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Improper Pricing on the McKinsey Professional Services Contract May Cost the United States an Estimated \$69 Million

Report Number A170118/Q/6/P19004
July 23, 2019

Executive Summary

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Why We Performed This Audit

We performed this audit as a follow-up to a preaward audit of the proposal for the option to renew GSA Contract Number GS-10F-0118S, with McKinsey & Company, Inc. Washington D.C. (McKinsey). McKinsey refused to provide the records required to complete the preaward audit; therefore, the audit report advised the contracting officer to obtain the necessary information or cancel the contract. However, instead of addressing the contractor's lack of cooperation during the preaward audit, a Federal Acquisition Service (FAS) division director (Division Director) removed the contracting officer from the contract negotiations and awarded the contract pricing with rates that were at least 10 percent higher than those originally proposed. As a result, we had concerns about how the contract pricing was awarded and how pricing was determined to be fair and reasonable. Our objective for this audit was to determine whether FAS administered Contract Number GS-10F-0118S in accordance with applicable laws, regulations, and policies.

What We Found

FAS did not administer Contract Number GS-10F-0118S in accordance with applicable laws, regulations, and policies. We determined that the Division Director used invalid price comparisons, relied on unsupported information, and performed insufficient analyses to justify the awarded contract pricing. We also found that the Division Director violated standards of conduct by advocating for McKinsey to other procurement officials. Finally, the Division Director impeded the audit by failing to take appropriate action as required by the Federal Acquisition Regulation to obtain required data to complete the preaward audit.

The Division Director's actions to justify and award this pricing violated federal regulations and the trust placed in him as a government employee with fiscal responsibilities to the federal government and taxpayers. As a result of these actions, we estimate GSA customers could pay an additional \$69 million over the option period. FAS should take the appropriate actions and establish controls to remedy the issues outlined in this report.

What We Recommend

We recommend the FAS Commissioner:

1. Cancel McKinsey's Contract Number GS-10F-0118S.

2. Cancel McKinsey's Schedule 70 Contract Number GS-35F-646GA.
3. Review all FAS contracts with team-based pricing to ensure they comply with Federal Acquisition Regulation requirements.
4. Establish additional controls to ensure contracting staff obtain required audit records to perform audits prior to awarding contract actions.
5. Assess whether the Division Director should be involved in future McKinsey contact or contract actions.
6. Establish additional controls to ensure that FAS contracting staff maintain independent and impartial relationships with FAS contractors in accordance with federal regulations.
7. Take appropriate action to address the Division Director's use of invalid price comparisons, reliance on unsupported information, and violation of standards of ethical conduct.
8. Take appropriate action to address the Washington Branch Chief's actions on the McKinsey Schedule 70 contract award and this audit.

FAS agreed with the concerns outlined in the findings and partially agreed with the recommendations. The FAS Commissioner's written comments are included in their entirety at **Appendix B**.

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Introduction

The audit team performed an audit of the GSA Federal Acquisition Service's (FAS) administration of GSA Contract Number GS-10F-0118S with McKinsey & Company, Inc. Washington D.C. (McKinsey).

Purpose

The audit team performed this audit as a follow-up to a preaward audit of the proposal for the option to renew Contract Number GS-10F-0118S with McKinsey. During the preaward audit, McKinsey refused to provide the required records; therefore, the audit report advised the contracting officer to obtain the necessary information or cancel the contract. However, instead of addressing the contractor's lack of cooperation during the preaward audit, the Division Director removed the contracting officer from the contract negotiations and awarded the contract pricing with rates that were at least 10 percent higher than those originally proposed. As a result, we had concerns as to how the contract pricing was awarded and how FAS determined the contract pricing to be fair and reasonable.

Objective

Our objective was to determine whether FAS administered Contract Number GS-10F-0118S in accordance with applicable laws, regulations, and policies.

See **Appendix A** – Scope and Methodology for additional details.

Background

According to FAS, GSA's Federal Supply Schedule Program establishes long-term government-wide multiple award schedule contracts with companies to provide federal agencies with access to commercial products and services at volume discount pricing. A goal of the program is to leverage the buying power of the federal government to achieve savings by combining the purchases of multiple government agencies under one contract. FAS administers this program and collects an Industrial Funding Fee to cover its cost of operating the program.

On January 27, 2006, FAS awarded Contract Number GS-10F-0118S to McKinsey.¹ The contract was for 5 years with three 5-year renewal options. Under its contract, McKinsey offers management consulting services to improve performance issues related to strategy, organization, operations, and business technology. McKinsey's contract offers weekly team-based pricing as opposed to hourly labor category-based pricing. The current contract option expires on January 26, 2021. Sales under the contract totaled \$956.2 million through March 31,

¹ McKinsey is a subsidiary of McKinsey & Company, Inc., a global consulting company that has been in business since 1926.

2019. Since its award, FAS has realized \$7.2 million in Industrial Funding Fee revenue from this contract.

In July 2015, as part of its offer to renew the contract, McKinsey proposed no change to its existing weekly team-based rates for the option period. The contracting officer awarded the contract option effective January 27, 2016, with no change in pricing pending the results of a preaward audit.

The preaward audit of McKinsey's proposal was performed and the report was issued on March 24, 2016. The report found that McKinsey's proposal did not provide sufficient information for the government to evaluate the offered pricing or establish fair and reasonable contract prices. The audit determined that McKinsey should provide either related party commercial sales from its parent company, McKinsey & Company, Inc., or cost buildup information to support its proposed pricing. McKinsey refused to provide either. As a result, the report advised the contracting officer to require McKinsey to provide this information or cancel McKinsey's contract. On May 19, 2016, the initial contracting officer formally agreed with the preaward audit findings and attempted to obtain the required audit information.

Subsequently, between July 6 and July 15, 2016, McKinsey exchanged several emails with the FAS Chief of Staff and the GSA Administrator's assistant regarding concerns about its contract and the contracting officer. The Administrator's assistant engaged the FAS Chief of Staff to look into the issue. The FAS Chief of Staff repeatedly encouraged McKinsey to address its concerns with the contracting officer. The FAS Regional Commissioner agreed and on July 13, 2016, emailed the FAS Chief of Staff stating, "[S]enior GSA Leadership should not be involved in this." Following this communication, the GSA Administrator's office and the FAS Chief of Staff became less involved in the contract. On the same day, the Division Director began assisting the contracting officer with contract negotiations.

On July 28, 2016, the Division Director asked the audit team for a list of information needed for the audit so he could forward it to McKinsey. The audit team provided the list to the contracting officer. However, the Division Director subsequently altered the list by deleting the requests for information from McKinsey's parent company and deleting any references to cost buildup information. The altered list was forwarded to McKinsey on August 2, 2016. On August 4, 2016, the audit team learned about the altered list and contacted the contracting officer because the audit team disagreed with the changes and sought to clarify the request. On August 29, 2016, McKinsey provided information in response to the altered list.

On August 30, 2016 – while the Division Director was negotiating the option pricing – the FAS Regional Commissioner met with McKinsey's Senior Partner at McKinsey's Washington, D.C. offices. The FAS Regional Commissioner told us this was a one-on-one meeting and that they did not discuss anything specific to the contract. On August 31, 2016, the audit team informed the contracting officer that the information McKinsey provided was not responsive to the audit requests.

Although the Division Director did not obtain the information the audit team needed, he moved forward with negotiating the contract pricing. On September 21, 2016, the Division Director provided the audit team with the draft pricing award documents. On the same day, the Division Director wrote a memorandum which formally reassigned the contract negotiations from the contracting officer to himself. On September 28, 2016, the audit team informed the Division Director that the draft pricing award documents did not address the audit findings. Despite the outstanding audit issues, the Division Director awarded the pricing modification to McKinsey on October 5, 2016.

The awarded pricing was at least 10 percent higher than the rates originally proposed by McKinsey.

Contract Terms Negotiated

As noted earlier, in July 2015, as part of its offer to renew the contract, McKinsey originally proposed no change to its existing weekly team-based rates for the option period. In September 2016, McKinsey revised its proposal to request a 10 to 14 percent rate increase, the same month the Division Director reassigned the contract to himself. The contract option pricing the Division Director awarded in October 2016 increased McKinsey’s weekly rates by at least 10 percent over McKinsey’s original proposal. See *Figure 1*. The Division Director also negotiated an additional increase up to 3 percent effective January 2017, effectively granting McKinsey the requested 14 percent rate increase.

Figure 1 – Awarded Contract Pricing

Team	Full-Time Team Makeup (includes undefined part-time leadership and staff)	Original Proposed Weekly Rate	Weekly Rate Awarded	% Above Existing Rate	Annualized Rate
A	Engagement Manager, 1 Associate Or Business Analyst (BA)	\$120,186	\$133,196	11%	\$6,926,192
B	Engagement Manager, 2 Associates/BAs	\$151,539	\$167,943	11%	\$8,733,036
C	Engagement Manager, 3 Associates/BAs	\$181,805	\$201,485	11%	\$10,477,220
D	Engagement Manager, 4 Associates/BAs	Not Proposed	\$217,801	N/A	\$11,325,652
E	1 Associate/BA	\$51,442	\$56,707	10%	\$2,948,764

The contract outlines McKinsey’s individual labor categories but does not include individual rates for them. These labor categories include the experience and education requirements outlined in *Figure 2*.

Figure 2 – Awarded Labor Categories and Minimum Requirements

Senior Partner	<ul style="list-style-type: none">• Bachelor's Degree• 10 Years Experience
Partner	<ul style="list-style-type: none">• Bachelor's Degree• 5 Years Experience
Engagement Manager	<ul style="list-style-type: none">• Bachelor's Degree• 2 Years Experience
Associate	<ul style="list-style-type: none">• Bachelor's Degree• 1 Year Experience
Business Analyst	<ul style="list-style-type: none">• Bachelor's Degree• No Experience

Results

The Division Director did not administer McKinsey's contract for consulting services under Contract Number GS-10F-0118S in accordance with applicable laws, regulations, and policies. The services awarded under the contract do not comply with regulations for Federal Supply Schedule contracts. We determined that the Division Director failed to comply with federal laws, regulations, and GSA policies by using invalid price comparisons, relying on unsupported information, and performing insufficient analyses to justify the awarded contract pricing. We also found that the Division Director violated standards of conduct by advocating for McKinsey to other procurement officials. Finally, the Division Director impeded the audit by failing to take appropriate action as required by the Federal Acquisition Regulation (FAR) to obtain required data to complete the preaward audit.

As a result, we estimate GSA customers could pay an additional \$69 million over the course of the option period.

Finding 1 – Awarded contract services do not comply with regulations for Federal Supply Schedule contracts.

The contract terms, conditions, and offered services do not comply with applicable laws and regulations. According to FAR 8.404, *Use of Federal Supply Schedules*, "Services offered on the schedule are priced either at hourly rates, or at a fixed price for performance of a specific task (e.g., installation, maintenance, and repair)."² McKinsey's contract is a services contract, but does not meet these requirements. The contract includes team-based weekly rates but does not define the number of people on each team, the number of hours each employee is required to work, or specific tasks to be performed.

In interviews with the OIG, the Division Director could not define the contract requirements. For example, he could not define what specific task the government would receive for a week of McKinsey's services or what constituted "full-time" or "part-time" staff as included in the contract. When questioned how many hours are included in McKinsey's weekly rates, the Division Director responded that the number of hours is irrelevant because McKinsey provides services without defined hours. However, the Division Director could not identify any contract clause that would hold McKinsey accountable for performance of any specific task.

The Division Director's award of the McKinsey rates did not comply with FAR 8.404 requirements. The awarded services are not priced at hourly rates or at a fixed price for performance of a specific task, and the Division Director could not define any such requirements.

² FAR 8.404(d).

Finding 2 – The Division Director failed to comply with federal laws, regulations, and GSA policy in awarding the contract pricing.

In awarding the contract pricing modification, the Division Director did not comply with federal laws, the FAR, and GSA policy. To justify the awarded pricing, the Division Director performed invalid price comparisons, relied on unsupported information, and performed insufficient analyses. The Division Director's focus on awarding contracts rather than achieving fair and reasonable contract pricing failed to comply with applicable laws and regulations.

The Division Director Performed Invalid and Unsupported Price Analyses

The Division Director performed invalid, unsupported, and insufficient analyses of McKinsey's proposed contract rates. As a result, he did not appropriately determine the negotiated rates as fair and reasonable. His analyses failed to comply with FAR 15.404-1, *Proposal Analysis Techniques*, which requires an evaluation of the reasonableness of the offered prices, and FAR 15.406-3, *Documenting the Negotiation*, which requires the preparation of a price negotiation memorandum documenting the reasons for any variances from audit recommendations, the price analysis performed, and the determination of fair and reasonable pricing.

We found numerous problems with the price analyses performed in awarding the contract pricing modification. For example, we found that the Division Director:

- Used unsupported information to convert the proposed weekly rates to hourly rates;
- Performed invalid price comparisons of the proposed rates to future competitor rates;
- Performed invalid price comparisons of the proposed labor categories to competitor labor categories requiring more experience;
- Manipulated the GSA Pricing Tool to skew the price analysis;
- Analyzed an outdated pricing proposal;
- Overestimated weekly rates for McKinsey competitors;
- Failed to consider information showing pricing exceeds market rates; and
- Incorrectly claimed cost savings despite the substantial increase in government costs.

These issues are discussed below.

Unsupported information used to convert the proposed weekly rates to hourly rates.

As described in *Finding 1*, the Division Director told us that McKinsey provides services without defined weekly hours. However, in an effort to justify McKinsey's rates, the Division Director attempted to compare McKinsey's weekly rates to the hourly rates of its competitors in the price analysis. To do so, the Division Director converted McKinsey's weekly rates to hourly rates by assuming McKinsey team members work 65 hours per week. In an interview, the Division Director acknowledged that he had no support for using a 65-hour week. By using the 65-hour week, the Division Director's computed hourly rates appeared more reasonable compared to a standard 40-hour week. However, these computed hourly rates were still high: the Division

Director calculated rates for an Associate with 1 year of experience at \$467 per hour (\$1.6 million per year) and an Engagement Manager with 2 years of experience at \$1,046 per hour (\$3.5 million per year). The Division Director used the GSA Pricing Tool discussed below to compare these calculated rates to the rates of McKinsey's competitors.

Invalid comparison of current contract rates to future and fabricated rates on competitor contracts.

The Division Director compared two of McKinsey's 2016 contract rates to a competitor's escalated 2019-2020 rates. He also compared four separate McKinsey labor categories to a 5-year average of that same competitor's escalated labor categories for 2015-2020. Further, he fabricated labor category rates for two other competitor labor categories. By using fabricated and future rates, the Division Director inappropriately inflated competitor rates to support awarding higher contract pricing to McKinsey. The Division Director said that these were mistakes; however, the file documentation shows the Division Director performed calculations and specific searches to identify these rates. We concluded that the Division Director computed these invalid comparisons to justify the awarded rates.

Invalid comparison of McKinsey labor categories to more experienced competitor categories.

The Division Director also compared McKinsey's labor categories to competitors' labor categories for much more experienced personnel. For example, the Division Director compared the McKinsey Associate labor category, which requires 1 year of experience, to a competitor's Experienced Senior Project Director category, which requires 10 years of experience. Typically, the more experience required, the higher the rate; so this comparison would result in the McKinsey rate appearing more reasonable. The Division Director stated that he was comparing functional duties, but the descriptions for these two categories were not comparable. The Division Director consistently used similar invalid comparisons to justify the awarded rates.

Manipulation of the GSA Pricing Tool to skew the price analysis.

The Division Director attempted to use the GSA Pricing Tool to compare McKinsey rates to other GSA schedule contractors. The GSA Pricing Tool searches other schedule contract labor categories based on key words, experience, and education requirements. The Division Director inputted incorrect search criteria, resulting in higher rate comparisons with a wider range of pricing. For example, the Division Director compared a McKinsey Associate with 1 to 5 years of experience and a Bachelor's degree to Executives with 1 to 20 years of experience and Master's degrees. We performed similar queries using correct search criteria and found the Division Director's comparison rates were overstated by \$96 to \$385 per hour.

Analysis performed on outdated pricing proposal.

In July 2015, McKinsey proposed no change to the then-existing contract rates for the option period as outlined in *Figure 1*. However, McKinsey revised its proposal with higher rates in September 2016. The Division Director did not analyze McKinsey's revised proposal as required by FAR 15.404-1. The Division Director evaluated McKinsey's existing contract pricing despite receiving the revised proposal and stating in the price analysis his intention to award higher rates. He subsequently awarded rates at least 10 percent higher than the existing contract

rates. In interviews with the OIG, the Division Director stated he could analyze either the existing contract rates or the revised proposed rates. By analyzing the existing contract rates, the Division Director attempted to make McKinsey's rates appear more reasonable compared to its competitors.

Overestimation of weekly rates for McKinsey competitors.

In an attempt to make McKinsey's rates appear reasonable, the Division Director also tried to compare McKinsey's weekly rates to its competitors. Since none of these competitors have weekly team rates, the Division Director converted other contractors' hourly rates to weekly rates using invalid and unsupported assumptions. After adjusting for these invalid and unsupported assumptions, we found the Division Director overstated the converted weekly rates for three of McKinsey's competitors by as much as 470 percent.

Failure to consider information showing pricing exceeds market rates.

The Division Director performed an analysis which showed that McKinsey's rate increases throughout the original contract period exceeded market rates by 43 to 53 percent, indicating that a further price increase for the option period was not warranted or supported. However, the Division Director disregarded this information in evaluating both the 10 to 11 percent price increase and the subsequent 3 percent increase, stating that this analysis is only one method of determining price reasonableness.

The Division Director also determined that the existing contract rates exceeded market prices by as much as 193 percent. However, this information did not prevent the Division Director from awarding rates at least 10 percent higher than those rates and granting a subsequent 3 percent increase.

Incorrect claim of cost savings.

Despite awarding 10 to 11 percent price increases, the Division Director stated in the price analysis that the rates awarded resulted in cost savings of \$4 million. We estimate that the price increases awarded by the Division Director could actually increase costs to the government by an additional \$69 million over the course of the option period.

As summarized above, the Division Director performed invalid price comparisons and relied on unsupported information to justify McKinsey's high contract pricing. The Division Director told us that he was "trying to back into" McKinsey's rates and that he was "trying to get to the offered price" by fitting "a square peg in a round hole." As a result, the Division Director failed to analyze the proposal or justify the negotiated rates as fair and reasonable as required by FAR 15.404-1 and FAR 15.406-3.

The Division Director Failed to Comply with the Competition in Contracting Act and GSA Policies

Federal laws and GSA policies emphasize the importance of fair and reasonable pricing on schedule contracts. For example, the Competition in Contracting Act of 1984 (CICA) (41 U.S.

Code 152) requires GSA multiple award schedule orders and contracts to be at the lowest overall cost to meet the needs of the government. In addition, General Services Administration Acquisition Manual 538.270-1, *Evaluation of offers without access to transactional data*, requires contracting officers to seek to obtain the offeror's best price.

The Division Director failed to comply with CICA and GSA requirements. By using invalid price comparisons, relying on unsupported information, and performing invalid price analyses, the Division Director did not ensure that the pricing would be at the lowest overall cost to meet the government's needs. The Division Director also did not seek to obtain the offeror's best price.

In interviews with the OIG, the Division Director made statements that were contrary to these requirements and demonstrated a lack of concern regarding pricing. He stated, "Rates on every [schedule] contract are not the lowest overall cost to meet the needs of the government." He also stated, "Ordering agencies should not rely on GSA's determination of fair and reasonable pricing" when placing orders against schedule contracts. Regional staff also told us that FAS regional management focused on awarding contracts and did not focus on pricing. This is reflected in staff performance evaluations that emphasize timeliness and productivity rather than pricing.

We issued previous reports recommending that FAS prioritize pricing. On July 31, 2007, we issued *Review of Multiple Award Schedule Program Contract Workload Management*, in which we recommended that FAS "Establish performance measures that evaluate [contracting officers/contract specialists'] (a) verification of vendor disclosures related to commercial sales practices, (b) effectiveness in analyzing prices and conducting negotiations, and (c) consideration of the field pricing assistance." In our September 30, 2009, report, *Review of Program Performance Measurement for Procurement*, we found that "FAS needs to strengthen performance measures for contract pricing." In our July 22, 2016, report, *IT Reseller Contracts Present Significant Challenges for GSA's Schedules Program*, we recommended that FAS establish performance measures that reinforce the objective to obtain most favored customer prices during price negotiations. The actions taken to award the McKinsey contract show a recurring issue related to FAS's lack of emphasis on pricing.

Overall, the Division Director's award of the McKinsey contract pricing was not in compliance with GSA policy, FAR requirements, or CICA. As a result, the Division Director's determination that McKinsey's contract pricing is fair and reasonable is baseless. We estimate the price increases awarded by the Division Director could cost the government an additional \$69 million over the current contract option period.

Finding 3 – The Division Director violated the standards of ethical conduct by advocating on behalf of McKinsey.

The Division Director violated requirements governing ethical conduct in federal acquisitions in his dealings with McKinsey. Acquisition professionals are required to adhere to a variety of laws

and regulations when awarding and administering contracts. For example, FAR 3.101-1, *Standards of Conduct – General*, states:

Government business shall be conducted in a manner above reproach and, except as authorized by statute or regulation, with complete impartiality and with preferential treatment for none. Transactions relating to the expenditure of public funds require the highest degree of public trust and an impeccable standard of conduct. The general rule is to avoid strictly any conflict of interest or even the appearance of a conflict of interest in Government-contractor relationships. While many Federal laws and regulations place restrictions on the actions of Government personnel, their official conduct must, in addition, be such that they would have no reluctance to make a full public disclosure of their actions.

Similarly, the Standards of Ethical Conduct for Employees of the Executive Branch (5 Code of Federal Regulations 2635) provide that “[e]mployees shall endeavor to avoid any actions creating the appearance that they are violating the law or the ethical standards.”

In addition to conducting a defective pricing analysis, the Division Director engaged in a pattern of conduct towards McKinsey that called into question his impartiality. We describe that conduct below.

The Division Director Advocated on Behalf of McKinsey for a GSA Schedule 70 Contract

At McKinsey’s request, the Division Director acted on behalf of the contractor to help it obtain a separate contract with FAS’s Schedule 70 for information technology professional services. The Division Director intervened in the matter to assist McKinsey even though he was not the assigned contracting officer and could not justify his involvement in the contract award.

McKinsey failed multiple times to obtain a Schedule 70 contract through FAS’s Fort Worth, Texas office. The Fort Worth contracting officer handling these offers told us she could not determine McKinsey’s offer to be fair and reasonable, stating McKinsey’s rates were “ridiculous” and unsupported. She also stated that McKinsey’s consultant told her if she kept rejecting the offers, McKinsey would continue resubmitting until it received a contract.

After failing to persuade the Fort Worth contracting officer to accept its offer, McKinsey asked the Division Director to intervene. On September 8, 2016, a McKinsey representative sent the following memo to the Division Director:

We would really appreciate it if you could assist us with our Schedule 70 application. In particular, given that you understand our model, it would be enormously helpful if you could help the Schedule 70 Contracting Officer understand how it benefits the government.

On November 28, 2016, the Division Director sent an email to GSA's FAS Washington Branch Chief and other GSA personnel, stating:

[McKinsey] told us [the Schedule 70 offer] was rejected due to issues in pricing documentation. We went through an audit with [McKinsey] and have just updated pricing. They would like to get on [Schedule] 70, and asked us if we could reach out and walk you through how we were able to substantiate the pricing.

On February 13, 2017, the Division Director and the Washington Branch Chief met with McKinsey representatives in Washington, D.C. On February 24, 2017, McKinsey resubmitted its Schedule 70 offer and sent the Washington Branch Chief an email notifying him of the submission.

Schedule 70's normal practice is to assign resubmitted offers to the contracting officer who handled the previous rejection. However, the McKinsey Schedule 70 offer was not handled according to this practice. Instead of being assigned to the Fort Worth contracting officer, it was assigned to the Washington, D.C. office.

The Washington Branch Chief told us he did not know why the contract was transferred to his office. However, GSA emails show that on the same day the Washington Branch Chief received notice from McKinsey of its resubmitted offer, the Branch Chief sent an email to the responsible Schedule 70 analyst specifically requesting assignment of the offer to the Washington Branch.

The Washington Branch Chief also stated he did not know the contract was previously rejected by the Fort Worth office. However, he was included in the Division Director's November 28, 2016, email described above regarding the rejection of McKinsey's previous offers. The same November 28, 2016, email chain discussed Schedule 70's practice of assigning resubmitted offers to the contracting officer who handled the previous rejection.

After the contract was reassigned to the Washington, D.C. office, McKinsey was awarded a Schedule 70 contract (Contract Number GS-35F-646GA) on August 30, 2017. The Schedule 70 contract has reported \$1.6 million in sales since its award and has not been audited.

When we asked the Division Director about his involvement with McKinsey's Schedule 70 offer, he initially told us that he called the Washington Branch Chief to offer assistance in leveraging the work the Division Director had already done. He later stated, "My only interest is helping out my contractor."

In this instance, the Division Director acted as an advocate for McKinsey by contacting Schedule 70 personnel regarding McKinsey's proposal. In addition, the Washington Branch Chief deviated from Schedule 70's normal procedure without a valid explanation to award the contract to

McKinsey and provided inaccurate information in response to our inquiries regarding his involvement in the Schedule 70 contract award.

The Division Director Acted on Behalf of McKinsey for Contracts with Other Agencies

McKinsey also requested the Division Director's help in obtaining various non-GSA contracts. For example, GSA documents show that McKinsey asked the Division Director to contact the National Oceanic and Atmospheric Administration (NOAA) to provide information on McKinsey's pricing structure in connection with McKinsey's efforts to secure a contract with that agency. In an email exchange with a McKinsey representative dated February 14, 2017, the Division Director stated:

The below [table] helped us "deconstruct" the team and price it based upon our typical market survey methodology. We also analyzed financial information from the financial statements provided...I have a feeling NOAA would like this information, but we would not provide without further discussion with McKinsey.

The McKinsey representative replied:

Thank you for yesterday and for talking to NOAA. We are comfortable with you sharing the table with NOAA. If you could add the following, that would be great.

*McKinsey prices on a firm-fixed price basis and not on an hourly basis. The estimated hours are not a commitment but are reflective of the average time spent on similar projects and are for evaluation purposes only. We would prefer to not share financials unless asked.

Similarly, McKinsey requested the Division Director's assistance with its efforts to obtain a contract with the Department of Interior. On April 16, 2018, the McKinsey representative sent an email to the Division Director stating:

I hope all is well. I just left you a voicemail. We would really appreciate your help in talking to the person listed below from the Department of the Interior. She is asking for hourly information that we don't have (as you know well), and we thought maybe talking to you would be helpful. Would you be willing to call her and explain how you were able to do a price justification?

GSA documents reflect that McKinsey made similar requests of the Division Director in early 2018 with respect to its efforts to obtain a contract with the Centers for Medicare and Medicaid Services.

The Division Director acknowledged to the OIG that he contacted other agencies at McKinsey's request and discussed McKinsey's pricing structure with them. When we asked why he did this,

he said that he “talk[ed] with contractors all the time.” However, he said he could not recall sharing pricing information with other agencies at any other contractor’s request. We asked multiple contracting officers if it was normal for a contractor to request their assistance in obtaining another federal contract. We were repeatedly told it is not, and it would be “inappropriate” and “a conflict of interest.”

Government employees should conduct business in a manner above reproach and avoid even the appearance of a conflict of interest in government-contractor relationships. In this case, the Division Director abandoned his role as an impartial contracting officer when he intervened to assist McKinsey in obtaining a Schedule 70 contract and in advocating for McKinsey’s pricing structure with other agencies. By providing McKinsey such assistance, the Division Director potentially gave McKinsey an unfair competitive advantage. Moreover, the Division Director told us he could not recall helping other contractors the way he helped McKinsey by contacting multiple agencies on McKinsey’s behalf and assisting McKinsey in obtaining government contracts. Under the totality of the circumstances, the Division Director’s conduct appears to contravene the broad principles of conducting business above reproach and showing “preferential treatment for none” outlined in FAR 3.101. This conduct creates the appearance of impropriety in violation of 5 CFR 2635 and FAR 3.101.

Finding 4 – The Division Director impeded the audit of the proposed pricing by failing to take appropriate action to obtain required data to complete the preaward audit.

The primary purpose of a preaward audit of a multiple award schedule contract is to ensure that the information submitted by the contractor is sufficient for the contracting officer to determine whether the proposed prices are fair and reasonable. In accordance with FAR 15.404-2(d), when an audit determines that the data is not sufficient, the contracting officer is required to take appropriate action to obtain the data.

However, for the McKinsey contract, the Division Director failed to take appropriate action to obtain the information needed for the audit. In essence, the Division Director worked to prevent the determination of fair and reasonable pricing for this contract.

As discussed previously in the background of the report, a preaward audit was performed on McKinsey’s proposal to extend the contract for the current option and the audit report was issued on March 24, 2016. The audit found that McKinsey’s proposal did not provide sufficient information to evaluate the offered pricing or establish fair and reasonable contract prices. The audit determined that McKinsey should provide either related party commercial sales from its parent company, McKinsey & Company, Inc., or cost buildup information to support its proposed pricing. However, McKinsey refused. As a result, the audit advised the contracting officer to require McKinsey to provide this information or cancel McKinsey’s contract.

The initial contracting officer agreed with the preaward audit findings and attempted to obtain the required audit information. However, the Division Director removed the initial contracting

officer from the contract and on October 5, 2016, the Division Director awarded contract pricing at rates at least 10 percent higher than McKinsey originally proposed.

In awarding the contract, the Division Director failed to take action to obtain requested records from McKinsey as required by FAR 15.404-2, *Data to Support Proposal Analysis*. According to FAR 15.404-2(d):

[I]f the data provided for review is so deficient as to preclude review or audit, or if the contractor or offeror has denied access to any records considered essential to conduct a satisfactory review or audit....The contracting officer immediately shall take appropriate action to obtain the required data. Should the offeror/contractor again refuse to provide adequate data, or provide access to necessary data, the contracting officer **shall withhold the award or price adjustment and refer the contract action to a higher authority.**
[emphasis added.]

The Division Director did not require McKinsey to produce the data the OIG required to perform the audit. As a result, the Division Director violated FAR requirements and awarded unsupported contract pricing as outlined in *Finding 1* and *Finding 2*.

Conclusion

The Division Director did not administer McKinsey's contract for consulting services under contract number GS-10F-0118S in accordance with applicable laws, regulations, and policies. The services awarded under the contract do not comply with the FAR. In addition, we determined that the Division Director failed to comply with laws, regulations, and GSA policies by using invalid price comparisons, relying on unsupported information, and performing insufficient analyses to justify the awarded contract pricing. We also found that the Division Director violated standards of ethical conduct by advocating for McKinsey. Finally, the Division Director impeded the audit by failing to take appropriate action as required by the FAR to obtain required data to complete the preaward audit.

As a result, we estimate GSA customers could pay an additional \$69 million over the course of the option period. FAS should take the appropriate contract and administrative actions and establish controls to remedy the issues outlined in this report.

Recommendations

We recommend the FAS Commissioner:

1. Cancel McKinsey's Contract Number GS-10F-0118S.
2. Cancel McKinsey's Contract Number GS-35F-646GA.
3. Review all FAS contracts with team-based pricing to ensure they comply with FAR requirements.
4. Establish additional controls to ensure contracting staff obtain required audit records to perform audits prior to awarding contract actions.
5. Assess whether the Division Director should be involved in future McKinsey contract or contract actions.
6. Establish additional controls to ensure that FAS contracting staff maintain independent and impartial relationships with FAS contractors in accordance with federal regulations.
7. Take appropriate action to address the Division Director's use of invalid price comparisons, reliance on unsupported information, and violation of standards of ethical conduct.
8. Take appropriate action to address the Washington Branch Chief's actions on the McKinsey Schedule 70 contract award and this audit.

GSA Comments

FAS agreed with the concerns outlined in the findings and partially agreed with the recommendations. The FAS Commissioner's written comments are included in their entirety at **Appendix B**.

OIG Response

In his response, the FAS Commissioner stated he will address the pricing issues the OIG's audit identified in the two McKinsey contracts by first, seeking bilateral modifications to renegotiate the contracts, and second, canceling the contracts if McKinsey declines or renegotiations do not yield a result in the Government's best interest. In light of the substantial issues the audit found in McKinsey's team-based pricing, the OIG urges GSA leadership to ensure that any renegotiation results in pricing with either hourly rates or a fixed price for a specific task in compliance with FAR 8.404. We also urge GSA leadership to ensure that McKinsey produces all information needed to support its proposed pricing. The OIG is available to offer pricing support to FAS through a preaward or post-award audit, as necessary.

Audit Team

This audit was managed out of the Heartland Region Audit Office and conducted by the individuals listed below:

Michelle Westrup	Regional Inspector General for Auditing
Erin Priddy	Audit Manager
Shane Dunlay	Auditor-In-Charge
David Garcia	Auditor

Appendix A – Scope and Methodology

We examined the actions of the Division Director regarding the administration of Contract Number GS-10F-0118S with McKinsey. Specifically, we examined his actions related to the price increase awarded on October 5, 2016.

To accomplish our objective, we:

- Reviewed contract file documentation;
- Analyzed contract award information;
- Assessed the reliability of information relied on in the contract actions;
- Reviewed email records;
- Reviewed the FAR, the General Services Administration Acquisition Manual, GSA policy, contract requirements, and other relevant criteria; and
- Performed interviews with GSA and other government agency staff.

We conducted the audit between September 2017 and September 2018 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

Our assessment of internal controls was limited to those necessary to address the objective of the audit.

Appendix B – GSA Comments



GSA Federal Acquisition Service

July 19, 2019

MEMORANDUM FOR: Jay Fisher
Acting Regional Inspector General for Auditing
Heartland Region Audit Office (JA-6)

FROM: Alan B. Thomas, Jr. 
Commissioner
Federal Acquisition Service (Q)

SUBJECT: Response to Draft Report "*Improper Pricing on the McKinsey Contract May Cost the United States an Estimated \$69 Million*," Report Number A170118

Thank you for the opportunity to comment on the referenced draft audit report *Improper Pricing on the McKinsey Contract May Cost the United States an Estimated \$69 Million*, Report Number A170118, dated June 17, 2019, and for your cooperation in working with us. We carefully reviewed the draft report and agree with the concerns. The pricing as presented on page 3 of the draft report is concerning, and the price analysis techniques outlined raise questions which require further review.

U.S. General Services Administration
1800 F Street, NW
Washington, DC 20405

To address the concerns, Federal Acquisition Service (FAS) is taking the following **immediate actions**:

1. FAS will reassign the McKinsey Professional Services Schedule contract and Schedule 70 contract to a new contracting team.
2. Once the OIG clears us to share the audit with McKinsey, FAS will immediately pursue a bilateral contract modification to prevent placement of new orders while FAS attempts to negotiate better pricing. FAS strongly considered adopting the OIG's recommendation to cancel the contracts; however, we decided to pursue the bilateral contract modification for three reasons: first, it protects taxpayers by immediately stopping any new work under the contracts; second, it allows agencies to continue to perform mission critical work; and third, it affords FAS the opportunity to negotiate better pricing with a contractor that works with agencies across Government. On the other hand, cancelling the contracts does not protect taxpayers as quickly because it allows new work to be awarded until the cancellation is effective (30 days after receipt of the notice of the cancellation), cancellation may stop mission critical work, and it does not afford FAS the opportunity to negotiate better pricing for the Government. If McKinsey declines to accept a bilateral contract modification or renegotiations do not yield a result in the Government's best interest, FAS will cancel the contracts.
3. GSA's Procurement Management Review team (PMR team) is examining all team based pricing across the Federal Supply Schedules (FSS or Schedules) program. The PMR team is part of the Office of Government-wide Policy (OGP), not part of FAS, and thus provides an independent review.
4. Once the OIG clears us to discuss the audit publicly, FAS will reach out to customer agencies to make sure they are aware of concerns about the pricing and help them navigate potential implications of actions taken on the contracts.

In addition to these immediate actions to the serious concerns raised, FAS provides responses to each of the OIG's specific recommendations of the draft report as follows:

OIG Recommendation 001

Cancel McKinsey's Contract Number GS-10F-0118S.

FAS Response: Based upon the findings, FAS agrees that there were errors made in the price evaluation.

Once the OIG clears FAS to share the audit with McKinsey, FAS will immediately pursue a bilateral contract modification, which will prevent placement of new orders while FAS attempts to negotiate better pricing. FAS strongly considered adopting the OIG's recommendation to cancel the contract; however, we decided to pursue the bilateral contract modification and negotiation for better pricing for three reasons: first, it protects taxpayers by immediately stopping any new work under the contract; second, it allows agencies to continue to perform mission critical work; and third, it affords FAS the opportunity to negotiate better pricing with a contractor that works with agencies across Government. On the other hand, cancelling the contract does not protect taxpayers as quickly because it allows new work to be awarded until the cancellation is effective (30 days after receipt of the notice of the cancellation), cancellation may stop mission critical work, and it does not afford FAS the opportunity to negotiate better pricing for the Government.

If McKinsey declines to accept a bilateral contract modification or renegotiations do not yield a result in the Government's best interest, FAS will cancel the contract.

OIG Recommendation 002

Cancel McKinsey's Contract Number GS-35F-646GA.

FAS Response: Based upon the findings, FAS agrees that there were errors made in the price evaluation.

Once the OIG clears FAS to share the audit with McKinsey, FAS will immediately pursue a bilateral contract modification, which will prevent placement of new orders while FAS attempts to negotiate better pricing. FAS strongly considered adopting the OIG's recommendation to cancel the contract; however, we decided to pursue the bilateral contract modification and negotiation for better pricing for three reasons: first, it protects taxpayers by immediately stopping any new work under the contract; second, it allows agencies to continue to perform mission critical work; and third, it affords FAS the opportunity to negotiate better pricing with a contractor that works with agencies across Government. On the other hand, cancelling the contract does not protect taxpayers as quickly because it allows new work to be awarded until the cancellation is effective (30

days after receipt of the notice of the cancellation), cancellation may stop mission critical work, and it does not afford FAS the opportunity to negotiate better pricing for the Government.

If McKinsey declines to accept a bilateral contract modification or renegotiations do not yield a result in the Government's best interest, FAS will cancel the contract.

OIG Recommendation 003

Review all FAS contracts with team-based pricing to ensure they comply with FAR requirements.

FAS Response: FAS agrees with this recommendation. GSA's PMR team has already begun a review of all team based pricing across the Schedules Program. Because the PMR team is part of OGP, not part of FAS, this is an independent review.

OIG Recommendation 004

Establish additional controls to ensure contracting staff obtain required audit records to perform audits prior to awarding contract actions.

FAS Response: FAS concurs with this recommendation. FAS has made strides in this area by launching a contract audit working group in partnership with the OIG, instituting quarterly reviews, updating relevant policies and procedures, and conducting training. FAS will continue working collaboratively with the OIG Office of Audits on improving the contract audit process, particularly in terms of obtaining required audit records to perform audits. FAS will continue to build on these efforts to address this recommendation.

OIG Recommendation 005

Assess whether the Division Director should be involved in future McKinsey contact or contract actions.

FAS Response: FAS concurs with this recommendation and agrees to take appropriate action. The Director of Contract Operations is no longer the assigned Contracting Officer for McKinsey's Professional Services Schedule contract. Further, FAS is taking immediate action to reassign the contract to a new contracting team.

OIG Recommendation 006

Establish additional controls to ensure that FAS contracting staff maintain independent and impartial relationships with FAS contractors in accordance with federal regulations.

FAS Response: FAS concurs with this recommendation and agrees to take appropriate action. Furthermore, FAS will institute ethics training specifically focusing on independent and impartial relationships with contractors for its contracting staff.

OIG Recommendation 007

Take appropriate action to address the Division Director's use of invalid price comparisons, reliance on unsupported information, and violation of standards of ethical conduct.

FAS Response: FAS shares the concern on invalid price comparisons and is addressing this through the PMR reviews, bilateral contract modification and negotiation of better pricing. FAS takes seriously concerns about ethical conduct, and agrees to review the facts and circumstances regarding potential violations of standards of ethical conduct and take appropriate action.

OIG Recommendation 008

Take appropriate action to address the Washington Branch Chief's actions on the McKinsey Schedule 70 contract award and this audit.

FAS Response: This employee is no longer a FAS employee and FAS no longer has supervisory authority over the employee. In addition, the employee has no further involvement in this matter. FAS is coordinating with the employee's current organization to take appropriate action.

Thank you again for the opportunity to review this draft audit report. FAS is deeply concerned by the OIG's findings, is taking the immediate actions outlined above, reviewing all facts and circumstances surrounding these issues, and will take appropriate action. As we move forward, we appreciate the OIG's assistance in obtaining any information needed to take appropriate action.

Appendix C – Report Distribution

GSA Administrator (A)

GSA Deputy Administrator (AD)

Commissioner (Q)

Acting Deputy Commissioner (Q1)

Deputy Commissioner (Q2)

Chief of Staff (Q0A)

Senior Advisor (Q0A)

Program Analysis Officer (Q1A)

Assistant Commissioner, Office of Policy and Compliance (QV)

Financial Management Officer, FAS Financial Services Division (BGF)

Director of Financial Management (BG)

Chief Administrative Services Officer (H)

Audit Management Division (H1EB)

Assistant Inspector General for Auditing (JA)

Director, Audit Planning, Policy, and Operations Staff (JAO)