



Testimony before the Subcommittee on Oversight and Investigations, Committee on Veterans' Affairs and the Subcommittee on Contracting and Workforce, Committee on Small Business, House of Representatives

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REVERSE AUCTIONS

Guidance Is Needed to Maximize Competition and Achieve Cost Savings

Statement of Michele Mackin, Director
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Chairmen Coffman and Hanna, Ranking Members Kirkpatrick and Meng, and Members of the Subcommittees:

I am pleased to be here this morning to discuss the federal government's use of reverse auctions. In recent years, federal agencies have been using this mechanism—in which sellers compete against each other in an online venue to sell their products or services—as a tool to reduce the price they pay for certain types of items. In theory, a reverse auction leverages competition, enabling agencies to obtain lower prices and reduce acquisition costs. We found that government agencies were increasingly using reverse auctions as a means to drive down prices but without adequate guidance to ensure that the potential benefits were maximized.

My remarks today are primarily based on our recently issued report on agencies' use of reverse auctions. Accordingly, this testimony addresses (1) what agencies are buying through reverse auctions and trends in their use; (2) how agencies are conducting reverse auctions; and (3) the extent to which the potential benefits of reverse auctions are being maximized.¹ My testimony today will summarize our findings from that report.

To conduct our work, we used fiscal year 2012 contract award information from Federal Business Opportunities (FedBizOpps.gov) to identify the Departments of the Army (Army), Homeland Security (DHS), the Interior (DOI), and Veterans Affairs VA) as the primary users of reverse auctions, representing approximately 70 percent of the activity. Because the agencies did not maintain the level of detailed information needed for our review, we obtained reverse auction data from FedBid, Inc., the company that conducted almost all of the government's reverse auctions in fiscal year 2012, according to FedBizOpps.

In addition, we reviewed, where applicable, government-wide and agency policies and guidance regarding reverse auctions at these agencies; interviewed government acquisition officials and officials from the Office of Management and Budget's Office of Federal Procurement Policy (OFPP); spoke with organizations representing government contractors; and reviewed a sample of contract files where a reverse auction was

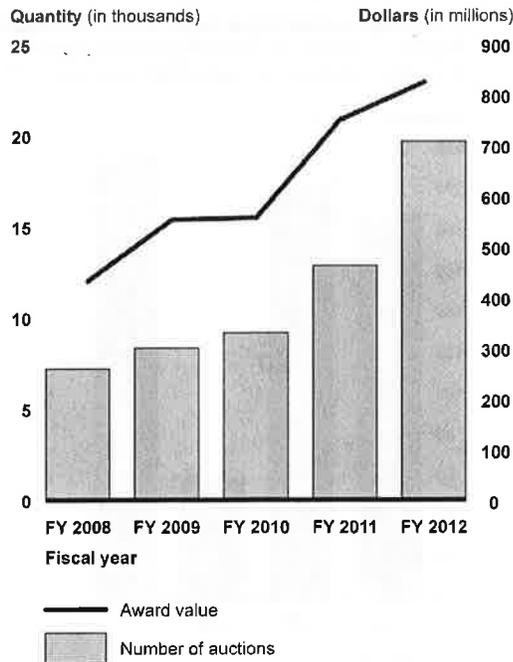
¹GAO, *Reverse Auctions: Guidance Is Needed to Maximize Competition and Achieve Cost Savings*, GAO-14-108 (Washington D.C.: Dec. 9, 2013).

used. This work was performed in accordance with generally accepted government auditing standards. Our report provides further details on our scope and methodology.

Reverse Auctions Have Increased and Have Been Used Primarily to Buy Commercial Products and Services

Across the four agencies representing the bulk of reverse auction activity in fiscal year 2012, use of reverse auctions increased almost 175 percent between fiscal years 2008 and 2012. Figure 1 summarizes the growth in use of reverse auctions in dollars and number of auctions.

Figure 1: Number and Value of Reverse Auctions across the Selected Agencies from Fiscal Years 2008 to 2012



Source: GAO analysis of FedBid data.

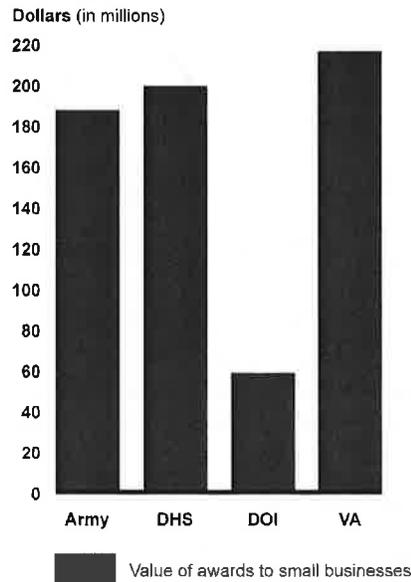
Of the \$828 million in fiscal year 2012 contracting actions that resulted from reverse auctions at these agencies, \$746 million—or 90 percent—was for products. Services, in contrast, constituted about 10 percent. Reverse auctions were used to purchase a variety of commercial products, primarily for information technology (IT) and medical equipment and supplies. While to date most reverse auctions have been used for commercial products, some agency officials told us that the use of

reverse auctions to acquire services is increasing and that they are also being used for more complex contracts.

Our analysis of the data also identified some common characteristics among contract awards resulting from reverse auctions. We found the following:

- About 95 percent of the reverse auctions resulted in awards of \$150,000 or less.
- About 86 percent of the reverse auction awards—representing 80 percent of the dollars—went to small businesses. Figure 2 shows a breakdown of small business dollars among the four agencies.

Figure 2: Value of Small Business Awards Resulting from the Use of Reverse Auctions across the Selected Agencies, Fiscal Year 2012



Source: GAO analysis of FedBid data.

- Further, almost 50 percent of the reverse auctions were conducted to place orders under existing contracts. In some cases, the use of these contract vehicles includes a fee that the ordering agency must pay.
- And we also found that almost 60 percent of reverse auction awards were in the last quarter of the fiscal year. Agency officials told us this

can occur due to the timing of when funds are released and that reverse auctions can facilitate the timely award of contracts late in the fiscal year.

Agencies Use the Same Fee-Based Contractor and Are to Follow Established Contracting Procedures to Conduct Their Reverse Auctions

All four agencies contracted with FedBid, a fee-based contractor, to conduct their reverse auctions during fiscal year 2012. Agency officials stated that contracting officers are required to follow established contracting procedures and rules. The contracting officer must also establish the basis for award. For example, the contracting officer can make the award to the lowest bidder or make the award based on a cost/technical trade-off process where it is in the best interest of the government to consider other than the lowest price. In fact, on the basis of our analysis of a random sample of auctions, we estimate that 24 percent of all reverse auction contracts awarded by the four agencies in fiscal year 2012 were not awarded to the lowest bidding vendor.²

Contracting officers can determine reverse auction features, such as the length of an auction, the amount of information available to bidders about each other's bids, and whether to set a target price, which may be based on a government cost estimate or market research. If a target price is in effect, or "active," a vendor must bid below that price and have submitted the lowest bid in order to be identified as the leading vendor. The leading vendor has the lowest price (below the target price) at any given time during an auction. However, a contracting officer can still award a contract even if no submitted bids meet the target price, that is, when no vendors were identified as the leading vendor. These strategies or features can affect the competitive environment of the auction and affect the magnitude of cost savings.

Vendors must register with FedBid and agree to the requirements established by the contracting officer before submitting a bid in an auction. Vendors can use FedBid's system to submit questions about requirements during the auction, and the system notifies the contracting officer via e-mail. It is up to the contracting officer to decide whether to answer them. Several vendors stated that FedBid's interface creates an additional layer between the vendor and the end user that can inhibit their efforts to clarify details in the solicitation—such as the type of material an agency requires—that are important in setting a bid price.

²This estimate has a 95 percent confidence interval that extends from 17 to 33 percent.

As part of our review, we gained an understanding of how reverse auction fees are paid. When a vendor submits a bid, FedBid automatically adds its fee and ranks the adjusted bid (i.e., the vendor's bid plus the fee) against adjusted bids submitted by other vendors. When the reverse auction ends and the contracting officer receives the results, the bids, which already include FedBid's fee, are ranked from lowest to highest. Then, when the agency receives the goods or services, it pays the entire bid amount to the selected vendor, including the fee. FedBid then sends an invoice to the selected vendor, who remits the fee to FedBid directly.

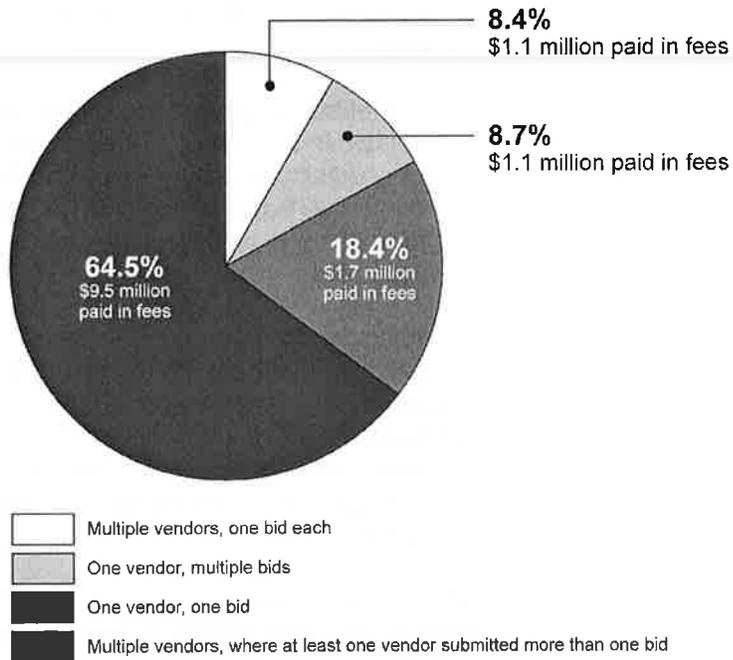
Agency officials and some vendors were confused about FedBid's fees. What we found is that FedBid caps its fee at 3 percent of the winning vendor's bid (though the fee is not to exceed \$10,000), but the fee may be less depending on the specifics of FedBid's contract with the agency. In addition, FedBid may reduce its fee or charge no fee in specific circumstances. In fact, we found that FedBid received no fees in 20 percent of fiscal year 2012 reverse auctions.

In July 2013, the General Services Administration (GSA) launched its own reverse auction tool to allow agencies to use reverse auctions with the GSA Schedule without using a separate contractor to conduct the auctions. GSA does not intend to charge a reverse auction fee for awards made to GSA Schedule holders, but agencies would still pay the 0.75 percent GSA Schedule fee. We did not conduct a detailed review of GSA's reverse auction tool.

Competition and Savings Are Not Always Maximized, in Part Due to Lack of Comprehensive Guidance

Competition and savings—two of the key benefits of reverse auctions cited by the agencies we reviewed—are not always being maximized. Both have been limited because not all reverse auctions involve what we refer to as interactive bidding, where vendors engage in multiple rounds of bids against each other to drive prices lower. We found that over a third of the fiscal year 2012 reverse auctions had no interactive bidding—and agencies paid \$3.9 million in fees for these auctions. Figure 3 shows the percentage of FedBid's fiscal year 2012 auctions for the agencies in our review that had interactive bidding among multiple vendors, versus those that did not, and the fees the agencies paid to FedBid.

Figure 3: Fees Paid by Selected Agencies Based on Number of Vendors and Bids, Fiscal Year 2012



Source: GAO analysis of FedBid data.

In addition, agencies cite savings as one of the benefits of reverse auctions. Although the agencies in our review stated that they do not publicly report the savings, they use the information—provided by FedBid—to assess the potential costs and benefits of reverse auctions. Using FedBid’s approach of calculating savings based on the delta between the agency’s target price and the winning bid, savings from fiscal year 2012 reverse auctions for the selected agencies totaled about \$98 million.

However, it is unclear whether these savings are accurate. We found that

- the \$98 million in estimated savings may be too high since it includes \$24 million in savings from auctions without interactive bidding, which in theory would help drive prices lower, and
- 1,111 auctions that had interactive bidding resulted in an award price higher than the agency’s target price, which may indicate that the contracting officer set the target price too low.

We also found that agencies

- rely on FedBid to identify their reverse auction activity,
- generally do not track how much they pay in reverse auction fees,³ and
- sometimes pay two sets of fees when using an existing contract vehicle in conjunction with a reverse auction. For example, 47 percent of acquisitions using reverse auctions were ordered under pre-existing contracts. Agencies paid \$6.5 million in fees to FedBid in these cases in addition to paying a separate fee to use some of the existing contracts..

However, we found that VA in particular has taken steps to gain greater insight into its use of reverse auctions. In 2012, the agency's senior procurement executive temporarily halted use of reverse auctions while an assessment was made of their effect on VA acquisitions. The reverse auctions were subsequently resumed, requiring collection of savings and fee calculations, which we found evidence of in the contract files we reviewed.

The Federal Acquisition Regulation (FAR) does not specifically address reverse auctions. Agencies have developed their own guidance, though most do not provide information on what to do in certain situations—for example, when only one vendor submits a bid. In our discussions with agency officials and vendors, we found they were uncertain about how reverse auction fees are paid and that confusion exists about how reverse auctions are managed. We believe that the lack of government-wide guidance addressing the use of reverse auctions and the confusion within the vendor community about the process may limit the potential benefits of reverse auctions.

³While agencies generally do not track the reverse auction fees they pay, pursuant to FedBid's GSA Schedule contract, federal agency buyers utilizing FedBid's reverse auction services reserve the right to pay the transactional fee directly to FedBid. We found that the VA in some instances asked FedBid for information regarding the fees paid on specific reverse auctions.

GAO Recommends that Office of Federal Procurement Policy Take Actions to Address the Use of Reverse Auctions

Given the clear trends showing that reverse auctions are on the rise and the lack of government-wide guidance on their use, we made several recommendations in our report. We recommended that the FAR be amended to address reverse auctions from a regulatory standpoint, and also recommended that the Office of Management and Budget (OMB) issue guidance addressing competition and fees and to share agency best practices.

OMB generally agreed with our recommendations.

Chairmen Coffman and Hanna, Ranking Members Kirkpatrick and Meng, and Members of the Subcommittees, this concludes my prepared statement. I would be pleased to respond to any questions that you may have at this time.

Contacts and Acknowledgments

If you or your staff have any questions about this statement, please contact Michele Mackin at (202) 512-4841 or MackinM@gao.gov. In addition, contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals who made key contributions to this testimony are Katherine Trimble, Assistant Director; Russ Reiter; Carl Barden; Virginia (Jenny) Chanley; Dayna Foster; Kristine Hassinger; Georgeann Higgins; Julia Kennon; Kenneth Patton; Roxanna Sun; Bob Swierczek; and Jocelyn Yin.

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