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Report to the Committee on Government
Reform, House of Representatives

June 2004

CONTRACT MANAGEMENT

Further Efforts Needed to Sustain VA's Progress in Purchasing Medical Products and Services



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Highlights of [GAO-04-718](#), a report to the Committee on Government Reform, House of Representatives

Why GAO Did This Study

The Department of Veterans Affairs (VA) provides healthcare to millions of veterans at VA's medical centers and healthcare facilities across the country. To support veterans, VA manages a Federal Supply Schedule (FSS) program and a national contract program. Both use VA's sizeable buying power to provide VA and other federal agencies discounts on medical products and services. To cover its costs in running the FSS program, VA charges its customers a user fee.

Although sales through VA's FSS and national contracts totaled almost \$7 billion in fiscal year 2003, concerns have been raised about the efficiency of these contract programs. GAO was asked to determine whether the FSS and national contracts have provided medical products at favorable prices and to identify opportunities to improve purchasing practices and increase savings. GAO was also asked to determine if VA's user fee is sufficient to cover program cost.

What GAO Recommends

GAO recommends that VA use its buying power to obtain more favorable prices for healthcare services, and strengthen oversight to ensure its medical centers obtain the best available prices. GAO also recommends that VA identify the complete cost of the FSS program and reassess its user fee to see if it needs to be adjusted. VA concurred with GAO's recommendations.

www.gao.gov/cgi-bin/gettrpt?GAO-04-718.

To view the full product, including the scope and methodology, click on the link above. For more information, contact David Cooper at (202) 512-4841 or cooperd@gao.gov.

CONTRACT MANAGEMENT

Further Efforts Needed to Sustain VA's Progress in Purchasing Medical Products and Services

What GAO Found

The more than 1,200 FSS and 330 national contracts that VA has awarded have resulted in more competitive prices and have yielded substantial savings. VA has achieved these favorable prices and savings, in part, by exercising its audit rights and access to contractor data to pursue best prices aggressively for medical supplies and services. For example, pre-award audits of vendors' contract proposals and post-award audits of vendors' contract actions resulted in savings of about \$240 million during fiscal years 1999 to 2003. VA has also taken steps to further leverage its buying power on widely used healthcare items—such as pharmaceuticals and high-tech medical equipment—through its national contracts. According to VA, its national pharmaceutical contracts have led to a cost avoidance of \$394 million in fiscal year 2003. However, VA has not taken the same aggressive approach to negotiate more competitive prices for healthcare services, such as radiology. In fiscal year 2003, healthcare services totaled about \$1.7 billion, yet VA facilities only purchased about \$66 million through VA FSS contracts. Instead, most medical healthcare services are purchased through contracts that individual VA medical centers have negotiated, a process that may not provide the most favorable prices.

VA could also realize additional savings through improved medical center purchasing practices. Despite increases in medical centers' FSS purchases—which more than doubled between fiscal years 1999 and 2003—medical centers have not always taken advantage of the best prices available through VA's contracts. For example, in fiscal year 2001, a VA Inspector General (IG) report stated that VA medical centers frequently purchased healthcare products from local sources, instead of from available FSS contracts. Although VA has since implemented policies and procedures that generally require its medical centers to purchase medical products and services through VA's contract programs, a more recent VA IG report found that medical centers continued to make purchases from local suppliers. The VA IG estimated that, with improved procurement practices at medical centers, VA could save about \$1.4 billion over 5 years. However, ensuring VA medical centers comply with VA's purchasing policies and procedures will be a challenge for VA, in part, because its monitoring of purchases lacks adequate rigor.

The user fee that VA collects on FSS purchases—0.5 percent of sales—is expected to approximate the program costs. VA, however, does not have complete information on the costs to administer the FSS program. Without this cost data, VA is unable to know whether it is charging an appropriate user fee.

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Abbreviations

BPA	Blanket purchase agreement
FSS	Federal Supply Schedule
IG	Inspector General
VA	Department of Veterans Affairs

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United States General Accounting Office
Washington, DC 20548

June 22, 2004

The Honorable Tom Davis
Chairman
The Honorable Henry A. Waxman
Ranking Minority Member
Committee on Government Reform
House of Representatives

In fiscal year 2003, the Department of Veterans Affairs (VA) spent over \$26 billion to provide healthcare to 4.5 million veterans at VA's medical centers and other VA healthcare facilities across the country. To provide healthcare services for veterans, VA operates a Federal Supply Schedule (FSS) program, which provides VA and other federal agencies access to over 1,200 contracts for buying medical products¹ and services from a wide range of vendors. Vendor prices are expected to be at least as good as those offered to the vendors' most favored customers.² To cover the cost of operating the FSS program, VA charges its customers a user fee. Once VA has awarded an FSS contract for a medical product, it looks for opportunities to award a national contract that can provide even better prices. In fiscal year 2003, VA sales through the FSS program were \$6.2 billion, and sales from national contracts were \$712 million.

As one of the largest buyers of medical equipment, products, and services, VA has the ability to realize significant savings and achieve management efficiencies by leveraging its vast purchasing power. At your request, we reviewed VA's contract programs. Specifically, you asked us to (1) determine whether VA's FSS and national contracts provide medical products at favorable prices and achieve savings, (2) identify opportunities to improve purchasing practices and increase savings at VA medical centers, and (3) determine if the FSS user fee is sufficient to cover the program's costs.

¹ Medical products include medical and surgical supplies as well as equipment and pharmaceuticals.

² Most favored customer pricing refers to the vendor's best price based on the evaluation of discounts, terms, conditions, and concessions that are offered to commercial customers for similar purchases. The pursuit of most favored customer pricing is consistent with the objective of negotiating a fair and reasonable price.

To conduct our work, we reviewed VA's policies, procedures, and internal controls associated with awarding and administering FSS and national contracts. We also reviewed a May 2002 report by VA's Procurement Reform Task Force and determined the status of VA's implementation of task force recommendations to improve procurement practices across VA. We met with officials from procurement and financial management activities at VA Headquarters and officials at the National Acquisition Center, which is responsible for managing both the FSS program and the national contracts program. We conducted our review from July 2003 through April 2004 in accordance with generally accepted government auditing standards. A more detailed discussion of our scope and methodology is at the end of the letter.

Results in Brief

VA's FSS and national contracts generally provide favorable prices and have achieved savings—in part, because VA has built into its contracts important clauses that allow it to aggressively pursue best prices for medical products and services. For example, through its FSS contracts, VA exercises audit rights and access to contractor data, which have helped VA negotiate better prices and achieve savings totaling about \$240 million from fiscal years 1999 to 2003. Consistent with a prior GAO recommendation, VA has also emphasized using national contracts to standardize and further leverage VA's buying power on widely used healthcare items, such as pharmaceuticals, medical supplies, and high-tech medical equipment.³ According to VA officials, VA plans to expand the use of national contracts to negotiate even better prices. However, VA could achieve additional savings. For example, to date, VA has rarely used its contracting programs to leverage its buying power when acquiring healthcare services. In fiscal year 2003, these services totaled about \$1.7 billion, yet VA only purchased about \$66 million through VA FSS contracts. Instead, most healthcare services are currently contracted for by individual VA medical centers, a process that may not result in the centers receiving favorable prices.

VA also has opportunities to improve purchasing practices and increase savings at its medical centers. Most notably, VA medical centers have not always taken advantage of the best prices available through FSS and

³ U.S. General Accounting Office, *DOD and VA Pharmacy: Progress and Remaining Challenges in Jointly Buying and Mailing Out Drugs*, [GAO-01-588](#) (Washington, D.C.: May 25, 2001).

national contracts. In fiscal year 2001, a VA audit report stated that VA medical centers frequently purchased healthcare products from local sources instead of from an FSS contract, in part because FSS contracts were not used as a primary source of supply. In response to the Procurement Reform Task Force's May 2002 recommendations, VA implemented purchasing policies and procedures that require its medical centers to use VA's contracts, to the extent feasible, to purchase medical supplies and services. However, a March 2004 VA audit report found that medical centers have continued to make purchases from local suppliers, indicating that VA's oversight of medical center purchasing may not be sufficient to ensure that centers comply with its purchasing policies and procedures. The audit report estimated that VA could save about \$1.4 billion over 5 years by using FSS and national contracts with more favorable prices.

To operate the FSS program, VA is supposed to identify all program costs and charge a fee to its customers to recover these costs. Currently, VA charges FSS users a fee of 0.5 percent of sales. VA, however, does not have complete information on the costs to administer the FSS program. While VA maintains FSS data on some program costs, it has not identified the amount of the FSS fees associated with each of the activities that support the program.

To improve VA procurement practices, we are recommending that VA take steps to (1) explore opportunities to use its buying power to obtain more favorable prices for healthcare services, (2) strengthen oversight to ensure medical centers use FSS and national contracts to get the best prices available, and (3) identify the complete cost of the FSS program and reassess its user fee to determine if it needs to be adjusted. In commenting on a draft of this report, VA agreed with GAO's conclusions and concurred with its recommendations. VA's comments are included in appendix II.

Background

VA operates one of the world's largest healthcare systems.⁴ In fiscal year 2003, VA spent about \$26 billion to provide healthcare to 4.5 million veterans. More than 1,300 VA healthcare facilities, which include 160 medical centers, provide a range of medical, surgical, outpatient, rehabilitative, and long-term care products and services. Between fiscal years 2001 and 2003, VA experienced over a 15-percent growth in the number of patients treated.

The General Services Administration established the FSS program in 1949 to facilitate federal agencies' acquisition of products and services from commercial suppliers through schedule contracts. In 1960, the General Services Administration delegated authority to VA to manage and award FSS contracts for all medical products and services needed throughout the federal healthcare system. VA currently operates eight schedules that cover a wide range of medical products and services. (See app. I for a complete list of the schedules.) In addition, VA currently has two new schedules under consideration. The first, laboratory tests, will be an expansion of VA's "clinical analyzers" schedule and will be used for off-site tests such as cytology, pathology, and endocrinology. The second schedule, "home infusion," will be used for intravenous services at nonmedical facility sites, such as patients' homes. VA projects that these two schedules will be available by the end of fiscal year 2004.

Currently, VA has over 1,200 FSS contracts in place for the eight schedules. These FSS contracts are available for use by all government agencies, including VA, the Department of Defense, Bureau of Prisons, Indian Health Services, Public Health Services, and some state veterans homes. All schedules are multiple award contracts with performance periods up to 5 years, under which many vendors that meet all competition requirements have contracts to sell products and services to the federal government. For example, under the pharmaceutical schedule, all manufacturers of aspirin can have a contract to sell their products to government agencies.

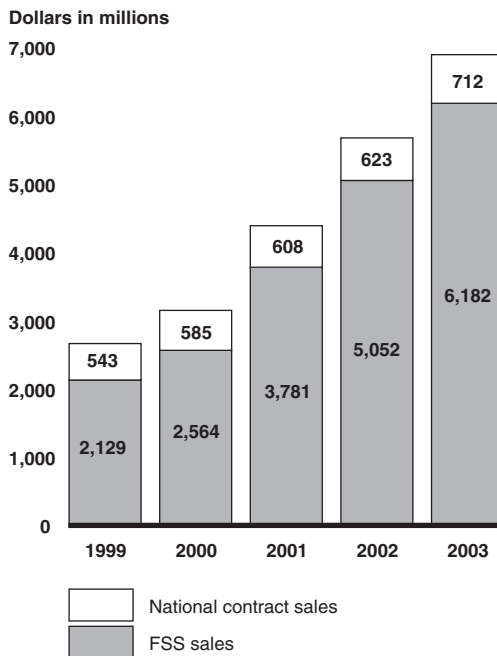
Since 1993, VA has been competitively awarding national contracts with vendors for a larger discount based on volume purchasing. As of April 2004, VA had about 330 national contracts. National contracts are

⁴ U.S. General Accounting Office, *VA and Defense Health Care: Potential Exists for Savings through Joint Purchasing of Medical and Surgical Supplies*, [GAO-02-872T](#) (Washington, D.C.: June 26, 2002).

best suited for products that are widely used and where competition is practical, such as pharmaceuticals and basic surgical supplies, and where clinicians are likely to agree to standardized product use across all VA medical centers. A national contract may also include requirements of other federal agencies such as the Department of Defense.

Since 1999, VA's FSS and national contract sales have steadily grown (see fig. 1).

Figure 1: FSS and National Contract Sales, Fiscal Years 1999 through 2003



Source: VA data.

VA medical centers account for more than half of all VA FSS sales. In fiscal year 2003, for example, VA medical center purchases represented \$3.9 billion, or over 63 percent, of the \$6.2 billion in total sales from VA's schedule contracts. While purchases from national contracts were much less than those from the schedules—totaling approximately \$712 million in fiscal year 2003—VA medical centers accounted for about \$591 million, or 83 percent, of the purchases from these contracts.

VA's National Acquisition Center is responsible for awarding and administering FSS and national contracts. The National Acquisition Center negotiates contracts, seeking to leverage VA's overall government buying

power by achieving pricing and terms equal to or better than those a vendor offers its most favored customers. Vendors submit offers to the National Acquisition Center, and contracting officers perform price analyses to arrive at a fair and reasonable price.⁵ Once the contracts are in place, it is then up to the purchasing offices at the VA medical centers to buy products and services from the schedules.

In fiscal year 2001, the VA Inspector General (IG) issued a report that expressed significant concerns about the effectiveness of VA's acquisition system.⁶ As a result, the Secretary of Veterans Affairs established, in June 2001, a Procurement Reform Task Force to review VA's healthcare procurement system. In its May 2002 report, the task force set five major goals that it believed would lead to improvements in VA's acquisition system: (1) leverage purchasing power, (2) standardize commodities in VA, (3) obtain and improve comprehensive procurement information for better decision making, (4) improve the effectiveness of the procurement organization, and (5) ensure that it maintained a talented and sufficient procurement workforce. The task force made recommendations to help VA achieve these goals.

Many VA Contracts Offer Favorable Prices and Savings, but VA Could Further Leverage Its Buying Power When Acquiring Healthcare Services

The FSS and national contracts that VA has awarded have resulted in more favorable prices and yielded substantial savings. To strengthen its bargaining position during FSS contract negotiations, VA has relied on pre-award audits of vendors' contract proposals and post-award audits of vendors' contract actions. VA has further leveraged its buying power to achieve discounts and savings through its national contracts—an area that the VA Procurement Reform Task Force recognized offered significant potential for additional cost savings and other procurement efficiencies. However, VA could achieve additional savings through FSS and national contracts for healthcare services.

⁵ During negotiations, vendors are required to disclose the prices and concessions they offer their most favored customers. The FSS multiple award schedules include a Price Reduction Clause that helps to ensure that prices remain comparable to the prices granted to the vendors' most favored customers throughout the life of the contract.

⁶ Department of Veterans Affairs, Office of Inspector General, *Evaluation of VA's Purchasing Practices*, Report Number 01-01855-75 (Washington, D.C.: May 15, 2001).

Audits Have Helped VA Obtain Most Favored Customer Prices and Savings

To help ensure VA obtains most favored customer prices on FSS contracts for medical products and services, VA's Office of Inspector General entered into a memorandum of understanding with VA's Office of Acquisition and Materiel Management to conduct pre-award and post-award audits of FSS contracts. These audits provide VA's contracting officers with detailed information about vendors' commercial sales and marketing practices. With this information, VA is able to strengthen the government's bargaining position during negotiations and achieve savings through cost avoidance and recoveries.

VA policy requires that pre-award audits be conducted before awarding pharmaceutical contracts of \$25 million or more, and other contracts of \$15 million or more.⁷ By performing a pre-award audit on a vendor's proposal, VA can determine whether the pricing information is current, accurate, and complete. Pre-award audits help VA avoid unnecessary costs by obtaining the most favored customer price during negotiations. Post-award audits also help VA protect against overcharging by vendors. They often result in recovery of money from vendors who overcharged VA. Most post-award audits are prompted by vendors' voluntary disclosures that prices charged to the government were too high.

The financial benefits attributed to these audit efforts have been significant. During fiscal years 1999 to 2003, VA audits identified \$151 million in cost avoidances from pre-award audits and \$90 million in recoveries from post-award audits (see table 1).

Table 1: Results of VA FSS Audits for Fiscal Years 1999 through 2003

Dollars in millions			
Fiscal year	Cost avoidance	Recoveries	Total
1999	\$32.7	\$10.2	\$42.9
2000	20.2	5.9	26.1
2001	17.1	24.4	41.5
2002	22.6	25.0	47.6
2003	58.2	24.3	82.5
Total	\$150.8	\$89.8	\$240.6

Source: VA data.

⁷ Pre-award audits are generally done at the request of the contracting officer.

National Contracts Have Resulted in Additional Savings

VA has also taken steps when possible to consolidate its requirements for medical supplies and equipment and pharmaceutical products it purchases by using national contracts. Through these contracts, VA has been able to further leverage its buying power and obtain even better prices than are available on FSS contracts.⁸ VA uses three methods to consolidate requirements into national contracts.

First, VA consolidates contracts through “standardization”—that is, it agrees on particular items that VA facilities purchase and then contracts with manufacturers of these items for discounts based on a larger volume.⁹ By leveraging its large purchasing power, VA can achieve significant cost savings and other procurement efficiencies. VA’s standardization efforts cover a variety of medical products, such as medical and surgical supplies and prosthetic equipment, but most of VA’s standardization has involved buying pharmaceutical products at large discounts. Since VA issued a policy in June 1999 requiring medical facilities to use standardized products, VA increased its use of national contracts. According to VA officials, VA’s pharmaceutical standardization program led to savings of \$394 million for 84 categories of drugs in fiscal year 2003.¹⁰ VA continues to look for opportunities for more national contracts. For example, in fiscal year 2003, the National Acquisition Center awarded 73 contracts for

⁸ Most of the solicitations for these contracts are competitive, best value procurements. National contracts’ performance periods are normally for one year with up to four option years.

⁹ In standardizing products, VA analyzes its procurement history and identifies like items, such as gauze bandages, for which it could potentially standardize and negotiate national contracts directly with vendors for a larger discount based on volume purchasing. After like items are identified, a team of clinicians—including doctors, technicians, and nurses—assesses the products for quality and agrees on a specific item or items that are acceptable for use by all VA hospitals. Acquisition officials then negotiate national contracts with the vendors of the chosen products to obtain lower prices.

¹⁰ To determine cost avoidance, VA compared the actual purchase cost of the drug types and the theoretical cost had the contracts not been awarded. For example, VA determined that a contract for Amiodarone (heart medication) awarded in June 2000 resulted in fiscal year 2003 cost avoidance of \$4.7 million, or 58 percent of the actual cost, because the cost of the drug in fiscal year 2003 was \$3.4 million, and the theoretical cost was \$8.2 million. VA estimated the theoretical cost by multiplying the weighted average price per unit that existed during the 3-month period before the contract took effect, by the quantity purchased in the current fiscal year. However, VA officials noted that its estimates of cost avoidance do not consider factors such as inflation and price changes that occurred since some of the older contracts were awarded. VA is currently working with DOD to develop a more accurate methodology for estimating pharmaceutical cost avoidance.

standardized medical products valued at \$34 million and 12 additional national pharmaceuticals contracts valued at \$227 million.

Second, VA consolidates its purchases of high-tech medical equipment to achieve additional savings. For example, the National Acquisition Center has negotiated national contracts with major equipment manufacturers for ordering X-ray, magnetic resonance imaging, diagnostic ultrasound, and other high-tech medical equipment for VA medical centers and other federal customers to obtain discount prices. Besides achieving savings through volume purchasing, consolidating purchases expedites ordering, reduces costs of administering contracts and placing orders, and provides needed technical assistance to users in designing a system and resolving any equipment issues. As a result, VA officials identified savings of \$9 million in fiscal year 2003.

VA's prime vendor distribution contracts—the third contract consolidation method VA uses—have also helped VA to achieve savings. These contracts provide customers significant flexibility and choice. Using these contracts, VA medical centers can place orders through the prime vendor,¹¹ which arranges for timely deliveries from manufacturers. VA has two prime vendor distribution contracts—one for pharmaceuticals and one for medical and surgical products.

- VA's prime vendor distribution contract for pharmaceuticals—which has been in effect since 1991—accounts for the distribution of nearly all pharmaceuticals used at VA medical centers. The contract provides that the prime vendor reimburse VA about 3-percent of pharmaceutical sales to medical centers.¹² Because this contract represented over \$3.4 billion in sales in fiscal year 2003, VA estimates it saved about \$100 million.
- VA's medical and surgical prime vendor distribution contract has been in effect since 2002. Total VA sales through the medical and surgical prime vendor contract were \$48.7 million in fiscal year 2003. According to VA officials, this resulted in savings of \$2 million. Currently, only about one third of VA's medical centers opt to purchase products through the prime

¹¹ Prime vendors are contractors that buy inventory from a variety of suppliers, store it in commercial warehouses, and ship it to customers when ordered.

¹² Under this program, VA pays the prime vendor once the pharmaceuticals have been shipped to VA medical centers. The prime vendor then generally has up to 15 days to pay manufacturers, giving substantial "use of money" benefits to the prime vendor. As a result, there is a "negative fee." The current contract, which took effect on April 1, 2004, is valued at \$2.9 billion per year and includes a reimbursement rate of about 5 percent.

vendor. To achieve even greater savings and efficiencies, VA has made a policy that would require its medical centers to purchase all medical and surgical products from a prime vendor. According to VA officials, VA's policy should be in full effect in fiscal year 2005.

VA Has Potential for Additional Savings When Contracting for Healthcare Services

While the National Acquisition Center has actively looked for ways to reduce the cost of pharmaceuticals and medical supplies and equipment, it has not taken the same aggressive approach to negotiate more favorable prices for healthcare services.¹³ In fiscal year 2003, VA medical centers purchased \$1.65 billion in healthcare services (see table 2). Only \$66 million of these services were purchased from FSS contracts. In most cases, the healthcare services that the medical centers purchased were for procedures or medical tests that could not be provided at a VA medical center. For example, one VA medical center we visited contracted out radiation therapy services to a local hospital because the center did not have the equipment or staff to provide such services. In other instances, healthcare services cover additional fee-based doctor, nursing, and dental services provided inside and outside the VA medical centers.

¹³ Healthcare services were not included on the FSS until 2001.

Table 2: Fiscal Year 2003 Healthcare Services Purchased from Vendors and Other Providers

Description	Expenditures	Percent
Medical care contracts and agreements	\$665,502,189	40.25
Off-station fee basis-medical and nursing services ^a	385,884,936	23.34
Scarce medical specialist contracts	228,178,372	13.80
Contract hospital and outpatient treatment	187,735,882	11.36
Emergency treatment of veteran	66,759,769	4.04
Other contract hospitalization	58,591,270	3.54
On-station fee basis-medical and nursing services ^b	45,677,016	2.76
Off-station fee basis-dental services ^a	12,318,546	0.75
Consultants	1,855,481	0.11
On-station fee basis-dental services ^b	637,007	0.04
Counseling	187,727	0.01
Total	\$1,653,328,195	100.00

Source: VA data.

^aService provided at a non-VA medical facility.

^bService provided at a VA medical facility.

Nearly all of VA's existing healthcare services contracts are awarded and administered by VA's medical centers. Typically, these contracts are with local healthcare providers. As a result, there is generally no coordination with the National Acquisition Center as to the type of contract arrangements being negotiated, and no assurance that contracts represent the best available prices. VA officials acknowledged that the area of healthcare services has not been reviewed to determine the potential for requirement consolidation and leveraging its buying power. These officials, however, also explained that VA needs a database that captures the specific types of healthcare services used by its medical centers to determine which healthcare services could be consolidated to achieve additional savings. We believe the National Acquisition Center is in the best position to negotiate contracts that would help ensure more favorable prices for healthcare services—as it does for pharmaceuticals, medical supplies, and equipment—and could take steps to do this.

Opportunities Exist to Obtain Additional Savings at the Medical Centers

Over the past several years, VA medical center purchases from contracts with more favorable prices have increased significantly, and VA has achieved substantial savings. However, these savings could have been even greater, as medical centers have not used these contracts as much as they could have. Although VA has taken several actions to address this weakness—including implementing new policies that establish purchasing requirements and developing systems to capture data needed to make informed acquisition decisions—it has yet to provide sufficient oversight to ensure its new policies are adhered to.

Between fiscal years 1999 and 2003, total medical-center FSS purchases more than doubled (see table 3). The most frequently used schedule was pharmaceuticals.

Table 3: Summary of FSS Purchases by VA Medical Centers in Fiscal Years 1999 through 2003

Dollars in millions					
Description of Federal Supply Schedule	Fiscal year				
	1999	2000	2001	2002	2003
Pharmaceuticals	\$1,239	\$1,571	\$1,957	\$2,477	\$3,237
Medical equipment and supplies	231	278	297	302	365
In-vitro diagnosis and test kits	54	47	59	50	46
Lab tests: blood/blood products	52	69	63	75	86
Patient mobility devices	29	28	38	46	50
X-ray equipment and supplies	20	18	18	16	16
Dental supplies	7	7	7	8	13
Healthcare services	N/A	N/A	N/A	15	66
Total	\$1,632	\$ 2,018	\$2,439	\$2,989	\$3,879

Source: VA Data.

Although medical centers' FSS purchases showed an increase between fiscal year 1999 and 2001, the VA IG reported in May 2001 that medical centers were often not using the VA contracts to purchase medical products because medical centers were not required to buy from FSS and national contracts. In response, the Procurement Reform Task Force recommended that VA establish a contract hierarchy to guide its

purchasing practices. In November 2002, VA implemented a new policy¹⁴ requiring VA medical centers to purchase medical products first from a national contract, second from a blanket purchase agreement (BPA),¹⁵ and third from an FSS contract. Only when items are not available from these sources should VA medical centers enter into local agreements or purchase items directly from local vendors—the least desirable option.

Despite these efforts, the VA IG again reported in March 2004 that medical center purchases were not made from the best sources.¹⁶ For example, the VA IG analyzed a sample of purchases made in fiscal year 2002 valued at \$23.4 million. Although all of the products were available through VA contracts, the medical centers purchased only \$14.2 million, or about 60 percent, of the products off the national contracts. The remaining \$9.2 million, or about 40 percent, was spent on generally higher priced locally purchased products. The VA IG estimated that over five years (the typical life of national contracts) VA could save about \$1.4 billion if medical centers purchased medical products from FSS and national contracts.

There are two primary reasons why VA medical centers have not purchased medical products from the best sources. First, as pointed out by the VA task force, VA does not have a readily accessible database that medical center personnel could use to determine the availability of medical products. VA is developing a web-based searchable database to provide catalog information from vendors holding FSS and national contracts. The new system, which was partially implemented in July 2003, is being designed to allow medical center personnel to search for medical surgical products available under FSS contracts and some national

¹⁴ The Deputy Assistant Secretary for Acquisition and Materiel Management approved a class deviation from VA Acquisition Regulation that changed the contracting hierarchy. Class deviation from VAAR 808.001, Priorities for Use of Government Supply Sources, Nov. 20, 2002

¹⁵ These BPAs are simplified methods of filling anticipated repetitive needs for supplies or services currently available on an FSS contract. This method allows the government the opportunity to negotiate better unit pricing based on anticipated sales volume or market share and to provide more timely procurement of products and services needed on a recurring basis. For example, the National Acquisition Center has negotiated a national BPA for several types of anti-embolism stockings.

¹⁶ Department of Veterans Affairs, Office of Inspector General, *Audit of VA Medical Center Procurement of Medical, Prosthetic and Miscellaneous Operating Supplies*, Report Number 02-01481-118 (Washington, D.C.: Mar. 31, 2004).

contracts. According to VA officials, the new system is expected to provide access to national contracts by October 2004. Second, according to the VA IG, VA has yet to provide adequate oversight to ensure that its recently implemented policy to use the contract hierarchy is being followed. For example, although two purchasing activities within VA had established procedures to monitor compliance with the new policy, the procedures only covered compliance with the use of national contracts and BPAs and did not cover FSS contracts. Consequently, VA cannot fully determine whether medical centers comply with the new contract hierarchy.

VA Does Not Have Complete Information on the FSS Program Costs

To operate the FSS program, VA is supposed to identify all program costs and charge a fee to its customers based on these costs. Currently, VA charges FSS users a fee of 0.5 percent of sales to cover the cost of operating the schedules program.¹⁷ VA maintains data on some FSS program costs, such as employee salaries and benefits. However, VA has not identified the costs associated with other activities, such as audit and legal services. Without knowing the full cost of administering the program, VA has no assurance that the user fee accurately covers program costs.

Conclusions

VA's aggressive efforts to ensure most favorable pricing in awarding FSS and national contracts for medical products and services have saved taxpayers hundreds of millions of dollars. Despite this accomplishment, VA could achieve significantly more savings—through leveraging its purchasing power to negotiate FSS and national contracts for healthcare services used at VA's 160 medical centers and through improved oversight of medical center purchases. Without such actions, VA risks losing opportunities to realize additional savings. At the same time, the costs of operating VA's contracting programs need to be better understood to ensure that the user fees VA collects from its customers are not excessive.

Recommendations for Executive Action

We are making three recommendations aimed at helping VA achieve maximum savings through its contract programs. Specifically, we recommend that the Secretary of the Department of Veterans Affairs

¹⁷ Department of Veterans Affairs has collected this fee since 1996. It collected \$66.1 million in user fees between fiscal years 2001 and 2003.

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- explore opportunities to use its buying power to obtain more favorable prices for healthcare services,
 - strengthen oversight to ensure medical centers use FSS and national contracts to get the best prices available, and
 - identify the complete cost of the FSS program and reassess its user fee to determine if it needs to be adjusted.

Agency Comments

In commenting on a draft of this report, the Secretary of Veterans Affairs agreed with GAO's conclusions and concurred with its recommendations. VA's written comments are included in appendix II.

Scope and Methodology

To identify the steps taken by the VA to ensure that schedule contracts provide medical products at favorable prices, we reviewed VA's policies, procedures, and internal controls associated with awarding and administering FSS contracts, as well as for national contracts that are structured to achieve even better prices for VA's customers. We discussed implementation of VA policies, procedures and internal controls with agency officials at VA's National Acquisition Center in Hines, Illinois; VA Headquarters in Washington, D.C.; and the VA's Office of Inspector General in Washington, D.C. We also visited six VA medical centers to help determine how VA procurement practices were being implemented. We collected data on FSS and national contracts purchases from the National Acquisition Center and the Financial Services Center, Austin, Texas. Further, we reviewed and analyzed VA's cost avoidance estimates related to the purchase of pharmaceuticals from national contracts.

To identify opportunities to improve purchasing practices and increase savings, we met with VA medical center procurement officials. We reviewed the VA's Procurement Reform Task Force (May 2002) report that recommended ways to better leverage VA's purchasing power and determined the status of VA's implementation of task force recommendations to improve procurement practices across VA. Additionally, we reviewed VA IG reports and analyzed VA data on medical center procurement practices.

To determine how much the VA spends annually administering the schedules program and the extent user fees cover program costs, we interviewed and obtained information from officials in the program and financial officers at VA headquarters and its National Acquisition Center.

We asked VA officials to identify the costs incurred to operate the schedules program. Further, we reviewed the legislative authority that allows VA to use excess fees to cover other program costs. We discussed this information with the VA program officials and VA General Counsel staff located in Washington, D.C.

As agreed, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies of this report to the Honorable Anthony J. Principi, Secretary of Veterans Affairs; appropriate congressional committees; and other interested parties. We will also provide copies to others on request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff has questions concerning this report, please contact me at (202) 512-4841 or by e-mail at cooperd@gao.gov, or James Fuquay at (937) 258-7963. Key contributors to this report were William Bricking, Myra Watts Butler, Jean Lee, Fred Naas, Sylvia Schatz, and Karen Sloan.



David E. Cooper
Director
Acquisition and Sourcing Management

Appendix I: Description of Products and Services Included in FSS Schedules

Table 4: FSS Schedule Name and Description of Items

Name	Description
Medical/surgical equipment and supplies	Repair service for home dialysis equipment Home oxygen—contractual agreements Other medical supply Home oxygen—supplies Oxygen equipment & supplies Prosthetic supplies Home dialysis equipment & supply Medical supplies Medical, dental, and scientific equipment Medical, dental and scientific equipment—non-capitalized
Dental equipment and supplies	Other medical and dental supply Medical, dental, and scientific equipment Medical, dental and scientific equipment—non-capitalized
Patient mobility devices	Equipment rentals Prosthetic repair services and supplies
X-ray equipment and supplies	Medical supplies Medical, dental, and scientific equipment Medical, dental and scientific equipment—non-capitalized
In-vitro diagnostics, reagents and test kits	Blood and blood products
Healthcare services	Medical care contracts and agreements Off-station fee basis medical & nursing services ^a On-station fee basis medical & nursing services ^b Emergency treatment of veteran Off-station fee basis dental services ^a On-station fee basis dental services ^b Other contract hospitalization Consultants and counseling Scarce medical specialist contracts Contract hospital and outpatient treatment
Pharmaceuticals	Drugs, medicines and chemical supplies Prescriptions Medicines, drugs, and chemicals
Laboratory tests, clinical analyzers	Blood and blood products

Source: VA Data.

^aService provided at a non-VA medical facility.

^bService provided at a VA medical facility.

Appendix II: Comments From the Department of Veterans Affairs



THE SECRETARY OF VETERANS AFFAIRS
WASHINGTON
June 18, 2004

Mr. David E. Cooper
Director
Acquisition and Sourcing Management
U. S. General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Cooper:

The Department of Veterans Affairs (VA) has reviewed your draft report, **CONTRACT MANAGEMENT: Further Efforts Needed to Sustain VA's Progress in Purchasing Medical Products and Services** (GAO-04-718) and agrees with your conclusions and concurs with your recommendations.

VA is rightfully proud that its rigorous procurement practices have resulted in significant cost savings—dollars that transfer to the care of our Nation's veterans. As your draft report illustrates, VA's use of pre- and post-award audits have underpinned VA's success in achieving these savings.

The enclosure discusses VA's concurrences with the General Accounting Office's recommendations. Thank you for the opportunity to comment on your draft report.

Sincerely yours,

A handwritten signature in cursive script that reads "Anthony J. Principi".

Anthony J. Principi

Enclosure

Enclosure

Department of Veterans Affairs (VA) Comments to
General Accounting Office (GAO) Draft Report,
**CONTRACT MANAGEMENT: Further Efforts Needed to Sustain VA's
Progress in Purchasing Medical Products and Services**
(GAO-04-718)

**GAO recommends that the Secretary of the Department of Veterans
Affairs:**

- **Explore opportunities to use its buying power to obtain more favorable prices for healthcare services,**

Concur - VA agrees that some healthcare services, for example radiology, could be pursued on a larger scale. The Veterans Health Administration (VHA) will explore opportunities to leverage its buying power to realize more favorable prices for health care services.

- **Strengthen oversight to ensure medical centers use of FSS and national contracts to get the best prices available, and**

Concur - In the past year, VHA has taken significant steps to ensure medical centers use the Federal Supply Schedule (FSS) and national contracts when appropriate. VHA's Office of Clinical Logistics (CLO) leads the effort in establishing effective cost-savings procurement processes in all areas of medical purchasing. The CLO will continue to work closely with VA's Office of Acquisition and Materiel Management and the National Acquisition Center (NAC) to achieve the goal of obtaining best pricing and value in purchases. Improved oversight and accurate data will both be required to achieve best pricing and value in purchases.

- **Identify the complete cost of the FSS program and reassess its user fee to determine if it needs to be adjusted.**

Concur - The Office of Acquisition and Materiel Management's Fiscal Service will work with the NAC to develop a mechanism that will identify the actual costs (direct and indirect) associated with the FSS Program. Once this mechanism is approved and implemented, the Office of Management will monitor it. Currently, VA charges the lowest fee in the Federal government. Annual assessments will be done, and recommendations for any changes in the fee will be made to VA's Supply Fund Board for approval.

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