

Statement of

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Before the

Subcommittee on Federal Financial Management, Government

Information, and International Security

Committee on Homeland Security and Governmental Affairs

United States Senate

Hearing on

“GSA – Is the Taxpayer Getting the Best Deal?”

July 26, 2005

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to testify regarding GSA's procurement processes and to present the view of the General Services Administration, Office of Inspector General. I will address two areas -- contract audit rights and, briefly, the user fees charged by GSA under its major contract vehicles. We applaud your decision to hold a hearing on this topic.

Contract Audit Rights

We believe that contract audit rights play a vital role in ensuring that taxpayers' interests are protected in the federal contracting arena and ensuring that taxpayers are, in fact, getting the best deal.

The MAS Contracting Program

The experience of the Office of Inspector General (OIG) in contract auditing has arisen primarily in the context of the Multiple Award Schedules (MAS) program, which is administered by the General Services Administration (GSA).¹ Under the MAS program, federal agencies and other entities can buy a wide range of commonly used commercial products and services at volume discount prices using a simplified buying method. The MAS program makes available a range of commercial items and services, from information technology products and services to office furniture and scientific equipment. The MAS program is currently comprised of over 17,000 individual contracts organized under 43 schedules (commodity or service groupings) encompassing over 6.8 million products and services. From a vendor's perspective, an MAS contract award enables a company to sell its products or services to the entire federal Government, as well as to a host of other entities, through a single contract vehicle. Individual MAS contracts are awarded for a five-year base period with three five-year options; these contracts, therefore, can be effective for up to a 20-year period. The popularity of the MAS program is undisputed; in fiscal year 2004, users bought over \$31 billion in products and services under these contracts.

¹ The Department of Veterans Affairs, under a delegation of authority from GSA, also awards and administers some MAS schedules -- including those for the purchase of pharmaceuticals and hospital supplies.

One of the aims of the MAS program is to provide agencies with the widest possible choice among qualified vendors. As such, the MAS program is open to all responsible vendors. In addition, GSA commits to MAS users that the schedule prices are fair and reasonable. Because the goal of the program is to maximize choice, there is no head-to-head competition as a means of ensuring fair and reasonable pricing. Instead, to get fair schedule pricing, GSA asks for information regarding a vendor's commercial pricing to its best customers and seeks to negotiate a price that is equal to this best price.² This most-favored customer (MFC) negotiation objective ensures that the negotiated MAS price reflects the purchasing power of the entire federal Government, rather than the less favorable price an agency could expect to achieve for a single, more limited quantity individual purchase. It is this reliance by GSA on vendor-supplied pricing information to achieve fair and reasonable pricing that gives rise to the need to audit.

MAS Audits – Preaward and Compliance Audits

Currently, there are two main types of audits that are conducted of MAS contracts: compliance audits and preaward audits. Compliance audits are conducted under GSA's Examination of Records clause (MAS), GSA Acquisition Regulation 552.215-71. This clause allows GSA -- typically the OIG Office of Audits -- to examine a vendor's books and records to check for overbillings or billing errors and to ensure compliance with the contract's Price Reduction and Industrial Funding Fee clauses.³ This audit authority extends up to three years from final payment under the contract. The OIG Office of Audits performed 14 of these audits in fiscal year 2004.

The second type of MAS audit is the preaward audit. These audits, conducted at the request of Contracting Officers (COs) by the OIG Office of Audits, are performed *prior* to GSA awarding or extending MAS contracts. Preawards examine the pricing information a vendor provides in its proposal. These audits provide COs with information about the accuracy of and any deficiencies in a vendor's pricing proposal. A CO uses the information in the audit report to negotiate a better price for the Government

² The most-favored customer (MFC) negotiation objective directs Contracting Officers to target commercial pricing and discounts from sales made under terms and conditions similar to those under which the Government would buy.

³ The Price Reduction clause is a mechanism that ensures that the Government keeps any relative advantage in pricing that it negotiated on a going forward basis throughout the 20-year MAS contract term. 48 C.F.R. § 552.238-75. The Industrial Funding Fee provisions require vendors to pay a percentage of their reported MAS sales to GSA in order to fund the costs of the program. 48 C.F.R. § 552.238-74.

under the MAS contract. As with other types of audits, the OIG is required by the Inspector General Act of 1978, as amended, 5 U.S.C. App § 4(b)(1)(A), to adhere to the Government Auditing Standards, also known as GAO's Yellowbook Standards, in performing preawards.⁴

In a report issued by our Office in 2001, we noted that despite GSA's public statement in 1997 that it intended to increase preawards, in fact the number of these audits had declined. In 1997, only 8 preawards were conducted; in 1998 and 1999, 28 and 24 preawards, respectively, were conducted of MAS contracts; whereas in the 7 years prior to 1997, an average of 148 preawards were conducted each year.⁵ During this same period, we note that sales under the MAS program rose from \$5.6 billion in 1997 to \$10.4 billion in 1999. Our report spurred the formation of a MAS Working Group within GSA, comprised of members of the Federal Supply Service (FSS) and the OIG, tasked in part with increasing the numbers of preaward audits. We are strongly encouraged by GSA's current efforts to develop a robust preaward program. By the end of this fiscal year, we expect to have conducted about 70 preaward audits covering \$5.2 billion of expected sales under the MAS program.

Preaward audits are a key control on pricing disclosures, and, when used effectively by COs, can generate significant savings for the Government. In fiscal year 2004, for example, the OIG conducted 40 preaward audits. With these audits, COs were able to negotiate better pricing, saving the Government at least \$75.4 million over the term of the affected contracts.⁶ For the current fiscal year, we have so far issued 46 preaward audits, which have recommended cost avoidances totaling \$612 million. For one recently completed preaward audit of a large information technology services vendor, the CO negotiated better pricing that will save the Government over \$70.7 million during the 5-year base term of the contract.

⁴ These standards, which address requirements regarding level of work, as well as auditor independence and ethics, dictate in many respects how audits are performed, and what types of documentation or records auditors seek in a standard preaward audit. Preaward MAS audits, as performed by our Office, are known as attestation reviews under current Yellowbook Standards. We also note that the GSA OIG, like other OIGs, undergoes a peer review every three years that examines, among other activities, the quality of preaward audits and their adherence to Yellowbook Standards.

⁵ Special Report on MAS Pricing Practices: Is FSS Observing Regulatory Provisions Regarding Pricing? (GSA OIG, August 24, 2001).

⁶ The \$75.4 million in savings relates to only 30 of the 40 preaward audits performed in fiscal year 2004; for the remaining 10 audits, we do not yet have the results of the negotiations.

Postaward Audits of Negotiation Information

Until 1997, GSA also had the ability to conduct postaward audits of pricing information provided during MAS negotiations -- so called defective pricing audits. The OIG Office of Audits initiated and conducted these audits, and their purpose was to determine whether the all-important pricing information MAS vendors provided was current, accurate and complete. Where an audit determined that a vendor provided faulty negotiation information, the report and contract would then be evaluated by the OIG for indications of fraud. If such indications were present, the OIG would refer the matter to the Department of Justice for action under the civil False Claims Act.⁷ Where there was no significant evidence of fraudulent conduct, the OIG would refer the audit report to the CO who would resolve the matter by seeking a simple refund of any overpayments and by negotiating improvements in the contract prices over the remaining term of the contract.

Industry groups have used the term “burden” to connote the potential for fraud liability and its consequences when defective pricing is found and then referred to the Department of Justice. Simply stated, this concern has always been greatly exaggerated. In the last period of time we have to measure (the 1994-1996 time period), only 15 percent of the over 70 postaward audits with defective pricing findings issued by the GSA OIG were referred to the Department of Justice based on concerns regarding the fraudulent nondisclosure or misrepresentation of pricing information. The remaining postaward audits were referred to GSA COs for administrative resolution.

In 1997, as part of a rule change revising the MAS program to implement the Federal Acquisition Streamlining Act, Pub. L. 103-355, and the Clinger-Cohen Act, Pub. L. 104-106, GSA virtually eliminated the authority to conduct postaward defective pricing audits. GSA Acquisition Regulation; Acquisition of Commercial Items, 62 Fed. Reg. 44518 (August 21, 1997). Instead of defective pricing audits, GSA noted that it expected to shift emphasis to conducting preaward audits in order to catch problems before contract award. Although GSA did retain language that would allow COs to modify the GSA Examination of Records clause to allow for defective

⁷ The civil False Claims Act provides for the Government to recover up to treble damages and penalties for fraudulent conduct involving submission of false claims to the Government. 31 U.S.C. §§ 3729-3733.

pricing audits, the modification requires high level approval and a CO finding that "there is a likelihood of significant harm" absent inclusion of the audit authority. To date, at GSA, this clause has not been modified and this contractual defective pricing audit authority has not been exercised. In contrast, the Department of Veterans Affairs (VA) modified its clause in 1997 and its OIG continues to conduct defective pricing audits under the VA MAS contracts; that Office's postaward defective pricing recoveries since 1997 have exceeded \$151 million.

Postaward Audits Rights Over Negotiation Information Are An Important Means of Ensuring the Integrity of Pricing Disclosures

We believe that postaward defective pricing audits are an important means of ensuring the integrity of pricing disclosures and should be reinstated. Their existence serves to ensure that the commercial pricing information vendors provide -- which is key to the Government negotiating a good MAS contract price -- is current, accurate, and complete.

In the three-year period prior to the 1997 rule that eliminated postaward audits, fully 84% of postaward audits contained findings of defective pricing. Although, as already stated, the great majority of our audits with defective pricing findings were referred to contracting officials for administrative resolution, they were nevertheless compensable to the Government. Looking only at the small numbers of audits that we referred to the Department of Justice, the Government recovered over \$110 million in civil fraud penalties in the eight years prior to the rule change. This does not include monies recovered by GSA COs administratively. It also does not include any amount attributable to improved forward pricing COs achieved based on the audit results.

Every indication we have, including hotline calls and qui tam actions filed under the civil False Claims Act,⁸ is that defective pricing is currently alive and well at GSA, although the contractual right to audit for it is not. Recently for example, in one case brought to our attention through a qui tam action, Humanscale, Inc., a company that supplies the Government with office chairs and ergonomic equipment through several MAS contracts, paid

⁸ The qui tam provisions of the civil False Claims Act allow private persons to bring fraud actions on behalf of the United States and receive a portion of any money recovered. 31 U.S.C. § 3730.

the Government \$9 million to settle allegations that it provided false pricing information to the Government during negotiations.

Audit rights also have important benefits that cannot be easily quantified. Audits cannot be measured solely in terms of numbers of contracts audited and dollars recovered. Even at the height of our postaward audit program in the 1990s, we conducted only approximately 40 to 50 postaward audits of negotiation information per year. Regardless of the actual number of audits conducted, it is the very existence of the audit right that serves as a deterrent to vendors that would misrepresent their pricing information to the Government and that encourages companies to put in place internal compliance or housekeeping measures. We believe that the success of the VA OIG's voluntary disclosure program is due in part to the fact that it retained contractual defective pricing audit rights; of the \$151 million the VA OIG has recovered since August 1997, fully \$105.7 million represents recoveries directly related to voluntary disclosures. In contrast, our Office has had a less successful voluntary disclosure program; we have had only 4 such disclosures and recovered \$1.7 million during that same period, despite the fact that GSA generates over 5 times the sales under its MAS program than does VA. We also point out that the existence of audit rights provides assurance to the vast majority of honest contractors that GSA is committed to providing a level playing field for all contractors.

Audits Exist in Commercial Practice; Alleged Burdensomeness of Audits

We are aware that the vendor community has argued that defective pricing audit rights should not be reinstated because they are not consistent with commercial practice and are overly burdensome. We disagree on both counts.

While we acknowledge that audits necessarily involve some degree of effort by a vendor, we point out that our Office has always taken steps to minimize burden by tailoring the audit process to a company's recordkeeping systems; by keeping our on-site fieldwork to reasonable time frames (typically 1-3 weeks); and by using electronic audit processes. We do not feel this level of "burden" is unreasonable given the risks to the Government of not having postaward audit rights and the monetary benefits that accrue to vendors with an MAS contract award. For example, one MAS vendor that was audited last year holds a contract that is expected to generate over \$1.5 billion in MAS sales for the five-year base contract period.

We also believe there is evidence of audit rights in commercial practice. We note that two studies -- one by our Office together with the VA OIG and one by GSA itself -- developed evidence that audit clauses do exist in various forms in the commercial world, and are used by commercial buyers and suppliers.⁹ As for industry's argument that some of these commercial audit clauses are not as broad in scope as the defective pricing audit authority, we note that there is no real commercial analog to the GSA MAS program; as such, it is unreasonable to expect commercial audit clauses to mirror the type of pricing information used to negotiate MAS contracts. Commercial purchasing arrangements do not typically involve multiple contracts for the same or similar items with as many suppliers; commercial buyers tend to use direct competition to limit more sharply the number of awards they make to suppliers. In contrast, as we already noted, multiple awards are key to the MAS program in that they are necessary to offer maximum choice. Making multiple awards, in turn, requires GSA to rely on pricing disclosures in order to effectuate its policy of targeting most-favored customer pricing. Thus, the fundamental structure of the MAS program dictates that any meaningful audit clause must cover such pricing information.

We nevertheless note that it is fairly evident from the commercial audit clauses we have reviewed that commercial contracts provide for audit authorities coextensive with the contractual requirements imposed, so that such rights cover access to any information provided by the seller to meet its obligations under the contract. In response to an industry petition challenging the existence of postaward audit rights in 1999, the Office of Federal Procurement Policy (OFPP) concluded that "the challenged safeguards are consistent with commercial practice to the maximum extent practicable given the current objectives of the MAS program."¹⁰

GSA Should Reinstate Postaward Audit Rights

We have strongly urged GSA to reinstate postaward audit access to negotiation information. The ability of GSA to negotiate prices commensurate with the Government's purchasing power is dependent on

⁹See GSA FSS Acquisition Management Center's "Anthology of Commercial Terms and Conditions" (July 1996); GSA and VA OIGs' "Procurement Reform and the MAS Program" (July 1995).

¹⁰ OFPP Response to Government Electronics and Information Technology Association (GEIA) Petition, July 30, 1999.

getting current, accurate and complete pricing data from vendors. We believe that postaward defective pricing audits are a critical adjunct to existing preaward audits. Although we expect to perform 70 preaward audits this year, we note that this represents only a small percentage -- less than 1% -- of the over 17,000 total existing MAS contracts. Postaward audits over negotiation information are a necessary piece of an effective MAS oversight program. We believe that as long as GSA wants to maintain maximum choice (and multiple awards) as a centerpiece of the MAS program, audit rights over pricing information should be an appropriate and necessary feature of these contracts.

Contract User Fees at GSA

GSA assesses user fees for the use of its interagency contracting vehicles, which mainly include MAS contracts and Governmentwide acquisition contracts (GWACs). These fees are intended to cover the administrative costs of the contracting vehicles and associated procurement consulting services. On the MAS side, GSA's FSS charges a .75% Industrial Funding Fee (IFF) to contract users on all MAS contract sales. When initiated in 1995, the IFF was 1% of MAS sales. GSA reduced the IFF to .75% in 2004 in response to findings by both our Office and the GAO that the MAS program was recouping significantly more in IFF than it cost to run the program.¹¹ We believe that this reduction more appropriately aligns fees with the actual costs of running the program.

FSS now also has responsibility for running GSA's GWACS. There are generally up to three types of fees that may apply under these vehicles. First, agency users of these vehicles pay a contract access fee of 1% for the use of most of these contracts. In addition, if they elect to seek procurement assistance services, users pay a fee ranging generally from 2% to 5% of the order amount; this fee reimburses GSA for services rendered in connection with conducting the task order procurement, such as performing market research or drafting the statement of work. Finally, on very large projects, users may elect to engage GSA as the project manager. These services, too, can vary in nature and complexity and are billed on an hourly rate basis. We

¹¹ GSA OIG, *Audit of the Federal Supply Service's Industrial Funding Fee for the Schedules Program*, Report Number A83309/F/H/V99513 (5/28/99)(found that for fiscal years 1998 and 1999, GSA recouped about \$30 million more per year than necessary to fund the full costs of the MAS program); GAO, *Contract Management-- Interagency Contract Program Fees Need More Oversight*, GAO-02-734 (July 2002)(found that GSA collected \$151 million more in fees than costs for the years 1999 through 2001 under the MAS program).

have a pending audit that would review whether current GWAC user fees are aligned with actual costs. However, because GSA is currently combining and restructuring FSS and FTS, which will necessarily impact the structure and nature of costs to administer these contracts, we have determined it is not practicable to continue this audit at the current time. We expect to resume the audit once the restructuring is in place.

Thank you again for the opportunity to testify. This concludes my formal statement. I will be glad to answer your questions.