

**AUDIT OF FTS REGIONAL
TELECOMMUNICATIONS AND
REGIONAL INFORMATION
TECHNOLOGY SOLUTIONS FEES
REPORT NUMBER A040132/T/A/Z05025**

SEPTEMBER 29, 2005

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U.S. GENERAL SERVICES ADMINISTRATION
Office of Inspector General

Date: September 29, 2005

Reply to: William D. Anthony, Audit Manager
Attn of: Acquisition Programs Audit Office (JA-A)

Subject: Audit of FTS Regional Telecommunications and
Regional Information Technology Solutions Fees
Report Number A040132/T/A/Z05025

To: Barbara L. Shelton
Acting Commissioner, Federal Technology Service (T)

This report presents the results of the Office of Inspector General's review of the Federal Technology Service's (FTS) Regional Telecommunications and Regional Information Technology Solutions Fees. The audit was included in the Fiscal Year (FY) 2004 Office of Inspector General's Annual Plan.

Background

The General Service Administration's (GSA) FY 2005 Budget reflects obligations totaling \$24.3 billion for programs under its accounts. Most funds, about 99 percent, become available to GSA from Federal customers through fees charged for services rendered and commodities and space provided. These fees provide reimbursements to three revolving funds: the General Supply (GS) Fund, the Federal Buildings Fund, and the Information Technology (IT) Fund. For information technology solutions and telecommunications activities, FTS recovers the costs of products and services - and the costs of their delivery - through the IT Fund. Current FTS and Federal Supply Service (FSS) consolidation planning includes merging the GS and IT Funds.

The revolving fund authority under which FTS operates requires that FTS fully recover all costs (salaries, benefits, operational costs) in its estimated fees. FTS fees currently include surcharges, hourly labor rates, flat fees, or some combination thereof. FTS develops fees annually that are consistent with the IT Fund Cost and Capital Requirements Plan submitted to the Office of Management and Budget (OMB) yearly. Fee assessment is also a part of the current GSA FTS/FSS and revolving fund consolidation activities.

The IT Fund was established by the Paperwork Reduction Reauthorization Act of 1986, as included in Public Laws 99-500 and 99-591, section 821 (a) (1); 40 U.S.C 322. Section 110 (a) (1) of the Federal Property and Administrative Services Act of 1949, as amended by P.L. 99-591 authorizes the Administrator to establish fees to



be charged to agencies receiving services that are consistent with the Cost and Capital Requirements Plan. For every dollar FTS collects from their customers, 95.6 percent goes to vendors for services provided. The remaining 4.4 percent covers FTS administrative/overhead expenses and IT Fund contributions (Appendix A).

The fee structure of the business units within FTS varies with the service delivery functions of the units. The FTS business units financed through the IT fund are:

- Regional IT Solutions
- National IT Solutions
- Regional Telecommunications (Telecom)
- Long Distance

While Regional IT Solutions and Regional Telecom fees are the focus of this discussion, an overview of all of the FTS business units' fee structure and usage of those fees can be viewed in Appendix B.

Regional IT Solutions

Regional IT Solutions offers support for IT projects and services through contracts with the private sector and uses a surcharge (percentage) fee structure as follows:

Service	Rate Base	Minimum Rate	Maximum Rate
Commodities	% of total Acquisition	2%	4%
Services	% of total Acquisition	3%	5%

Exceptions outside of the standard surcharge ranges require a business case and the approval of the Assistant Regional Administrator. Regions may also use flat fees instead of surcharges or collect no fee or surcharge at all: a zero percent surcharge may be used because of a reimbursable agreement with an agency. Also, on occasion regions charge customers labor-hour fees.

Surcharges are determined based upon the complexity of the acquisition. Services provided at the lower ends of the scale represent cost recovery for providing basic acquisition services, which include:

- Review of statement(s) of work (SOW), deliverables, acquisition strategy, project or delivery schedules, and best value award criteria.
- Conducting a competitive acquisition to award and managing client funding and contractor payments.

Additional services that may be rendered, and which may support fees up to the maximum, include:

- Significant consulting on acquisition projects
- Significant SOW Revisions
- Complex mixed-type acquisitions
- Multiple deliverables requiring review or multiple delivery points
- Cost plus and/or mixed contract types
- Extensive competitive requirement, such as industry conferences or past performance reviews
- Management of complex funding arrangements
- Project management requirements

Regional Telecom

Regional Telecom offers local voice, data, and video telecommunications products and services. Regional Telecom's fees for its three primary activities are as follows:

- **Regional Dial-tone Services**: The provision for dial-tone service is recovered primarily through a line rate (Appendix B). Other costs that are directly related to the customer order such as mileage charges and features (e.g., call forwarding) are charged to the ordering Federal customer. An additional order-processing fee is charged by FTS to recover its direct operating expenses associated with the order processing activity. A regional surcharge is applied to all direct program charges above.
- **Expanded Services (Telecommunication Task Orders)**: A surcharge that typically ranges between 2 – 5 percent (equipment: 2 – 4 percent and Support Services and Solutions: 3 – 5 percent) is applied to the task order. The assisted service rate is designed to reflect the level of effort necessary for the Regions to recover their costs and was based on the structure previously developed for Regional IT Solutions. Connections¹ also include a 1 percent contract access fee (associated government fee) that is applied to all orders and automatically included in any quotes provided by industry partners.
- **Commercial Tolls** – A surcharge of 16.6 percent is applied to commercial toll call billing by the vendor. FTS operating expenses associated with this program are recovered through the surcharge. FTS encourages customers to utilize the Long Distance Network (which applies a 7 percent surcharge) over commercial networks for long distance calls to benefit from the lower rate.

¹ Connections is a governmentwide, multiple award, indefinite-delivery indefinite-quantity contract to deliver equipment, support services, or customized solutions.

Objective, Scope and Methodology

The objectives of our audit were to answer the following questions: ***Do the number of IT solutions surcharges vary greatly from one region to the next? Would it be advantageous to have fewer and more consistent IT Solutions surcharges throughout the regions? Do Dial-tone surcharges vary greatly from one region to the next? If so, why, and what are the effects of having such a variance?***

To make our assessment we:

- Reviewed establishing legislation;
- Interviewed cognizant officials from the Office of the FTS Chief Financial Officer, the Regional Telecom Atlanta Financial Service Center, the Business Management, Resources Management Staff, the IT Solutions Regional Services Center, and the Regional Telecom Billing Management Center.
- Reviewed relevant prior GSA Office of Inspector General audit reports;
- Reviewed FTS Cost and Capital Requirements Plans for FY 2004/2005 and FY 2005/2006;
- Evaluated Income Statements for overall FTS and the Regional IT Solutions and Regional Telecom business units for FYs 1999 through 2004;
- Evaluated fee data provided by the Philadelphia and Atlanta Financial Service Centers;
- Utilized FY 2003 and FY 2004 FTS Audited Consolidating Balance Sheets, Consolidating Statements of Net Cost, and Consolidating Statements of Changes in Net Position to reconcile and validate, on an end of FY basis, financial information;
- Assessed testimony provided to Congress relevant to the consolidation of FTS and FSS activities and of the IT and GS Funds.

Our audit work was performed during the period April 2004 through April 2005. The survey phase of the audit involved looking at four business lines and the reserves of the IT Fund. We performed two audits: the first on the working capital/reserve fund levels of the IT Fund (AUDIT OF FTS WORKING CAPITAL / RESERVE FUND LEVELS - REPORT NUMBER A040132/T/A/Z05012 - MARCH 28, 2005) and this second, addressing the fees of Regional Telecom and Regional IT Solutions. These audits were conducted in accordance with generally accepted government auditing standards.

Results of Review

IT Solutions and Regional Telecom surcharges vary between regions. Multiple surcharges in Regional IT Solutions result in confusion and a perception of inconsistency among customers and contractors alike. Fewer surcharges would facilitate planning, lessen customer confusion, and help ensure that costs are recovered. While Regional Telecom has limited control over surcharges that are based primarily on regional line rates, excess revenue from Expanded Services (ES)

could be distributed more equitably. A subsidy effectively results when customers within a region have their dial-tone surcharge reduced by excess ES revenue obtained from customers outside of their region.

Regional IT Solutions

In FY 2004, Regional IT Solutions had revenue of \$5.4 billion, down slightly from its FY 2003 peak of \$5.8 billion. The FY 2004 contribution margin percentage was 2.8 percent, up from 2.73 percent in FY 2003 and 2.71 percent in FY 2002 (Appendix C presents a comparative income statement for FYs 2001 through 2004). This history of positive aggregate Net Operating Results (NOR) and steady contribution margin percentages is available to assist in rate setting.

Fee Overview

Some regions reported usage of as many as ten surcharges and others as few as two. Information supplied by the Philadelphia Financial Service Center (FSC) indicated that even more rates are in use, with fees often graduated into fractions of a percent. Commodities transactions had among the fewest number of surcharges in regular use (defined as being used on multiple occasions), and services had the most.

Our review of the Philadelphia FSC data indicated that the fewest number of commodity surcharges in regular use by a region was one (2 percent surcharge), and the greatest number of commodity surcharges used by a region was eight (1.5, 1.75, 2, 2.5, 3, 3.5, 4, and 5 percent surcharges). In addition to the greater numbers of service surcharges in use, we noted a high percentage of these approached or equaled the 5 percent ceiling above which ARA approval is needed. Two regions had almost 200 occasions (combined) of using service surcharges from 4.90 to 4.99 percent. No apparent correlation exists between the number of regional surcharges and regional revenue, number of active tasks, direct operating expense, or NOR.

The current rate structure permits Contracting Officers (CO) to negotiate rates that may be inequitable to customers, insufficient to cover costs, and result in insufficient IT funds to meet the mission needs. Also, conflicts may result if employees are rewarded for increasing sales and surcharge negotiation influences these sales. Additionally, fee differences may encourage client agencies to shop regions to the detriment of overall FTS operations.

Fee simplification was one goal of IT Solutions leadership when the current fee system was implemented. Multiple rates were developed at the regional level in an environment that emphasized revenue growth and client agency satisfaction. Having fewer and more consistent surcharges throughout the regions would result in less confusion for customers and contractors, minimize inequities, enhance planning, and ensure that costs are recovered.

Regional IT management has recognized this issue and has made positive strides to address it. OMB has also recognized this issue and directed Regional IT Solutions to initiate steps to address it in their 2006 performance measures. Additionally, GSA is including a review of fees in the on-going FTS/FSS consolidation activities.

Alternatives Reviewed

One form of simplification and streamlining service fees would be to adopt a structure based on hourly rates. National IT Solutions fees consist primarily of hourly rates, as do those of vendors on FSS Schedule 70. Regional IT Solutions is already exploring this option and has developed a number of scenarios for legal review. As yet, this issue does not appear to have been resolved.

Commodities fee benchmarks include NASA's contract vehicle for large indefinite-delivery, indefinite-quantity IT contracts: Scientific and Engineering Workstation Procurement (SEWP). SEWP uses a flat rate for all commodities with some integration of services permitted. Services must directly support the associated equipment/product purchased and may not exceed 30 percent of the price of the associated equipment/products. Further simplification is achieved by not charging fees on orders below an established floor and by capping fees on purchase amounts exceeding an established ceiling.

Regional Telecom

Regional Telecom had revenue of \$623 million in FY 2004 and experienced rapid ES growth that was not balanced among the regions; Region 6 dominated that revenue generation and had excess ES revenue as a result. However, this situation did not continue in FY 2005. Region 6 ES revenue was under plan by roughly \$62 million at the end of May 2005 and Regional Telecom officials inform us that this condition is expected continue through FY 2006.

Fee Overview

Regional Telecom surcharges are region specific and vary due mainly to the regionally distinct line-rates upon which they are based. Line-rates are designed to fully recover direct program costs and are often dictated by factors over which Regional Telecom has little control, such as supply and demand within each region. Holding all else equal, a smaller line-rate requires a larger surcharge to cover the same indirect costs.

While the geographically segmented nature of Regional Telecom's dial-tone business lessens confusion associated with varying rates, there are factors that can contribute to inequities. One example is the reduction of dial-tone surcharges from excess ES surcharge revenue generated from customers outside the serving region.

A subsidy effectively results when customers within a region have their dial-tone surcharge reduced by excess ES revenue obtained from customers outside of their region.

Regional Telecom currently uses a cost-based fee structure. Expenses that can be directly traced to a revenue center are allocated to that center; expenses that cannot be directly traced are put into a regional indirect cost pool along with allocated FTS and GSA corporate overhead. The indirect cost pool is initially reduced by excess revenues from the region's ES program and programs related to special customers. What remains in the indirect cost pool is then cleared by a regional surcharge designed expressly to clear the indirect cost pool and/or create positive NOR as directed by the Central Office.

Excess ES revenue can be attributed to uneven program growth between Regions, inaccurate revenue estimation, and a dynamic business landscape characterized by rapid technological change, cyclic volume, and an underlying fee structure that has been in flux. In the long-term, growing the capability of all regions to serve the ES needs of customers within their regions will offset imbalances and minimize unintended subsidization of dial-tone surcharges.

To meet this long-term goal, Regional Telecom has set ES performance targets for the regions, tracks their progress, and provides technical support. Regional Telecom indicated that they would address short-term imbalances by using a portion of excess ES revenue from dominant regions to reduce the indirect costs of other regions. However, the significant drop in ES revenue in FY 2005 has eliminated excess ES revenue and the immediate need for its reallocation.

On a smaller scale, programs for special customers can also affect the consistency of surcharges. Special customer pricing, such that for the Army Recruiting Command dial tone program, needs to be accurately costed to avoid unintended impact on the indirect cost pool, and subsequently the regional surcharge. Regional Telecom was already assessing this program at the time of our review.

Although its effect is minor, inconsistent use of fully loaded rates by the Regions can also affect the level of dial-tone surcharges. Fully loaded rates reduce surcharges both by increasing the rate base and by eliminating the need to clear loads via the surcharge. Regional Telecom management recognized inconsistencies in regions using fully loaded charges and has addressed this issue via guidance and directives.

Recommendations

We recommend that the FTS Acting Commissioner have the Assistant Commissioner for Regional IT Solutions:

1. Continue to advance the FTS Business Architecture BPA and the related development of an effective project costing methodology to use as a basis for

rate design. Design considerations should include a simplified, flat commodity surcharge, surcharges stratified by dollar amount, and/or a simplified hourly fee structure for services. Ensure that any rate structures developed are consistent with the outcome of the current consultation regarding legality of simplified hourly fees and with Agency plans for consolidation of FTS and FSS operations and the General Supply and IT Funds.

We recommend that the FTS Acting Commissioner have the Assistant Commissioner for Regional Telecom:

2. Continue the long-term development of ES capability in all regions so that they can effectively serve their customers and thereby minimize ES revenue earned from customers outside of the region. Evaluate whether ES revenue projection methodologies adequately address the nature of ES business (cyclic volume, etc.) to minimize variances, and assess whether simplified fee structures under consideration in Regional IT may be appropriate for ES. Monitor regions for excess ES revenue that may require reallocation.

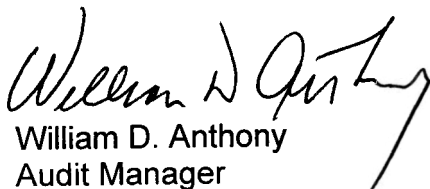
Management Response

The Acting Federal Technology Service Commissioner's response to our draft report recommendations indicated general agreement.

Internal Controls

This review did not require, nor did we perform, a review of internal controls.

We wish to thank the FTS for the assistance provided during the audit. If you have any questions, please contact me on (703) 603-0189.



William D. Anthony
Audit Manager
Acquisition Programs Audit Office (JA-A)

AUDIT OF FTS REGIONAL TELECOMMUNICATIONS AND
 REGIONAL INFORMATION TECHNOLOGY SOLUTIONS FEES REPORT
 NUMBER A040132/T/A/Z05025
 APPENDIX A – COST OF SERVICES

Information Technology Fund

Cost of Services Managed by GSA’s Federal Technology Service (FTS)

	<u>FY 2003 Actual</u> (\$Millions)		<u>FY 2004 Actual</u> (\$Millions)	
Revenue	\$8,731		\$8,459	
Cost of Goods Sold (Payments to Vendors)	<u>8,385</u>	96%	<u>8,085</u>	95.6%
Gross Margin	\$ 346	4%	\$ 374	4.4%

For every dollar FTS collects from their customers, 96 cents goes to vendors for services provided. The remaining 4 cents covers FTS/GSA administrative/operating expenses. The following information reflects how the remaining 4 cents is spent within FTS. ^{\1}

Salaries	\$ 131	37.9%	=	1.51 cents
Commercial Services ^{\2}	65	18.8%	=	0.75 cents
FTS Administrative Expenses ^{\3}	56	16.2%	=	0.65 cents
GSA Administrative Expenses ^{\4}	47	13.6%	=	0.54 cents
Rent, Utilities, Other	26	7.5%	=	0.31 cents
Non-Rate Recoverable Expenses	<u>21</u>	6.0%	=	<u>0.24 cents</u>
Total FTS/GSA Administrative/ Operating Expenses	\$ 346	100.0%	=	4 cents

^{\1} FTS/GSA Administrative/Operating Expense breakdown presented for FY 2003 only.

^{\2} Contractor provided support services to FTS.

^{\3} Includes FTS Administrative costs (i.e., cost of the Commissioner, Deputy Commissioner, FTS CFO, FTS CIO and FTS Office of Acquisition).

^{\4} Includes GSA Centralized Administrative Support Services (i.e., CFO, CPO, CIO and legal services), GSA Centralized Charges (i.e., agency-wide common distributable costs) and GSA Information Infrastructure (i.e., GSA network support costs).

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APPENDIX B – RATE STRUCTURE

Federal Technology Service (FTS)								
	Regional IT Solutions	National IT Solutions		Regional Telecommunications			Long Distance	
Type of Service	IT Solutions ^{1/}	IT Solutions ^{1/}	IT Solutions ^{1/}	Local Telecommunications Services	Expanded ^{2/} Services	Commercial ^{3/} Tolls	Long Distance Services	Wireless and Satellite Services
Rate Type	Surcharge	Hourly by Grade	Surcharge	Average Line Rate	Surcharge	Surcharge	Surcharge	Surcharge
Rate Base	% of Total Acquisition	Labor Hours Provided	% of Total Acquisition	Number of dial tone lines	% of Total Acquisition	% of Vendor Billing	% of Vendor Billing	% of Vendor Billing
Rate Range	Commodities 2% - 4% Services 3% - 5%	GS-15 - \$166 GS-14 - \$147 GS-13 - \$140 GS-12 - \$132 GS-11 - \$127 GS-09 - \$114 GS-07 - \$107 GS-03/06 - \$99	Commodities 2% - 4% Services 3% - 5%	^{4/} Region 1 - \$21.55 Region 2 - \$20.36 Region 3 - \$20.47 Region 4 - \$24.14 Region 5 - \$18.01 Region 6 - \$26.81 Region 7 - \$21.80 Region 8 - \$25.32 Region 9 - \$26.19 Region 10 - \$18.68 Region 11 - \$10.11	Equipment 2% - 4% Services 3% - 5%	16.6%	7%	Direct bill to agency from vendor 1% - 2% Ordering and billing provided by GSA 4%

1/ IT Solutions includes commodities such as hardware and software, and advisory services for information technology

2/ Includes any services in support of the local telecommunications infrastructure, such as equipment, servers, and project management and other services

3/ Comprises that portion of the long distance service provided by the local exchange carrier

4/ These FY03 line rates and associated charges vary widely by geographic location and are strongly influenced by the degree of competition in the marketplace.

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 APPENDIX C – COMPARATIVE INCOME STATEMENTS

Regional IT Solutions

	FY 2001	FY 2002	FY 2003	FY 2004
Revenues	\$3,845,699.0	\$4,722,820.6	\$5,833,842.8	\$5,407,711.5
Less: Cost of Goods Sold	\$3,747,703.0	\$4,594,796.7	\$5,674,379.9	\$5,256,173.3
Gross Contribution Margin	\$97,996.0	\$128,023.9	\$159,462.9	\$151,538.2
Less: Total Program Expenses	\$66,044.2	\$64,297.0	\$90,990.4	\$79,238.1
Program Contribution Margin	\$31,951.8	\$63,726.9	\$68,472.5	\$72,300.1
Less: Total Reserve Expenses	\$4,620.3	\$5,391.6	\$11,667.5	\$8,268.3
Program Margin After Reserves	\$27,331.5	\$58,335.3	\$56,805.0	\$64,031.8
GSA Corporate Expenses	\$11,911.0	\$22,232.0	\$26,945.4	\$25,283.5
FTS Corporate Expenses	\$7,701.0	\$17,898.0	\$17,649.1	\$32,090.2
Less: Total Corporate Expenses	\$19,612.0	\$41,431.0	\$44,594.5	\$57,373.7
Net Operating Results	\$7,719.5	\$16,904.3	\$12,210.5	\$6,658.1

Regional Telecom

	FY 2001	FY 2002	FY 2003	FY 2004
Revenues/Business Volume	\$360,742.0	\$450,175.4	\$552,491.0	\$623,574.0
Less: Cost of Goods Sold	\$281,188.0	\$348,310.9	\$445,455.9	\$517,004.4
Gross Contribution Margin	\$79,554.0	\$101,864.5	\$107,035.1	\$106,569.6
Less: Total Program Expenses	\$49,449.1	\$52,804.9	\$63,512.3	\$59,690.1
Program Contribution Margin	\$30,104.9	\$49,059.6	\$43,522.8	\$46,879.5
Less: Total Reserve Expenses	\$6,703.5	\$4,738.1	\$3,752.6	\$1,501.2
Program Margin After Reserves	\$23,401.4	\$44,321.5	\$39,770.2	\$45,378.3
GSA	\$10,736.0	\$9,296.0	\$10,662.0	\$7,105.5
FTS	\$11,761.0	\$10,419.0	\$7,937.9	\$10,869.3
Service-wide Initiatives (TS)	\$0.0	\$1,301.0	\$1,709.0	\$2,275.4
Less: Corporate Expenses	\$22,497.0	\$21,016.0	\$20,308.9	\$20,250.2
Net Operating Results	\$904.4	\$23,305.5	\$19,461.3	\$25,128.1

**AUDIT OF FTS REGIONAL TELECOMMUNICATIONS AND
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APPENDIX D – FTS ACTING COMMISSIONER’S RESPONSE**



GSA Federal Technology Service

AUG 26 2009

MEMORANDUM FOR KENNETH L. CROMPTON
DEPUTY ASSISTANT INSPECTOR GENERAL
FOR ACQUISITION AUDITS (JA-A)

FROM: BARBARA L. SHELTON
ACTING COMMISSIONER 

SUBJECT: Audit of FTS Regional Telecommunications and Regional
Information Technology Solutions Fees
Report Number A040132

Thank you for the opportunity to comment on Office of the Inspector General's (OIG) draft report on the FTS Regional Telecommunications and Regional Information Technology Solutions Fees.

FTS concurs with the report's recommendations that:

1. Regional IT Solutions

- Continue to advance the FTS Business Architecture BPA and the related development of an effective project costing methodology to use as a basis for rate design. Design considerations should include a simplified, flat commodity surcharge, surcharges stratified by dollar amount, and/or a simplified hourly fee structure for services.
- Ensure that any rate structures developed are consistent with the outcome of the current consultation regarding legality of simplified hourly fees and with Agency plans for consolidation of FTS and FSS operations and the General Supply and IT Funds.

2. Regional Telecommunications

- Continue the long-term development of ES capability in all regions so that they can effectively serve their customers and thereby minimize ES revenue earned from customers outside of the region.

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2

- Evaluate whether ES revenue projection methodologies adequately address the nature of ES business (cyclic volume, etc.) to minimize variances, and assess whether simplified fee structures under consideration in Regional IT may be appropriate for ES.
- Monitor regions for excess ES revenue that may require reallocation.

FTS will revisit the recommendations and re-evaluate the actions required to implement once the merger of FTS and FSS is completed. This will enable management to identify the necessary steps to implement the audit recommendations in the new organization.

If you have any questions, please contact Magdy Bastawrous at 703-306-6129.

AUDIT OF FTS REGIONAL TELECOMMUNICATIONS AND
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