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TELECOMMUNICATIONS

GSA's Difficulties Managing FTS 2000



GAO

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Report to the Chairman, Committee on
Government Operations, House of
Representatives

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United States
General Accounting Office
Washington, D.C. 20548

Information Management and
Technology Division

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The Honorable John Conyers, Jr.
Chairman, Committee on
Government Operations
House of Representatives

Dear Mr. Chairman:

This report responds to your November 19, 1990, and December 7, 1990, requests that we review the General Services Administration's (GSA) management of the Federal Telecommunications System (FTS) 2000 contracts. GSA awarded the FTS 2000 contracts to American Telephone and Telegraph (AT&T) Company and US Sprint Communications Company in December 1988, to replace the government's outdated FTS system with advanced telecommunications services at a lower cost. A major objective of the contracts is that FTS 2000 revenues will be divided between AT&T and Sprint on a 60/40 percentage basis, respectively, for the initial contract period.

In discussions with your office, we agreed to assess GSA's justification for reassigning Navy from AT&T's network to Sprint's, and to evaluate the impact of the reassignment on the revenue allocation between the vendors. We also agreed to determine if GSA is effectively enforcing the mandatory use statute (Public Law 101-509), which requires federal agencies to use FTS 2000 services unless they have unique requirements that cannot be met under the two contracts.¹ Finally, as agreed, we are currently reviewing GSA's management of its Information Technology Fund, which we will discuss in a future report. Details of our objectives, scope, and methodology appear in appendix I.

Results in Brief

GSA was not justified in reassigning Navy from AT&T to Sprint. In addition, the reassignment will not result in a 60/40 revenue split. GSA reassigned Navy from AT&T to Sprint as part of an agreement between GSA and Sprint to resolve a dispute over Sprint's violation of contractually mandated price caps. Although the agreement resulted in price reductions from Sprint worth nearly \$43 million to the government, GSA's concessions to Sprint—including relief from having to refund the government for possible overcharging during the initial contract

¹A unique requirement is any requirement that GSA determines cannot be satisfied by FTS 2000 at the time the requirement is needed.

period—were costly and disruptive. In our view, this agreement may not be in the government's best interests. Further, GSA's contention that the Navy reassignment will result in a 62/38 revenue split in favor of AT&T is not supported by reliable revenue estimates, and thus does not justify the reassignment decision. On May 10, 1991, GSA suspended the assignment of Navy to Sprint, pending a review by the GSA Administrator.

Finally, while GSA is effectively enforcing mandatory use, in some cases compliance with the statute can cost agencies more for FTS 2000 services than they would pay under a separate contract.

Background

FTS 2000 is being implemented to provide state-of-the-art voice, data, and video telecommunications services for the federal government. Estimated to cost nearly \$25 billion over 10 years, FTS 2000 replaces the outdated and expensive FTS network, and is projected to save the government millions of dollars over the life of the contract. Transition to the new system was completed in June 1990, 18 months ahead of schedule; by April 1991, FTS 2000 had more than 1.3 million users.

To foster competition throughout the contract term, GSA adopted a dual vendor approach to the procurement and awarded FTS 2000 contracts to two vendors: AT&T and Sprint. GSA awarded each vendor traffic volumes with the intent of achieving a 60/40 percentage revenue allocation between AT&T and Sprint, respectively.² GSA believed that a 60/40 revenue split (as opposed to 70/30 or 50/50) would optimize vendor competition, resulting in lower prices for the government. Further, as specified in the contracts, GSA was to maintain this revenue allocation when it assigned additional traffic to the two vendors' networks. At the time of contract award, several large agencies—including the Postal Service and the Department of Defense's (DOD) military departments—were unassigned, and their traffic was available for GSA to use in managing toward a 60/40 revenue allocation during the initial contract period.

GSA, in administering the contracts, is responsible for ensuring that the government pays competitive prices for FTS 2000 telecommunications services. Consequently, to ensure that FTS 2000 prices are comparable to market prices, GSA developed a price cap requirement, found in section

²At the end of the fourth and seventh years of the contracts, GSA can re compete all or a portion of each vendor's estimated revenue. Only the incumbent FTS 2000 vendors will be permitted to participate in the recompetition.

B.1.2 of the contracts. This requires that vendors' switched voice prices be no more than publicly available prices and that any vendor overcharges be refunded to GSA. In addition, GSA expects to obtain lower prices, through economies of scale, by effectively enforcing mandatory use and buying telecommunications services in bulk. Under Public Law 101-509, using FTS 2000 telecommunications services is mandatory for most federal agencies. However, GSA has the authority to grant an exception to the use of FTS 2000 if (1) an agency's requirements are unique, and (2) the agency's procurement would be cost-effective and not adversely affect the overall cost-effectiveness of FTS 2000.

GSA's Agreement to Reassign Navy to Sprint May Not Be in Government's Best Interests

GSA's efforts to enforce contractually mandated price caps on the two vendors resulted in the reassignment of Navy traffic from AT&T to Sprint, in return for volume discounts from Sprint. Additionally, GSA contends that the reassignment of Navy will allow it to achieve a 62/38 revenue split by the end of fiscal year 1992. In our view, the agreement between Sprint and GSA, as documented in a memorandum of understanding, may not be in the best interests of the government.

GSA's memorandum of understanding with Sprint resulted from the agency's year-long attempt to enforce price caps mandated under section B.1.2 of the FTS 2000 contracts. In the fall of 1989, GSA notified both vendors that they were exceeding the price caps and asked them to lower their prices. Both vendors contested GSA's interpretation and implementation of the price cap provision.

The dispute continued for nearly a year, until September 7, 1990, when GSA sent letters notifying both vendors that they were violating section B.1.2 and were liable for overcharging the government. AT&T was told that it owed approximately \$167,000 for February 1990, and was directed to reduce its prices accordingly. Sprint was told that it owed approximately \$706,000 for February 1990, and was also directed to reduce its prices. GSA added that a further analysis would be performed for the months of March through September 1990 and that additional charges might be made against their accounts.

Sprint vigorously protested GSA's attempted price cap enforcement, and the agency immediately withdrew the assessment letter sent to Sprint.³ Although GSA's internal analysis indicated that B.1.2 was legally

³AT&T also contested GSA's attempted price cap enforcement; however, its enforcement letter was not withdrawn until October 2, 1990.

enforceable, GSA began to negotiate with Sprint over the implementation of B.1.2. GSA took this course of action because it believed that negotiation would yield cost savings similar to those that could be achieved through enforcement, without a protracted and costly legal proceeding.

On October 15, 1990, GSA and Sprint signed a memorandum of understanding in which GSA agreed to assign an agency worth \$20 million in switched voice revenue to Sprint in return for a volume discount worth about \$43 million over 2 years. Sprint had specifically asked for Navy to be assigned to its network, but at the time Navy was assigned to AT&T. A proposed contract modification reassigning Navy to Sprint was sent to AT&T, but AT&T refused to sign it. Three days later, on October 18, 1990, GSA issued a unilateral modification assigning Navy to Sprint. GSA and Sprint also agreed to develop a mutually acceptable index that would be used to determine a price cap for switched voice service.

The agreement between GSA and Sprint contains some definite benefits for the government:

- With Sprint's increased volume discounts, the government will save millions of dollars over 2 years.
- The government now has an agreed-upon methodology with which to calculate and enforce price caps on Sprint.

However, GSA's concessions to Sprint were costly and disruptive:

- The government waived its right to enforce section B.1.2 on Sprint until the end of the fourth year of the contract, giving up any chance to collect possible overcharging for December 7, 1988, through December 6, 1992.
- In conducting these negotiations with Sprint, GSA lost credibility with AT&T. AT&T was not informed of the memorandum of understanding until 4 months after the document was signed. Further, AT&T asserts that GSA did not give it an opportunity to offer a better volume discount than Sprint.⁴
- GSA unsuccessfully spent an entire year trying to enforce section B.1.2, paying contractors to develop price cap methodologies that were eventually discarded.

Finally, as discussed below, we believe the assignment of Navy will not result in a 60/40 revenue split by the end of fiscal year 1992. On May

⁴AT&T and GSA have not yet agreed on a methodology to calculate price caps.

10, 1991, GSA suspended the assignment of Navy to Sprint pending a review by the GSA Administrator.

GSA's Reassignment of Navy Will Not Result in a 60/40 Revenue Split

GSA's reassignment of Navy traffic from AT&T to Sprint will not produce a 60/40 revenue allocation and cannot be justified on this basis. The agency's approach to achieving a 60/40 revenue split—by providing additional traffic to the vendors' networks through the assignment of unassigned agencies—was reasonable. However, when GSA reassigned Navy to Sprint, and simultaneously assigned the Postal Service and several smaller agencies to AT&T, the decision was ostensibly based on GSA's contention that these actions would result in a 62/38 revenue split between AT&T and Sprint, respectively, in fiscal year 1992. In our opinion, GSA did not use reliable revenue data in its fiscal year 1992 revenue estimates and, consequently, cannot support the decision to reassign Navy.

GSA's Strategy for Managing the Revenue Split Was Reasonable

In developing the network split, GSA used 1986 traffic tapes from the old FTS network to estimate volume and assumed that the offerors would bid nearly equal prices—thus generating an anticipated 60/40 revenue split. However, after the contracts were awarded, GSA realized that the significant disparity in the vendors' prices would not initially result in a 60/40 revenue split between the two vendors. GSA believed it would be inequitable to the offerors to change the contract traffic allocations on the basis of the prices bid; consequently, it decided to use unassigned agencies, taking into account contractors' prices, to manage toward a 60/40 revenue split. Managing toward this revenue split became even more challenging, however, when GSA realized that due to unanticipated traffic growth by agencies assigned to Sprint's network, the traffic on each network by June 1990 would be approximately equal.

GSA's approach in managing toward a 60/40 revenue split was demonstrated in May 1990, when GSA issued a contract modification assigning the military services to AT&T, with a \$60-million cap. Sprint would be assigned traffic from the military services where redundancy in the network was needed. At the time, GSA projected that the revenue split in fiscal year 1991 would be 46/54 percent in favor of Sprint, and believed the assignment of DOD traffic to AT&T was required to correct this imbalance. However, Sprint disputed this assignment and requested a contracting officer's final decision on the interpretation of the 60/40

revenue allocation issue. Sprint argued that 60/40 was not a contractually required allocation of revenue and that Sprint's proper allocation was 49 percent, the amount it had at contract award.

In response, GSA issued a contracting officer's final decision on June 29, 1990, reiterating its support for a 60/40 revenue allocation. GSA stated that the contracts allow the government to assign agencies to the vendors to achieve and maintain a 60/40 revenue allocation. Further, GSA noted that the original assignment of agencies in the contracts did not create a 60/40 allocation. GSA contended that it is the government's obligation to assign new agencies in a manner consistent with the revenue allocation specified for the initial contract period.⁵

GSA's Revenue Estimates Are Not Reliable

Four months after issuing its final decision on the 60/40 revenue allocation issue, GSA reassigned Navy from AT&T to Sprint and simultaneously assigned the Postal Service to AT&T. GSA took this action ostensibly because of its contention that the Navy reassignment would result in a 62/38 percent revenue allocation in favor of AT&T by the end of fiscal year 1992. However, GSA did not adequately evaluate information concerning the possible impact of the Navy and Postal Service assignments on the revenue split. Therefore, GSA's revenue estimates are not reliable and do not justify the reassignment of Navy to Sprint.

To arrive at its 62/38 revenue projection, GSA estimated Navy traffic would be worth \$10 million to Sprint in fiscal year 1992. However, more reliable estimates show Navy being worth about \$30 million to Sprint—for switched voice services only.⁶ Further, GSA's contention that Navy would be worth only \$10 million to Sprint contradicts the memorandum of understanding provision requiring the assignment of an agency worth at least \$20 million annually in voice traffic. In addition, GSA estimated that Postal Service traffic would be worth about \$36 million to AT&T in fiscal year 1992; however, the Postal Service estimates that actual revenue will be approximately \$7.5 million.

⁵GSA suspended this decision on September 27, 1990, as agreed in its memorandum of understanding with Sprint. According to GSA's contracting officer, GSA intends to reinstate the decision; however, as of June 3, 1991, it had yet to do so.

⁶Switched voice is but one of six services offered on FTS 2000; however, as of June 3, 1991, switched voice represented approximately 90 percent of total contract revenues.

GSA Will Not Achieve a 60/40 Revenue Split

Our estimates lead to the conclusion that the percentage revenue split in 1992 will be roughly 57/43, in favor of AT&T. This estimate represents the revenue split for only the final year of the initial 4-year contract period. In fiscal year 1990, the revenue split was 42/58 in favor of Sprint, and in fiscal year 1991, the estimated percentage split is 48/52, also in favor of Sprint. Looking at the figures cumulatively, by the end of fiscal year 1992, AT&T will have received an estimated \$502 million, 51 percent of the revenue, while Sprint will have received an estimated \$479 million, 49 percent of the revenue. These estimates suggest that, in total, GSA's efforts will not come close to achieving a 60/40 revenue split.

Mandatory Use Is Being Enforced but Pricing Concerns Have Arisen

Most federal agencies are required by law to use FTS 2000 services to meet agency telecommunications requirements, unless an exception from GSA is obtained. GSA enforces the mandatory use of FTS 2000 through its delegation-review process. Overall, GSA's review of agencies' exception requests complies with the mandatory-use requirement. Further, GSA recently rescinded blanket exceptions it granted certain agencies after determining that FTS 2000 services might meet these agencies' requirements.⁷ Finally, we found that some agencies have expressed concern that complying with the mandatory-use requirement of FTS 2000 can cost them more for telecommunications services than if they acquired services from an alternative source. GSA has responded to these concerns and is taking action to partially mitigate the financial impact of transitioning to FTS 2000.

GSA's Review of Agencies' Exception Requests Is Adequate

GSA's authorizations branch reviews agencies' requests for exceptions when the value of the telecommunications requirement is greater than \$250,000. For requirements less than this amount, GSA service oversight center managers (for both networks) review their respectively assigned agencies' requests and make the determination. Even when GSA grants approvals for FTS 2000 exceptions, it places conditions on the approvals to use as leverage in getting the agencies to make a transition to FTS 2000. All exceptions are for an interim period and require the agencies to move their requirements to FTS 2000 when services become available.

⁷A blanket exception is a type of delegation of authority provided to federal agencies for procuring certain types of agency-specific computer and telecommunications systems requirements without obtaining a separate delegation of procurement authority from GSA prior to conducting the procurements.

Our review of 28 agency FTS 2000 exception requests found that GSA was complying with the law and regulations in granting and denying exceptions. As of January 15, 1991, GSA had approved 102 exceptions out of a total of 172 requests (59 percent). Most exceptions were granted early in the program. The most frequent exceptions have been for enhanced 800 number services and multi-drop data lines.⁸ Initially, the FTS 2000 contracts did not require the vendors to provide 800 service. However, 800 number services became available during 1990, and GSA has required agencies to transition their requirements to FTS 2000. Multi-drop lines are not available on either network; thus, GSA will continue to exempt this requirement until it is added as a service offering.

GSA Has Rescinded Blanket Exceptions to FTS 2000

Until May 24, 1991, five agencies had blanket exceptions to procure telecommunications services outside of FTS 2000. GSA granted these exceptions to provide the agencies procurement flexibility for certain unique requirements. However, these exceptions allowed a significant amount of telecommunications traffic to remain off the FTS 2000 networks. For example, one of the five agencies, the Federal Aviation Administration (FAA), was incurring annual communications costs in excess of \$200 million. When GSA recently reviewed the blanket exceptions, it determined that FTS 2000 might be able to meet some of these agencies' requirements. As a result, GSA rescinded all blanket exceptions, requiring agencies to transfer these telecommunications services to FTS 2000 by September 30, 1991, unless granted a specific exception by GSA. A summary of the blanket exceptions that were rescinded is presented below:

- The Department of Transportation's exception was for FAA's operational telecommunications requirements associated with regulation and protection of air traffic. Administrative traffic was not exempt from FTS 2000.
- The Department of Energy's exception covered operational traffic for power plants and communications traffic related to nuclear production and emergencies.
- The National Aeronautics and Space Administration's (NASA) exception was for that portion of the NASA communications network satisfying requirements for missile and satellite tracking facilities.
- The Nuclear Regulatory Commission's (NRC) exception was for emergency telecommunications services for NRC.
- The Tennessee Valley Authority's exception was for all intercity telecommunications.

⁸Multi-drop data lines provide data services to multiple users on a single line.

Agencies Express Concern About FTS 2000 Costs

A number of federal agencies have expressed concern about the higher costs they would incur from using FTS 2000 services. Specifically, the combined effects of levelized pricing and the application of GSA overhead have resulted in instances in which the GSA price for certain FTS 2000 services is higher than what might be obtained outside of FTS 2000.⁹ For example, AT&T's raw contract prices for the Social Security Administration's (SSA) 800 number service are comparable to the current contractor, MCI Telecommunications Corporation. However, when levelization and GSA overhead are factored in, SSA will spend about \$12-\$14 million more with FTS 2000 in fiscal year 1992 than with its current contract. The Department of Health and Human Services has requested that GSA waive price levelization for SSA's 800 number service.

GSA has taken action to encourage agencies not subject to the mandatory-use statute to procure FTS 2000 services. For example, GSA removed price levelization for some agencies, including the Postal Service, beginning with services delivered after June 1, 1991. Further, GSA has waived price levelization for those DOD requirements currently exempted from FTS 2000 by the Warner Amendment.¹⁰

Conclusions

FTS 2000 is providing the federal government advanced telecommunications services at a lower cost than under the old FTS system. By all accounts, FTS 2000 is providing high-quality service, and GSA is to be commended for making the transition to the new service ahead of schedule. Yet FTS 2000 has been plagued with controversy and dissension, which may threaten its continued success. GSA—after making initial good faith efforts—has not succeeded in achieving a 60/40 revenue split. GSA's memorandum of understanding with Sprint represented a relatively easy way to reduce Sprint's prices, but at tremendous cost: movement away from 60/40 and potential alienation and mistrust by the larger service provider.

Several factors have combined to bring about this situation. The large, unanticipated price difference between the two vendors made it difficult for GSA to achieve the intended revenue split and created the need for

⁹To prevent agencies from having to pay different prices for comparable services, GSA applies a mathematical factor to each vendor's prices (called a levelization factor) to make their prices roughly equivalent.

¹⁰Section 111(a)(3) of the Federal Property and Administrative Services Act of 1949, as amended, exempts DOD from obtaining GSA authorization for the procurement of automatic data processing equipment and services associated with, for example, intelligence activities and command and control of military forces.

levelized prices. Because one vendor's prices for certain FTS 2000 services were significantly higher than the commercial market, levelized prices for some services also exceeded commercially available prices. This situation has masked the cost advantages offered by the other, low-cost vendor, and contributed to making some FTS 2000 services economically unattractive to several federal agencies. Failure to correct these problems during the recompetition could seriously undermine the effectiveness of FTS 2000.

We conducted our review from January through June 1991, in accordance with generally accepted government auditing standards. In accordance with your wishes, we did not obtain official agency comments on a draft of this report.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this letter. We will then send copies to the Chairman of the Senate Committee on Governmental Affairs; the Administrator of General Services; and other interested parties. Copies will also be made available to others upon request. Please contact me at (202) 275-3195 if you have any questions about this report. Major contributors to this report are listed in appendix II.

Sincerely yours,



Jack L. Brock, Jr.
Director, Government Information
and Financial Management

Objectives, Scope, and Methodology

This review was requested by the Chairman, House Committee on Government Operations. As agreed with the Chairman's office, our objectives were to determine (1) whether GSA was justified in reassigning Navy traffic from AT&T to Sprint, (2) what impact the Navy assignment had on the 60/40 revenue split, and (3) the adequacy of GSA's enforcement of the mandatory-use statute. To evaluate GSA's reassignment of Navy and the impact this assignment had on the 60/40 revenue split, we (1) obtained and reviewed documentation related to the 60/40 revenue split and agency assignments; (2) analyzed revenue estimates provided by GSA, vendor, and agency officials; and (3) analyzed the data and methodology used to support these estimates. We also interviewed

- GSA officials responsible for monitoring the revenue split, as well as MITRE corporation officials who performed revenue split assessments for GSA;
- AT&T and Sprint officials to determine their views on the revenue split and the Navy reassignment; and
- agency officials from the Postal Service, SSA, and DOD, to determine their plans for transitioning to FTS 2000.

Additionally, to assess the reasonableness of GSA's 60/40 revenue split estimate for fiscal year 1992, we developed an estimate of the potential revenue split using the most reliable data obtained from the agencies and the contractors. In formulating our assumptions, we used information relating to the value of agencies' telecommunications requirements and their corresponding transition schedules obtained through interviews with GSA, vendor, and agency officials, and a review of relevant documentation. However, given that agency requirements, transition schedules, and vendor prices are continually changing, we were unable to validate our revenue estimates for fiscal year 1992.

To determine whether GSA is effectively enforcing mandatory use of FTS 2000 we reviewed applicable laws, federal regulations, and agency policy concerning mandatory use of FTS 2000. We also reviewed GSA's process for determining whether an agency should use FTS 2000 government-furnished services to satisfy telecommunications requirements or whether it should be allowed to proceed with an independent procurement to satisfy such requirements. We analyzed 28 agency procurement requests for FTS 2000 exceptions processed by GSA and relevant documentation to determine whether GSA was granting exceptions in accordance with the statute. Additionally, we conducted a telephone survey

on seven of the approved exceptions to determine the subsequent outcome of the agencies' actions and their plans for existing telecommunications requirements in the future. We also interviewed GSA, vendor, and agency officials to identify factors affecting agencies' use of FTS 2000 services.

We conducted our review at GSA headquarters in Washington, D.C.; GSA service oversight centers in Vienna and Herndon, Virginia; DOD offices in Arlington, Virginia; SSA headquarters in Baltimore, Maryland; and AT&T and Sprint offices in the Washington, D.C., area.

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