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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

HUMAN RESOURCES DIVISION

B-211827

SEPTEMBER 20, 1983

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The Honorable Harry N. Walters
Administrator of Veterans Affairs

Dear Mr. Walters:

Subject: Better Management and Price Negotiation Will Improve the Veterans Administration's Multiple Award Schedule Program (GAO/NSIAD-83-33)

We reviewed the Veterans Administration's (VA's) procurement of drugs and pharmaceuticals, medical equipment, and subsistence products through the multiple award schedule (MAS) program. Under the MAS program, commercial vendors negotiate with VA for the opportunity to sell medical and related supplies to VA and other agencies at discounted prices that are equal to or less than those offered their most favored customers. After agreements are reached on the supplies and discounted prices, medical units in VA and other agencies select required supplies from approved schedules and order directly from vendors. Over $497 million was expended under the MAS program during fiscal year 1982 and over 800 vendors had MAS contracts as of January 1983. The results of our review are summarized below and are discussed in detail in the enclosure.

SUMMARY OF FINDINGS

Our review disclosed that VA may not be obtaining the lowest prices possible under the MAS program because (1) prices offered by vendors are not fully analyzed, (2) inadequate and unreliable vendor-submitted data are used for negotiations, and (3) offers are frequently accepted without counteroffers or negotiations. Management of the MAS program is also hampered by the large volume of products and contracts. We believe program management can be improved by eliminating contracts with inadequate savings potential and products with limited sales. In addition, identifying products which could be procured competitively will result in more favorable contract terms. We also found that the format of the drug and pharmaceutical schedules does not provide customers with enough information to make buying decisions.

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RECOMMENDATIONS TO THE ADMINISTRATOR OF VETERANS AFFAIRS

To obtain the best discounts from the vendor's prices, we recommend that you direct the Veterans Administration Marketing Center (VAMKC) to

--obtain specific product discount information from vendors who now provide only the range of discounts given to their most favored customers,

--perform required price analyses utilizing all available information,

--establish specific price or discount negotiation objectives, and

--negotiate vendor offers, even though most favored customer status is the initial offer, when price analyses indicate that VA should obtain a lower price.

To reduce the number of contractors and product groups in the MAS program and allow VAMKC to efficiently use its staff resources, we recommend that you direct VAMKC to

--identify MAS products that can be procured competitively,

--eliminate product groups that fall below established sales volume criteria, and

--establish a negotiation objective that prevents awarding contracts that will not be cost effective.

To provide MAS program customers with more useful schedule information, we recommend that you direct the Assistant Deputy Administrator for Procurement and Supply to develop and maintain a combined generic and brand name schedule with unit costs for drug and pharmaceutical products.

AGENCY COMMENTS

VA officials generally agreed with our findings and recommendations and said that, based on our report, they would take action to strengthen the negotiation process and to reduce the number of contracts and product categories in the MAS program.

Concerning our recommendation to combine the generic and brand name drug and pharmaceutical schedules into one schedule, VA officials said similar proposals have been considered before, but were not implemented because of limited resources. They believe reformating the schedules would be useful and will attempt to address our recommendation as a long-range goal.

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As you know, 31 U.S.C. § 720 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director of the Office of Management and Budget, the Chairmen of the above committees, the Administrator of General Services, and other interested parties. We are also making copies available to others upon request.

Sincerely yours,

Richard L. Fogel

Richard L. Fogel
Director

Enclosure

VA'S MULTIPLE AWARD SCHEDULE PROGRAM

BACKGROUND

The VA Marketing Center (VAMKC) in Chicago, Illinois, is responsible for negotiating, awarding, and administering contracts for 11 multiple award schedules (MAS). Each schedule lists a number of vendors that will provide supplies under a particular product category at stated prices for a given period of time, similar to supply catalogs for drugs and pharmaceuticals, medical equipment, and subsistence products. VAMKC solicits proposals for indefinite quantity contracts for each product category and negotiates discounts off the vendors' commercial prices. VA and other agencies select the particular product that best meets their needs and order directly from the vendors. The MAS program was implemented to provide a wide selection of commercial products at prices lower than those available through open market purchases and make commercial items available when it is impractical to draft adequate specifications for competitive solicitations.

OBJECTIVES, SCOPE, AND METHODOLOGY

We reviewed the MAS program to determine if (1) VAMKC obtains fair and reasonable pricing arrangements from participating vendors, (2) the contracts and products provide adequate sales volume and savings potential, and (3) the schedules of the products provide information that the customers need to make buying decisions. We performed the review in accordance with generally accepted government audit standards.

Our review covered VAMKC's analyses of vendor offers and contract negotiations from July 1982 through January 1983. We chose this time period for review because VA implemented new MAS program operating procedures on June 28, 1982. During this time, offers were received and contracts were negotiated for 5 of the 11 MAS that VA administers. We reviewed VAMKC's analyses of offers and contract negotiations for four of the five schedules. We chose three of the larger dollar volume schedules and only one of the two smallest dollar volume schedules. This allowed us to evaluate the implementation of procedures in all three VAMKC divisions (Federal Supply Schedules, Drugs and Pharmaceutical, and Subsistence) that administer schedules.

We reviewed a random sample of 90 offers for 3 schedules and all offers for the fourth schedule. Our sample is described as follows:

VAMKC division	Schedule	Number of offers received	GAO sample size
Federal Supply Schedule	Medical/veterinary equipment and supplies	244	30
Federal Supply Schedule	Dental equipment and supplies	94	30
Drugs and Pharmaceuticals	Drugs and pharmaceuticals	246	30
Subsistence	Dietary supplements	6	6
Total		590	96

We evaluated VAMKC's analyses of offers and contract negotiations by comparing actual practice with MAS program operating procedures that were implemented on June 28, 1982. These procedures are based on a draft General Services Administration (GSA) MAS program policy statement issued in May 1982 that was formally adopted in October 1982. Our evaluation criteria also considered any revisions included in the final GSA policy statement. Where necessary, we discussed and clarified procedures followed in analyzing and negotiating a specific offer with the responsible contracting officer.

To determine if the schedules provide useful information to customer agencies, we interviewed VA supply and pharmacy officials at five medical facilities in Illinois, New Jersey, and Tennessee. We also contacted selected vendors for ideas on various alternative formats for the schedules.

BETTER DATA ANALYSES COULD PRODUCE LOWER PRICES

In negotiating MAS contract prices, VAMKC's goal is to obtain a discount from a vendor's catalog or commercial price list that is equal to or greater than the discount given the vendor's most favored customer (MFC). However, VA performs limited price analyses, uses inadequate and unreliable vendor-submitted data, and frequently fails to make counteroffers or to negotiate. As a result, VA may not be obtaining the lowest prices possible.

Negotiations are based on limited analysis and inadequate vendor-submitted data

By conducting a price analysis, VAMKC attempts to determine if the vendor's discount is at least as low as that granted the MFC. We found that most VAMKC price analyses only summarized and restated the vendor's offer and that VAMKC analyzed such essential information as pricing and discounting in only a few cases. Also, VAMKC was not aware of and, hence, did not use past pricing audits. This occurred because GSA formerly administered MAS for medical and related supplies and performed audits of the vendors. Audit reports issued by GSA during 1980 and 1981 on 31 current MAS vendors disclosed that 27 had failed to disclose all pertinent data. This problem should not recur, since VAMKC has initiated a vendor audit program. (See p. 8.)

VAMKC operating procedures, which conform to GSA policy on MAS, require that when contract terms offered to VA differ from terms given the vendor's MFC, the vendor should submit information establishing the value of these differing terms. Then, the VA contracting officer should analyze these terms and determine whether their valuation is reasonable. However, we found that the analyses were not being documented. For example, one vendor offered VA a 30-percent price discount and the payment of freight charges, while the vendor's MFC received a 40-percent discount and paid the freight charges. Although the vendor did not submit information establishing the value of freight charges, the VA contracting officer assigned a value equal to an 8 percent price discount and then, in conjunction with other factors, concluded that MFC status had been attained. As another example, a vendor offered discounts of 40 percent to the MFC and 38 percent to VA. MFC status for VA was attained by assigning a 15-percent discount for freight charges, but the VA contracting officer did not document the computation of the assigned value. We found other price analyses that valued freight charges from 5 to 10 percent which did not document the basis for the value used. When analyzing the value of freight charges, we believe VA should document how such factors as size and weight of the product and potential destinations were considered. VAMKC planned to initiate a study to determine a more realistic and consistent approach to the valuation of differing freight terms, in light of our findings.

Determining MFC status is further complicated because vendors often submit only the range of discounts given the MFC. They do not disclose the specific discount given on a particular product or even what group of products the discount range relates to, and VA's contract solicitation forms do not call for such data. For example, one vendor offered a 15-percent discount on 270 products. Although the vendor-submitted data indicated that the discount given its MFC ranged from 10 to 30 percent, it did not provide discount information on any specific product. VAMKC did not request additional discount information and awarded a contract based on the initial offer.

A price analysis should form the basis for developing a specific price discount negotiation objective. However, VAMKC did not establish a specific price or discount objective beyond the general concept of obtaining the vendor's MFC status and generally awarded a contract with no further negotiations when a vendor offered MFC status. Additional negotiations could increase savings when price analysis shows that the circumstances justify a lower price than the vendor's initial offer of MFC status. For example, one VAMKC division obtained additional estimated savings of $750,000 on one contract by negotiating a 10-percent discount, instead of the 2-1/2-percent discount offered, based on an analysis of Government sales volume and discount arrangements with other vendors who provide comparable products.

During our review, VAMKC instituted a policy to challenge every vendor offer, in an attempt to obtain greater discounts. The implementation of this policy should be accomplished by (1) analyzing available data in detail and (2) obtaining more specific discount information from vendors to substantiate a negotiation position.

Unreliable vendor data indicates the need for an effective vendor audit program

The vendor must report current and complete sales and marketing data to enable VAMKC to negotiate fair and reasonable prices. Although vendors must certify to the accuracy of data submitted, we found instances where the accuracy of vendor-submitted data was questionable. For instance, one vendor certified that VA was the only organization that received a discount. However, the vendor's price list to a local purchasing group showed that for 29 of the 51 identical products offered, VA pays an average of 9.6 percent more than the local purchasing group. Another vendor, who certified that VA is the vendor's MFC, provides significantly reduced prices on 52 of 58 identical products offered to the local purchasing group. Overall, VA paid an average of 36 percent more for the 52 items, and for the 10 products, paid more than double what the local purchasing group paid. Although the local purchasing group's contract terms may differ from VA's, these significant differences should be questioned.

These examples indicate the need for a vendor-audit program that will provide an effective method of monitoring the accuracy of vendor-submitted information. VAMKC implemented a vendor-audit program for fiscal year 1983 using GSA guidelines for requesting preaward audits. However, the guidelines resulted in audits being limited to only certain schedules, because other schedules did not have vendors with sales exceeding GSA's guidelines. At our suggestion, VAMKC established its own audit criteria to ensure that all schedules receive at least some audit coverage.

THE VOLUME OF CONTRACTS AND PRODUCTS HAMPERS PROGRAM MANAGEMENT

The MAS program has grown from about $372 million in fiscal year 1981 to almost $500 million in 1982. As of January 1983, over 800 vendors were providing supplies in 611 product categories to VA's medical facilities and other Government agencies. The potential savings associated with many of these contracts are not large enough to cover the cost to negotiate and administer contracts. Also some product categories with only limited sales are needlessly retained in the MAS program.

Retaining infrequently used products and awarding contracts with inadequate savings potential hamper VAMKC's ability to effectively manage the MAS program and to concentrate on negotiation efforts. Furthermore, VAMKC has not identified which products in the MAS program could be procured competitively under more favorable contract terms.

Contracts should provide potential savings that at least equal administration costs

Since the purpose of awarding a centralized contract is to reduce procurement costs in comparison to decentralized open market purchases, the potential savings should at least equal the costs to negotiate and administer the centralized contract. However, VAMKC officials said that they will award a contract if estimated Government sales of the item or items on the contract are at least $10,000 and the Government is offered MFC status, regardless of the potential cost savings.

VA data indicates that the average cost to negotiate and administer a MAS contract exceeds $1,000. However, we found that 19 of the 185 contracts on one schedule provided potential savings of less than $1,000. One contract provided savings of only $165 and two others provided no savings.

VA should consider following GSA policy of advising offerors that there is no guarantee that every offeror will receive a contract and that the potential savings will be considered in determining whether or not to award an MAS contract.

Low volume product categories should be eliminated

Although VA policy prohibits retention of an entire product category, which may include numerous items, on an MAS if anticipated Government purchases from the MAS will be less than $20,000, VA did not review product categories to eliminate those with sales below this level. For example, 18 of 81 product categories on the dental equipment schedule were retained even though projected sales indicated they would not meet the retention criteria. One retained product category had only $28 in projected sales. Furthermore, vendors often do not report sales by product categories as required, and VA officials do not attempt to obtain the information from the vendor. As a result, over $9 million in sales over a 9-month period was classified in a miscellaneous category on one schedule rather than specific product categories.

According to VAMKC officials, product categories are not carefully reviewed because of personnel limitations. During our review, VAMKC officials began stressing the importance of accurate sales data in award letters to vendors and reformated a quarterly sales report to show sales by product groups in an attempt to identify product categories that should be dropped from the MAS program.

VA needs to identify products that could be procured competitively

GSA policy emphasizes reducing the number of items procured through the MAS program and increasing the use of competitive procurement methods, such as the single award program. This policy recognizes that competition is the preferred method to achieve the most favorable contract terms. For example, GSA estimated savings of nearly $5 million by converting $100 million in MAS program purchases to competitive procurements.

VA has a similar policy to reduce the number of items procured through the MAS program, but it has not identified which products could be procured competitively. For example, currently VA has converted less than 1 percent of its $500 million in schedule contracts from multiple awards to competitive single awards. Although VAMKC officials said that they refined product categories, we noted that the latest solicitation for drugs and pharmaceuticals had fewer product categories, but more items in each category.

FORMAT OF DRUG AND PHARMACEUTICAL SCHEDULES NEEDS TO BE CHANGED TO MEET CUSTOMER INFORMATION NEEDS

The format of the drug and pharmaceutical schedules does not provide customers with enough information to make buying decisions. Changing the format of these schedules would provide useful information to customers, valuable data to contracting officers, and an incentive to vendors to reduce prices.

Currently, two schedules provide customers information on drug and pharmaceutical products available through the MAS program. One schedule, with an estimated sales volume of $43.5 million, lists generic products with their unit prices. The other schedule, for brand name items with an estimated sales volume of $242 million, lists only the name of the vendor who was awarded an MAS contract and has no product or price information. According to VA hospital officials, this schedule is virtually useless since they must go to individual vendor catalogs to determine product availability and cost. For example, one schedule has 106 vendors who were awarded contracts to supply pharmaceuticals and drugs.

We believe this process places an undue burden on most customers. Combining the two schedules into a single schedule that lists both generic and brand name items by unit cost would give customers better access to the information needed to compare prices.

In our May 1979 report 1/ on GSA's management of its MAS program, we noted that a major vendor complaint was the need to prepare and distribute costly catalogs to all customers. Combining the schedules would eliminate the need for separate catalogs, reduce vendors' cost, and provide an incentive to reduce prices. In discussing alternatives to the current drug schedule format, officials from two companies said they would offer greater discounts if their products were given greater visibility. If a vendor's products are shown in cost order with other products under the same nomenclature, we believe greater savings would occur over the long term. Furthermore, combining the schedule

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1/"Ineffective Management of GSA's Multiple Award Schedule Program--A Costly, Serious, and Longstanding Problem" (PSAD-79-71, May 2, 1979).

would highlight instances where VAMKC contracted for functionally similar or even identical items with more than one vendor. Corrective action could be taken, and the future occurrence of duplicate items could be eliminated.

The initial time and cost to combine the two schedules may be considerable. However, the maintenance cost would only include updating the information. We believe VA should consider developing a single schedule that would provide useful information to customers, valuable data to contracting officers, and an incentive to vendors to reduce prices.