

July 1986

GSA PROCUREMENT

Are Prices Negotiated for Multiple Award Schedules Reasonable?



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July 8, 1986

The Honorable William V. Roth, Jr.
Chairman, Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

In response to your January 11, 1985, request, we conducted a survey of the General Services Administration's (GSA's) price negotiations for multiple award schedule (MAS) contracts. On February 13, 1986, we discussed the results of our survey with your staff and agreed to issue this briefing report covering our work. The results are summarized below and detailed in appendix I.

Our survey centered on two issues in your January 11 letter requesting GAO to initiate a series of jobs regarding GSA's procurement practices and procedures:

--Does GSA follow existing laws and regulations when purchasing common-use goods and services for user agencies?

--Is GSA obtaining fair and reasonable prices when procuring goods and services?

The specific methodology used and limitations on the data collected are discussed on pages 4 and 5. Our work included reviewing 20 selected MAS contracts from the GSA's Federal Supply Service offices that awarded the largest dollar volume of MAS contracts in fiscal year 1984.

SURVEY RESULTS

GSA generally negotiated the MAS contracts we reviewed in compliance with existing laws and regulations within the degree of contracting officer discretion allowed by procurement regulations. In two areas where the regulations are very specific we noted that the negotiators sometimes did not fully comply with existing regulations. The areas were (1) contracting officers' determinations concerning the need for contractors to provide cost or pricing data in support of their proposed prices and (2) contracting officers' preparation of the price negotiation memorandum.

GSA uses a most-favored customer (MFC) policy as its standard for determining that MAS contract prices obtained are fair and reasonable. GSA's policy is to award MAS contracts only to offerors granting the government prices/discounts equal to or better than what the offerors' most-favored customers receive, i.e., the comparable customers who receive the best discounts from the offerors' commercial price lists. We found that in 19 of the 20 contracts we sampled, GSA negotiators obtained at least MFC pricing or justified obtaining less favorable prices. On the remaining contract, the negotiator improperly excluded educational institutions from MFC status and approved a contract that called for a lesser discount than educational institutions received.

While the prices GSA obtained on MAS contracts generally appeared to be fair and reasonable, we noted several actions that GSA could have taken to possibly obtain even better prices for MAS items. These actions, which we have discussed with GSA officials, were:

1. assuring adequate Inspector General (IG) audit coverage of offerors' price proposals;
2. having negotiators perform more thorough price analyses of offerors' price proposals by using additional price analysis techniques; and
3. having negotiators attempt to obtain the best possible prices.

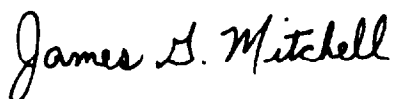
GSA has taken some actions to address the possible improvements we noted. For example, a training course has been created which addresses steps necessary for determining whether contractors should be exempt from submission of cost or pricing data, preparation of price negotiation memoranda, and setting of negotiation price objectives. On the issue of assuring adequate IG audit coverage of offerors' proposals, GSA is aware of the situation, and an IG official told us that GSA has shifted resources to provide additional contract audit coverage.

As you requested, we did not obtain official agency comments but we obtained the views of GSA officials throughout the review. Their views have been incorporated in this briefing report where appropriate.

As arranged with your office, unless you publicly announce its contents or authorize its release sooner, no further distribution of this report will be made until 30 days from its issue date. At that time, we will send copies to the GSA Administrator and other interested parties and make copies available to others on request.

Should you need additional information on these matters, please call William F. Engel of my staff on 275-4407.

Sincerely yours,



James G. Mitchell
Senior Associate Director

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ABBREVIATIONS

FAR	Federal Acquisition Regulation
FSS	Federal Supply Service
GAO	General Accounting Office
GSA	General Services Administration
IG	Inspector General
MAS	Multiple Award Schedule
MFC	Most-Favored Customer
PNM	Price Negotiation Memorandum

The Federal Property and Administrative Services Act of 1949 established the General Services Administration (GSA) to give the federal government a system for procuring and supplying personal property and nonpersonal services. GSA, through its Federal Supply Service (FSS), makes common-use items available to federal agencies through three basic buying programs: (1) Federal Supply Schedules, (2) stores (depot stock), and (3) nonstores (special order). Federal Supply Schedules consist of both multiple award schedules and single award schedules. The multiple award schedule (MAS) program is the largest FSS purchasing program. In fiscal year 1985, the program consisted of 3,311 contracts with sales of about \$2.3 billion. Our survey consisted of evaluating 20 selected MAS contracts with estimated sales of about \$204 million (see p. 21).

MULTIPLE AWARD SCHEDULE OVERVIEW

Under the MAS program, FSS awards indefinite-quantity contracts to various vendors for particular commercially available product categories such as office furniture, scientific equipment, and library services. Prices are based on negotiated discounts from vendors' commercial price lists. Agencies may use these contracts to obtain such goods and services. The purpose of the program is to (1) decrease agency open-market purchases by offering a wide selection of commercial products at prices lower than available through open-market purchases and (2) make commercial items available to agencies when it is impractical to draft adequate specifications for bids.

MAS contracts are awarded to contractors based on the results of price negotiations between FSS negotiators and individual contractors. FSS's goal when negotiating MAS contracts is to obtain discounts from a contractor's commercial price list which are equal to or greater than that contractor's most-favored customer's (MFC's) discounts. The MFC is that customer who receives the best discounts from the contractor's commercial price list when purchasing quantities comparable to the government's under similar terms and conditions. Contracts are negotiated by either FSS's contracting officers or contract specialists.¹

OBJECTIVES, SCOPE, AND METHODOLOGY

In a January 11, 1985, letter the Chairman, Senate Committee on Governmental Affairs, asked us to review several issues concerning GSA's procurement practices and procedures. This assignment focused on two of the issues in the Chairman's request letter:

¹ In this report, we will refer to both contracting officers and contract specialists as "negotiators."

--Does GSA follow existing laws and regulations when purchasing common-use goods and services for user agencies?

--Is GSA obtaining fair and reasonable prices when procuring goods and services?

Our objectives were to respond to the above issues and, if appropriate, to provide our observations on ways GSA could improve its price negotiations. We are addressing the other issues in separate studies.

We judgmentally selected and reviewed 20 contracts awarded by two FSS commodity centers at the central office in Arlington, Virginia, and FSS's Boston Office. These locations were selected because they awarded the largest dollar volume of MAS contracts in fiscal year 1984. The estimated sales for the selected contracts were about \$204 million and 18 of the contracts were awarded during fiscal year 1985.² Our sample is not statistically valid and cannot be projected to the universe of FSS contracts. In selecting the 20 contracts for review, we considered a number of factors such as the amount of the contract, the type of product and service procured, period of time covered by the contract, whether a preaward or postaward audit was done, and whether the contract was reviewed by one or more of GSA's internal review groups. The table on page 14 provides information on the dollar value and contract period for each of the 20 contracts we reviewed.

We used a structured data collection instrument to systematically review the 20 contract files, conducted structured interviews with contract negotiators, and interviewed GSA and FSS officials who review the contracts before they are awarded. We reviewed applicable laws, regulations, and agency policies and procedures. To further understand these and other procurement matters, we also attended GSA's 1 week price negotiations course. This new course addresses agency-recognized negotiation problems.

Our work was performed from June 1985 through March 1986, and it was conducted in accordance with generally accepted government auditing standards.

THE PRICE NEGOTIATION AND CONTRACT REVIEW PROCESS

Price negotiation steps

FSS solicits proposals from prospective contractors for its MAS program. When negotiators receive these proposals, they follow four basic steps in preparing for and conducting

² The exceptions were two contracts awarded during fiscal year 1984 for a 3-year period.

negotiations: (1) analyze the offer, (2) establish negotiation objectives (i.e., discounts, terms, and conditions based on price analysis), (3) conduct negotiations, and (4) prepare the price negotiation memorandum (PNM). To analyze the offer, negotiators review in detail the data submitted by prospective contractors, determine if they need to have the prospective contractors submit cost or pricing data to support their proposed prices, and analyze prices and discounts offered to determine their reasonableness.

Negotiators may also request the GSA Inspector General to audit the contractor's submitted pricing data when they believe that an audit is needed. To determine whether an audit should be requested the negotiator will consider (1) whether cost or pricing data are required, (2) the dollar value of the contract, (3) the contractor's past performance, and (4) whether any sensitive or unusual conditions exist.

Negotiators establish negotiation price objectives based upon the results of the offer analysis. GSA's goal is to obtain discounts from commercial price lists equal to or better than an offeror's discounts to its most-favored customer. Negotiators meet with the prospective contractors and reach agreement on the price. At the conclusion of negotiations, negotiators prepare a memorandum summarizing the principal elements of the negotiations, such as a summary of the offer, information pertinent to the price negotiations, and the parties involved in negotiation.

Contract review process

After the price negotiation memorandum is prepared, the contract proposal may undergo several reviews before a contract is awarded, as illustrated in the chart on page 15. GSA's contract review and approval process calls for a preaward review of proposed contracts to ensure that the contracts conform to applicable laws, regulations, and established policies and procedures and that contract conditions represent sound business judgment. Agency officials conducting the preaward reviews are qualified as contracting officers and are selected because of demonstrated procurement proficiency and sound business judgment. They completely review proposed contracts and pay particular attention to the proposed pricing. Reviewers attach memoranda to the proposed contract files either approving or disapproving contracts. The memoranda include conditions or points for negotiators to consider on a particular contract and/or future price negotiations.

FSS IS GENERALLY ADHERING TO LAWS AND REGULATIONS

The Federal Property and Administrative Services Act of 1949, as amended by various laws, permits GSA to award MAS contracts that are used by federal agencies to obtain needed common-use items at established prices. The Federal Acquisition Regulation (FAR) is the primary regulation GSA uses when

negotiating MAS contracts. The FAR was developed in accordance with the Office of Federal Procurement Policy Act of 1974, as amended. GSA's 1982 MAS policy memorandum supplements the FAR by addressing specific contract pricing policies.

Both FAR and GSA's MAS policy outline specific steps that negotiators should follow when conducting negotiations; however, much of how to conduct these steps is left to the discretion of the negotiator. For example, the FAR states that the contracting officer is responsible for selecting and using whatever price analysis techniques that will ensure a fair and reasonable price. The FAR also states that negotiators should be allowed wide latitude to exercise business judgment.

The 20 contracts we reviewed were generally negotiated in compliance with existing laws and regulations within the degree of negotiator discretion allowed by procurement regulations. In two areas where the FAR is very specific as to negotiation steps, we noted that the negotiations sometimes did not fully comply with existing regulations in the following areas: (1) contracting officer determinations concerning the need for contractors to provide cost or pricing data in support of their proposed prices and (2) contracting officers' preparation of the PNM.

Opportunity to improve tests
that determine whether cost
or pricing data is needed

The FAR requires contractors to submit and certify the accuracy of cost or pricing data for all negotiated contracts with solicitations in excess of \$500,000 issued prior to April 1, 1985, and \$100,000 for solicitations issued after March 31, 1985. However, our sample cases showed that it was normal for the negotiator to exempt the contractor from this requirement. This exemption is permitted when the prices of items are determined to be (1) based on established catalog or market prices, (2) sold as commercial items, (3) sold in substantial quantities, and (4) sold to the general public. Before issuing the exemption, the negotiator must ensure that all four preceding conditions apply. In our cases where exemptions were granted it was readily apparent from documentation in the contract files that conditions 1, 2, and 4 were met. However, to determine if condition 3 was met, it was necessary to perform two additional tests.

Of the 20 contracts reviewed, contractors for 16 were exempted from having to submit and certify their cost or pricing data because the four conditions stated above were met, contractors for 2 contracts submitted and certified their cost

or pricing data, and the dollar values of 2 contracts were too low to require the submission and certification of cost or pricing data. We found that in 7 of the 16 contracts where exemptions were granted, the negotiator did not adequately determine whether the items were sold in substantial quantities. The primary cause was that negotiators were not completing the tests to determine that substantial quantities had been sold. Where adequate data was available (6 of the 7 contracts) we analyzed the data and determined that each contractor would have been exempted from the cost or pricing data requirement if the negotiator had completed the tests. Therefore, these omissions did not affect granting exemptions for cost or pricing data.

GSA's Office of Acquisition Management and Contract Clearance has criticized FSS negotiators for not completing the required tests to determine if cost or pricing data is required. It pointed out that not completing the tests may incorrectly indicate that the offeror should be exempt from the requirement to submit cost or pricing data.

We believe that any exemption to the cost or pricing data requirement is an important action and that contract files including the PNM should contain sufficient information to clearly justify such exemptions. We discussed this issue with FSS negotiators and agency officials, and they agreed to conduct and document the tests in all future analyses. FSS officials told us that a software package has been developed and is being used to assist negotiators in making this determination.

Opportunity to improve price negotiation memoranda

The FAR requires the negotiator, at the conclusion of negotiations, to prepare a PNM containing the principal elements of the negotiation. These elements include a summary of the offer; support for any cost and pricing waivers; reference to, or inclusion of, price analyses; significant facts relating to negotiation price objectives and the negotiated price; and the names and positions of each individual involved in the negotiations. We found that, although most PNMs (for 17 of the 20 contracts reviewed) adhered to the FAR requirements, 3 did not fully comply. One PNM did not include a summary of the offer, negotiation results, or reference to or inclusion of a price analysis. Another PNM did not include support for the waiver granted for cost or pricing data. The remaining PNM did not contain a complete discussion of product lines. One reason FSS gave us for these deficiencies was that the negotiator could not locate some of the information.

We believe that preparing PNMs in accordance with existing requirements is important because the PNM is a primary record of information when attempting to determine whether prices received are reasonable.

GSA GENERALLY OBTAINED
FAIR AND REASONABLE PRICES

We found that FSS negotiators generally obtained prices equal to or better than those contractors were offering their MFCs or followed GSA policy in justifying obtaining prices less favorable than the MFCs were paying. For 15 of 20 contracts, FSS negotiators obtained MFC prices or better. In four cases, negotiators justified less-favorable prices within the parameters permitted by procurement regulations. The remaining contract was awarded even though it did not comply with GSA policy because educational institutions were obtaining the items at prices lower than those offered GSA. More details on the five cases where MFC prices were not obtained appear below.

The FAR assigns sole responsibility to the negotiator for obtaining prices that are "fair and reasonable." GSA, in turn, interprets the FAR for its negotiators through its MAS policy which sets some parameters for negotiators. The MAS policy requires the negotiator to affirmatively determine that prices are fair and reasonable. Additionally, it states that GSA's goal when negotiating contract awards is to obtain discounts on prices that are equal to, or greater than, those given to the firm's MFC. According to the MAS policy, negotiators may also award MAS contracts where the government's discount is not as good as the MFC's if factors making the government different from the MFC are adequately valued--i.e., if factors and their valuations are deemed reasonable by the negotiator.

In four of the five contracts where MFC pricing was not obtained, negotiators justified their acceptance of prices that were less favorable than MFC prices in accordance with the MAS policy. The policy allows negotiators to accept discounts for the government which are less favorable than those given to distributors, participating dealers, and original equipment manufacturers. These customers, in effect, add value to the product either by changing it physically or by performing services, such as sales, marketing, or overhead functions. Therefore, the customers are entitled to better discounts than the government since the government does not contribute similarly to the item's value. In these four contracts negotiators determined that the government was not entitled to MFC prices because they judged distributor and participating dealer factors and the valuation of these factors as reasonable.

In the remaining contract the negotiator exempted educational institutions from MFC price comparisons; however, educational institutions should be included in MFC price comparisons under the current MAS policy. The negotiator excluded educational institutions from MFC consideration, citing both a proposed revision to the MAS policy which would exclude them and FSS management's approval of excluding them in the past. We believe that the negotiator should have followed current policy and included the discounts given to educational institutions when determining whether the government received

the MFC price. GSA agreed that current policy requires considering educational institutions as MFCs, however, officials pointed out that this will be changed if the proposed revision to the MAS policy is approved.

FSS PRICE NEGOTIATIONS
COULD BE IMPROVED

During our survey we noted several areas where price negotiations for MAS contracts could have been improved but GSA has initiated actions to realize such improvements. The areas noted were:

- assuring adequate IG audit coverage of offerors' price proposals,
- having negotiators perform more thorough price analyses of offerors' price proposals by using additional price analysis techniques, and
- having negotiators attempt to obtain the best possible prices.

We found that GSA's Office of Acquisition Management and Contract Clearance identified similar weaknesses in the negotiation process during its reviews. A price analysis training course has been developed which addresses the price negotiation process. FSS plans to have all of its negotiators attend the course which was first offered in October 1985. As of May 1986, some FSS negotiators have attended the course. We were also told that GSA has taken action to provide needed contract audit coverage.

IG preaward audits of MAS contracts
are useful but decreasing at FSS

Negotiators rely on contractors to supply them with accurate information on which to base negotiations, such as sales data and discounts provided to other customers. IG audits are the means for assuring that the offeror-supplied data are current, accurate, and complete. We found that preaward audit coverage of MAS contracts has decreased in recent years.

Preaward audits by the GSA IG had been conducted for 7 of the 20 contracts we examined in our survey. Two other IG audits were requested by negotiators but were not performed because resources were not available or the contractor had recently been audited by the IG. Another negotiator told us she did not request an audit because she believed the "turnaround" time would have been too long.

We saw evidence that preaward audits are often useful to negotiators. For instance, the seven preaward audits conducted for the contracts we reviewed disclosed discrepancies in contractor data and other useful information. For one contract, the contractor understated the discounts given to its commercial customers. The IG concluded that the data submitted on this contract was neither current, complete, nor accurate.

Another indication of the usefulness of preaward audits was contained in a recent IG report to the Congress. The report referred to a preaward audit that disclosed an overstatement of unit costs by 21 percent. This information resulted in the negotiator being successful in avoiding expenditures of over \$2.6 million. Also, prior GAO reports³ have addressed the need for preaward audits and these reports indicate that limited audit coverage has been a continuous problem for contracting officers in conducting negotiations.

Although IG preaward audits of MAS contracts have been useful, the amount of such effort at FSS decreased from fiscal years 1984 to 1985: (1) the number of audits decreased from 114 to 50, (2) dollars reviewed decreased from \$988 million to \$426 million, (3) the recommended cost avoidance declined from \$54 million to \$19 million, and (4) the audit hours were reduced from 21,000 to 10,000. IG officials told us that the decreases were due to reductions in IG staff, a shift in resources to audits of higher dollar value contracts in the ADP area, and the change at FSS from single-year to multiple-year contracts.

We are concerned that if preaward audit efforts continue to decrease, the extent of MAS preaward audits may diminish to the point where contractors face little risk when submitting inaccurate or incomplete data. GSA is aware of this situation and is trying to increase contract audits. We were told steps have been taken to provide adequate audit coverage including a shift of resources from other GSA offices to the IG, a shift in IG internal resources to contract audit, and an increased IG budget in fiscal year 1987 despite decreases elsewhere in GSA.

Negotiators could use additional price analysis techniques

The FAR and MAS policy suggest techniques that negotiators may use in performing price analyses and setting negotiation objectives, but negotiators are permitted discretion as to the

³ Federal Supply Service Not Buying Goods At Lowest Possible Price (March 4, 1977, PSAD-77-69) and Ineffective Management Of GSA's Multiple Award Schedule Program--A Costly, Serious, And Long-Standing Problem (May 2, 1979, PSAD-79-71).

techniques they choose to use. We found that negotiators were using techniques such as making comparisons to previous contract terms and, in seven cases, using preaward audit results, but certain suggested techniques were consistently not applied. We believe that GSA negotiators could use these additional techniques to make more informed decisions when setting negotiation objectives and thereby strengthen the government's negotiating position. These techniques include:

- a net price evaluation, which is a comparison of commercial prices less applicable discounts between contractors offering identical or similar items; and

- a trend analysis of price changes, which could be done using indices such as the Producer Price Index, other market indicators, and price changes in similar products offered by other companies.

Negotiators generally did not apply these price analysis techniques in the cases we reviewed because they believed either that the analyses were not necessary or they did not have enough time to conduct them.

One of the 11 negotiators we interviewed performed net price evaluations to ensure that net prices (commercial prices less discounts) were comparable or reasonable among contractors offering similar items. Several negotiators recognized the worth of such comparisons and one stated that in the future she would research both the company and the product market better to get additional information on contract items. Several FSS officials told us that net price evaluations are not practical given the amount of time the negotiator has to prepare for negotiations. We agree that it may not be practical in all instances; however, we believe that making more net price comparisons of similar items, perhaps on a "spot-check" basis, could improve negotiations.

None of the negotiators we interviewed performed a trend analysis of price changes. We were advised by FSS that these analyses are unnecessary because the prices of commercial items are established by competition in the marketplace. An analysis of trends in prices of the items under negotiation could help the negotiator establish price reasonableness as called for by the FAR and MAS policy. The negotiator's increased market knowledge from such analysis would aid the negotiator in establishing a stronger negotiation position.

GSA's Office of Acquisition Management and Contract Clearance has commented that trend analyses, such as comparisons with changes in the Producer Price Index, should be made when prices change from previous procurements. The GSA IG agrees that any techniques the negotiator can use to enhance his/her knowledge of the items and their market, such as net price evaluations and trend analyses of price changes, would aid the negotiator in (1) assuring that the government is being

offered prices that are fair and reasonable and (2) establishing achievable negotiation objectives. GSA's new price analysis training course also covers various trend analysis techniques which negotiators may use.

Negotiators may not obtain
the best possible prices

Negotiators could better prepare themselves for negotiations by exercising better business judgment when analyzing prices and consequently setting negotiation objectives.

According to FSS policy officials and negotiators, contracting officer discretion is vital to contract negotiations. Since all contracts are not alike, many combinations of techniques can be used to arrive at an end price which is reasonable. Office of Acquisition Management and Contract Clearance officials believe that allowing negotiators to use professional discretion demands that they apply sound business judgment to each negotiation situation. They believe negotiators often do not demonstrate such judgment and consider this an area where improvements can be made by pursuing the best possible prices/discounts. GSA's new training course addresses the importance of establishing proper negotiation objectives.

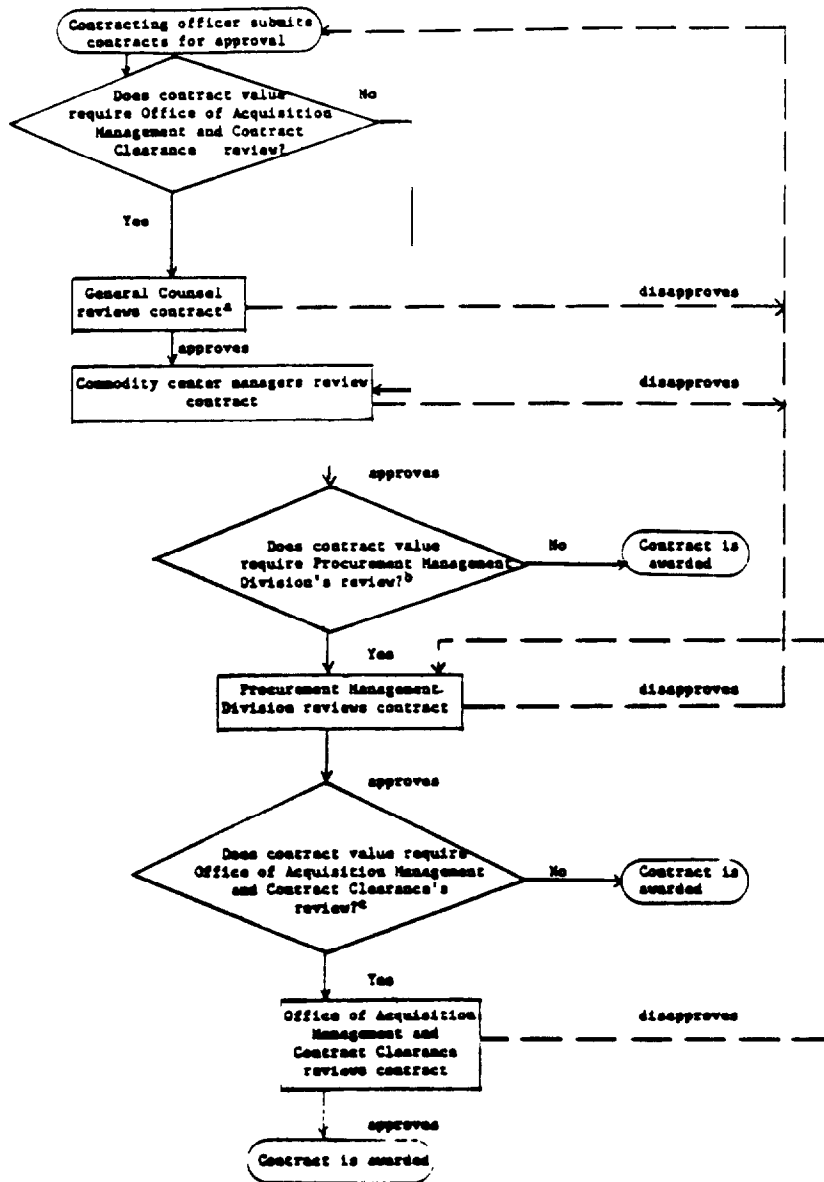
In the cases we reviewed, we noted instances where better business judgment might have improved negotiations by encouraging negotiators to obtain better prices. We also found that letters written by the Office of Acquisition Management and Contract Clearance had identified instances where negotiators had not used sound business judgment. In these cases the review group had negotiations reopened and as a result the government received better prices. For instance, in one contract where the review group found that the government was not offered discounts comparable to the MFC, the reopening of negotiations resulted in an estimated savings of \$1.6 million. In another case the contracting officer was successful in obtaining an additional 3-percent discount from the contractor's catalog prices.

ESTIMATED SALES VALUE AND TERM
OF CONTRACTS THAT WE REVIEWED

<u>Central Office awards</u>			<u>Regional awards</u>		
<u>Contract number</u>	<u>Estimated sales (\$ millions)</u>	<u>Contract term^a (years)</u>	<u>Contract number</u>	<u>Estimated sales (\$ millions)</u>	<u>Contract term^a (years)</u>
1	2.6	2	11	1.6	3
2	2.1	3	12	1.9	1
3	21.2	3	13	.1	1
4	.5	3	14	93.0	3
5	2.5	2	15	5.2	3
6	34.8	3	16	.3	1
7	.5	1	17	9.0	3
8	5.8	3	18	1.0	2
9	13.7	3	19	1.2	2
10	4.8	3	20	2.0	1
	<u>\$88.5</u>			<u>\$115.3</u>	
			TOTAL	<u>\$203.8</u>	

^a Term rounded to nearest year.

FLOWCHART OUTLINING FSS CENTRAL OFFICE
PREAWARD CONTRACT REVIEW AND APPROVAL PROCESS
FOR MAS CONTRACTS



- ^a General Counsel review is required for all contracts reviewed by Office of Acquisition Management and Contract Clearance.
- ^b FSS's Procurement Management Division reviews contracts that meet or exceed \$2,000,000 for furniture purchases and \$3,000,000 for office and scientific equipment purchases.
- ^c GSA's Office of Acquisition Management and Contract Clearance reviews contracts that meet or exceed \$3,000,000 for furniture purchases and \$6,000,000 for office and scientific equipment purchases.

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