracting officer's final decision on the 60/40 allocation issue. Sprint argued that 60/40 was not a contractually required allocation of revenue and that Sprint's proper allocation was 49 percent, the amount it had at contract award.

In response, GSA issued a contracting officer's final decision on June 29, 1990, reiterating its support for a 60/40 revenue allocation and denying Sprint's protest, stating:



"Given the actual allocation of revenue--it would be illogical for the government to assign new agencies on the happenstance of disparate prices and revenue stream for Sprint."

When GSA reassigned Navy from AT&T to Sprint, it developed figures ostensibly to support its contention that the Navy assignment would help reach a 60/40 revenue allocation by the end of FY 1992. These figures are not reliable; in fact, they are misleading. The assignment of Navy to Sprint cannot be justified on this basis.

For example, GSA did not adequately evaluate information concerning the possible revenue impact of the Navy and Postal Service assignments. As a result, GSA significantly underestimated the amount of revenue that Navy would be worth either to AT&T or to Sprint in FY 1992. In addition, GSA overestimated the potential revenue AT&T might receive from the Postal Service in FY 1992. GSA had indicated that one of the reasons Sprint got Navy was that the Postal Service was assigned to AT&T. However, USPS is not subject to the mandatory use statute and has recently indicated that it plans to issue an RFP for telecommunications services at certain locations, because the FTS 2000 prices are too high. This decision to scale back use of FTS 2000 may further decrease AT&T's revenue.

Based on our estimates, we believe the revenue split in 1992 will be roughly 57/43, in favor of AT&T. This estimate represents the split only for the last year of the initial 4-year contract period. In FY 90, the split was 42/58 in favor of Sprint, and in FY 91, the estimated split is 48/52, also in favor of Sprint. Looking at the figures cumulatively, by the end of FY 1992, AT&T will have received an estimated \$502 million, or 51 percent of the revenue, while Sprint will have received an estimated \$479 million, or 49 percent of the revenue. Clearly, these estimates suggest that, in total, GSA's efforts will not come close to achieving a 60/40 revenue split.

Mandatory Use is Being Enforced

But Pricing Concerns Have Arisen

I would now like to turn my attention to a discussion of GSA's implementation of mandatory use. Agencies subject to the Brooks Act are required to use FTS 2000 unless (1) they have requirements that cannot be met under the contracts and (2) agencies' acquisitions of these requirements are cost-effective and would not adversely affect the cost-effectiveness of FTS 2000. Toward that end, GSA reviews agency requests for exceptions to FTS 2000. So far, GSA has granted 102 exceptions out of a total of 172 FTS 2000 exception requests. Our review of 28 exception requests found that GSA's approval action met the requirements of the mandatory use statute.

It is true that some agencies have been slower than others in transitioning their services to FTS 2000--for instance, the Social Security Administration (SSA) and the Department of Defense. In these cases, the reluctance to use FTS 2000 was, in part, due to the higher costs that would be incurred. Specifically, the combined effects of levelized pricing and GSA overhead sometimes increase the GSA price so that certain FTS 2000 services cost more than they might outside of FTS 2000.<sup>1</sup> For example, AT&T's raw contract prices for SSA's 800-number service are comparable to MCI's, the current contractor. However, when levelization and GSA overhead are factored in, SSA will spend about \$12-14 million more in FY 1992 than its current contract with MCI.

GSA has taken action to help agencies out. For example, GSA waived levelization for USDA's electronic mail service--which AT&T provides--because the levelized price was significantly higher than the agency's current contract with Sprint.

GSA's Allocation of FTS 2000 Overhead Costs  
Through the Information Technology Fund

The next topic I would like to address is GSA's operation of the Information Technology (IT) fund, specifically the 10-percent

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<sup>1</sup>To levelize prices, GSA applies a factor to each vendor's prices to make them roughly equivalent.

overhead charge that GSA levies on FTS 2000 users. The IT fund is a revolving fund through which GSA provides and finances a variety of services and assistance to federal agencies, including FTS 2000. GSA bills the agencies quarterly, in advance, for the estimated FTS 2000 telecommunications services to be provided them. The agency bills cover the cost of services provided by the contractor plus an overhead charge, currently 10 percent, added to cover GSA's costs allocated to the FTS 2000 program.

GSA uses the FTS 2000 overhead charge to fund personnel to staff the service oversight centers, manage the billing system, provide technical support, and other functions. In addition, the overhead charge is used to pay outside contractors supporting FTS 2000 and general management and administrative expenses.

We are concerned about the magnitude of GSA's allocation of FTS 2000 program costs through the IT fund. These costs are estimated by GSA to be about \$50 million for fiscal year 1991. At your request, we are conducting a full audit of the IT fund, including an assessment of FTS 2000 overhead expenses.

Maximum Practicable Opportunity May Not Have Been  
Afforded to Small and Small Disadvantaged Businesses

I would now like to turn to another issue related to the FTS 2000 contracts: subcontracting for small and small disadvantaged

businesses. As you know, the former chairwoman of the House Subcommittee on Government Activities and Transportation, Representative Cardiss Collins, asked that we determine whether small and small disadvantaged businesses are being afforded "maximum practicable opportunity" for subcontracting under FTS 2000 and related contracts.

The Small Business Act requires that any contractor receiving a government contract for more than \$10,000 agree that small and small disadvantaged businesses shall have "maximum practicable opportunity" to participate in contract performance. Most prime contractors are required to submit subcontracting plans committing to use these small businesses. In turn, subcontractors who receive subcontracts expected to exceed \$500,000 (\$1 million for construction) must develop plans for further subcontracting to small and small disadvantaged businesses.

AT&T and Sprint do appear to be, in fact, exceeding their goals for subcontracting to small and small disadvantaged businesses under the FTS 2000 contracts. However, because some large subcontractors did not provide plans for further subcontracting, it is not clear whether maximum practicable opportunity has been given such businesses under these contracts. In our report, which we plan to publish by the end of May, we are recommending that GSA and SBA strengthen their oversight of small and small

disadvantaged business subcontracting to ensure that large subcontractors submit properly developed subcontracting plans.

In conclusion, FTS 2000 is providing the government with an array of telecommunications services not available under the old FTS service, and at a lower cost. However, GSA has not been successful in obtaining a 60/40 split and has had difficulty in getting price reductions from Sprint without making disruptive contract modifications. Further, some agencies will have to pay higher prices for certain services under FTS 2000 than they are currently paying for identical commercial services. We believe that the underlying cause of these contract problems is the large, unanticipated price difference between the two vendors. Failure to address these problems could seriously undermine the effectiveness of FTS 2000.

This concludes my remarks. I will now answer any questions you may have concerning these issues.