

February 27, 2001

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SUBJECT: Contracting Practices for the Procurement of Mail Transport Equipment Services (Audit Report Number CA-AR-01-001)

This report presents the results of our review of the Postal Service's contracting practices used in the procurement of mail transport equipment services (Project Number 99PA024TR000). We conducted the review as part of the Office of Inspector General's (OIG) audit of the progress of mail transport equipment service centers in meeting performance and financial goals outlined in the Postal Service's Decision Analysis Report for the project.

The audit revealed that the Postal Service awarded three noncompetitive contracts, under which it may pay up to \$53 million more than it will for competitive contracts awarded for the same or similar levels of service. In addition, the three noncompetitive contracts were initially awarded as letter contracts, which potentially exposed the Postal Service to more performance and cost risks than other forms of contracting. Furthermore, Postal Service contracting officials did not define the cost and performance expected under the contracts within the six months required by Postal Service procurement policy. Instead the letter contracts were not definitized until 3 to 12 months beyond the 180-day time frame. The audit also disclosed that a Postal Service senior manager had been directing contractors to perform work without the required contracting authority. To correct the issues identified in the report, we provided nine recommendations, which could save the Postal Service almost \$11 million in contract costs. Management generally agreed with all nine recommendations, but did not agree with all of our findings. We evaluated management's comments and believe we have presented a fair representation of contracting practices used by the Postal Service to procure mail transport equipment services. Management's comments and our evaluation of these comments are included in the report.

We appreciate the cooperation and courtesies provided by your staff during the review. If you have any questions, please contact Hermeta Martin-Reddon, acting director, Contracts, or me at (703) 248-2300.

Billy Sauls  
Assistant Inspector General  
for Business Protection

Attachment

cc: John R. Gunnels

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## EXECUTIVE SUMMARY

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### Introduction

This audit report presents the results of our audit of the Postal Service's contracting practices in the procurement of mail transport equipment services (Project Number 99PA024TR000). We conducted the audit as part of the Office of Inspector General's (OIG) assessment of the progress of mail transport equipment service centers in meeting the performance and financial goals outlined in the Postal Service's Decision Analysis Report for the project. This report is the third<sup>1</sup> in a series of reports resulting from our audit of mail transport equipment service centers, which was initiated at the request of the Board of Governors.

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### Results in Brief

Our audit determined that the Postal Service awarded three noncompetitive contracts, under which it may pay up to \$53 million more than it will for competitive contracts awarded for the same or similar level of service. According to data in the contract files, the noncompetitive contracts were awarded, in part, to compensate a contractor for preparing the statement of work used to award other competitive contracts for the mail transport equipment service center project. However, we found that the justification for noncompetitive contract awards did not fully meet Postal Service requirements. In addition, the noncompetitive contracts were awarded as undefinitized letter contracts, which potentially exposed the Postal Service to cost and performance risks.<sup>2</sup> Due to inadequate staffing, these contracts were not definitized until 3 to 12 months beyond the 180-day time frame required by the Postal Service Purchasing Manual.

Finally, the review disclosed that a Postal Service senior manager directed contractors to perform work without the required authority. As a result, the Postal Service paid a contractor over \$1.3 million for work which was not properly authorized. In addition, the Postal Service is at risk of being billed an additional \$11.2 million by this contractor for other unauthorized work. Postal Service officials stated that the senior manager might have believed he had contracting

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<sup>1</sup> The first report, Mail and Other Items Missent to Mail Transport Equipment Service Centers, (report number TR-AR-00-007), was issued on April 5, 2000. The second report, Adequacy of Mail Transport Equipment Service Centers Network Internal Controls (report number TR-AR-01-001) was issued on October 31, 2000.

<sup>2</sup> Contracts are classified as undefinitized until contract terms and conditions can be negotiated. The Purchasing Manual requires that letter contracts be definitized within 180 days of initiating contractor performance.

authority because the roles, responsibilities, and authorities of participants in the procurement cycle were not clear.

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**Summary of  
Recommendations**

We recommend the vice president, Purchasing and Materials, direct the contracting officer to renegotiate the rates of two noncompetitive contracts, seek competition in the award of contracts whenever possible, and clarify existing policy on the roles, responsibilities, and authorities of participants in the procurement cycle. Further, we recommend the vice president, Purchasing and Materials implement corrective actions he agreed to in response to our March 31, 2000, report, including developing a process to ensure buyers comply with the 180-day time period for definitizing cost and performance deficiencies, and controlling and documenting letter contract risks.

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**Summary of  
Management's  
Comments**

Management generally agreed with the nine recommendations but did not agree with all of our findings. Management agreed to work with its noncompetitive contractor to reduce contract costs and to implement improvements in seeking contract competition, issuing letter contracts, and making unauthorized commitments. However, management questioned our finding that it may pay up to \$53 million more to its noncompetitive contractor. Management also disagreed with our conclusions regarding the basis for the noncompetitive awards and that all the contracts could have been awarded competitively, resulting in more fair and reasonable contract prices overall. We summarized these comments in the report and included the full text of the comments in Appendix C.

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**Overall Evaluation of  
Management's  
Comments**

We evaluated management's comments and believe we have presented a fair representation of contracting practices used by the Postal Service to procure mail transport equipment services. We conducted interviews, reviewed contract file documents, and used statistical analysis to evaluate contract data and conclude that Postal Service may pay up to \$53 million more to its noncompetitive contractor. The details of our analysis have been shared with individuals involved in the mail transport project and are available for further review. We also conducted interviews and reviewed all available data forming the basis for the noncompetitive awards. As a result, we maintain that all the

contracts could have been awarded competitively, resulting in more fair and reasonable contract prices overall. Because management's planned or implemented actions are responsive and address the issues identified in this report, no further action is required.

## INTRODUCTION

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### Background

On May 13, 1992, the Postal Service awarded a contract for Contractor A to establish and operate a pilot mail transport equipment service center in Greensboro, North Carolina. The pilot center contract was completed on February 28, 1999, after which Postal Service officials requested Contractor A to prepare a statement of work that could be used to solicit bids for competitive contracts. Subsequently, Postal Service officials awarded two noncompetitive contracts to Contractor A.

The first contract was awarded in December 1997 to operate a mail transport equipment service center. The second contract was awarded in February 1998 to establish an integration service center to provide management support and an integrated system of collecting and analyzing production data for all of the equipment service centers. In September 1998, Postal Service officials competitively awarded six more contracts to four other companies to establish and operate mail transport equipment service centers. Finally, in May 1999, the Postal Service awarded a third noncompetitive contract to Contractor A to operate another equipment service center.

The mail transport equipment service centers were established to process, repair, store, and distribute mail transport equipment, such as pallets, mailbags, trays, and containers. The service centers were divided into eight clusters with three centers per cluster except for cluster eight, which has only one center.

The following table lists the eight contracts awarded to establish and operate the service centers and the integration service contract. The contracts were issued for a 5-year period, except the contract for cluster eight, which is for 3 1/2 years.

Contractor	Cluster Number	Award Date	Competitive/ Noncompetitive	Contract Value
A	7	12-28-97	Noncompetitive	\$267,078,746
A	Integration Contract	2-13-98	Noncompetitive	\$ 62,006,891
B	1	9-18-98	Competitive	\$169,000,299
C	2	9-18-98	Competitive	\$136,732,627
D	3	9-18-98	Competitive	\$139,904,696
E	4	9-18-98	Competitive	\$ 99,829,082
D	5	9-18-98	Competitive	\$105,111,849
B	6	9-18-98	Competitive	\$140,502,459
A	8	5-10-99	Noncompetitive	\$ 38,800,000
			<b>Total</b>	<b>\$1,158,966,649</b>

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**Objectives, Scope,  
and Methodology**

Our objective was to evaluate the contracting practices used to procure services for the mail transport equipment service center project. We reviewed contract files and contractor invoices for the five contractors, and reviewed Postal Service procurement and purchasing policies and procedures. In addition, we interviewed headquarters contracting personnel responsible for contract award and administration. Our review was conducted from December 1999 through February 2001 in accordance with generally accepted government auditing standards, and included such tests of internal controls as were considered necessary under the circumstances. We discussed our recommendations with appropriate management officials and included their comments where appropriate.

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**Prior Audit Coverage**

We conducted a review and issued a management advisory report on contract audit practices, report number CA-MA-00-001, dated March 31, 2000, where we noted that the Postal Service issued letter contracts that could result in increased costs and performance deficiencies. We suggested and the vice president, Purchasing and Materials agreed to:

- Develop a process to ensure buyers comply with the 180-day time period for defining contract terms and conditions.



- Include required controls in letter contracts to reduce cost and performance deficiencies.
- Document contract risks when using letter contracts.

In addition, the Postal Inspection Service conducted five audits relating to Mail Transport Equipment Service Center contracting issues. These reports are summarized in Appendix A.

## AUDIT RESULTS

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### Noncompetitive Contract Awards

We found the Postal Service had issued noncompetitive contracts at higher prices than competitive contracts and that the noncompetitive contracts were not justified according to Postal Service requirements. The Postal Service may be able to reduce the cost of these contracts through negotiations with the contractor. We also observed that these noncompetitive contracts were awarded as letter contracts, which might have exposed the Postal Service to increased cost and performance risks.

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### Contract Costs

We compared the noncompetitive contract prices for clusters seven and eight awarded to Contractor A with the prices for the six competitive contracts awarded to other contractors to establish and operate clusters with the same or similar volume and services. Based on the estimated processing volumes in the contracts, the noncompetitive contracts were at least \$53 million more over the life of the contracts than the competitive contracts for the same or similar volume and type of equipment processed.

Postal Service officials defended their award of more costly noncompetitive contracts, stating that Contractor A's proposed prices were more realistic than the competitive contractors' cost proposals, which may have been priced too low to win contract awards. However, this argument was not supported by pricing proposals submitted by Contractor A. For instance, Contractor A proposed significantly higher prices for the cluster seven noncompetitive contract, but proposed lower prices for cluster eight noncompetitive contract which was awarded after competitive contract awards for clusters one through six.

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### Justification for Contracts

In accordance with section 1.7.1 of the Purchasing Manual, purchases valued at more than \$10,000 (the competitive threshold) must be made on the basis of adequate competition whenever appropriate. It further states that adequate competition need not be obtained for purchases subject to noncompetitive procedures in section 3.5.5. Also, in accordance with section 3.5.5 of the Purchasing Manual and Management Instruction AS-710-97-1, the Postal Service completed a "Justification for Noncompetitive Purchases" for the three noncompetitive contracts. The

justification stated that only one source was available, and that awarding the contract to Contractor A was in the best interest of the Postal Service.

Despite prequalifying 17 competitive sources, contracting officials justified the noncompetitive contracts by stating that Contractor A was the only supplier with the knowledge and experience to bring the first three mail transport equipment service centers on-line in a timely manner, due to the contractor's operation of the pilot site. However, within nine months after Contractor A received the noncompetitive contract to operate cluster seven, the Postal Service awarded six competitive contracts to other companies to operate clusters one through six. Further, the Postal Service awarded another noncompetitive contract to Contractor A eight months later, to establish and operate an equipment service center in Greensboro, North Carolina-cluster eight.

In addition, according to Postal Service contracting officials and documentation in the contract files, Postal Service officials wanted to give Contractor A noncompetitive contracts in exchange for writing the statement of work used by the Postal Service to award the competitive contracts. Based on an email from the Postal Service purchasing manager to the contracting officer, Postal Service contracting officials believed Contractor A stood the chance of being awarded several future competitive contracts, and thus agreed to award Contractor A at least one cluster, noncompetitively, provided Contractor A did not bid on the later competitive contracts.

Based on a review of these events, we believe all of the contracts to operate clusters could have been awarded competitively, resulting in more fair and reasonable contract prices overall.

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Cost Savings Analysis

At the time of our audit, Postal Service management requested the contracting officer provide a termination analysis of the mail transport equipment service center project to help management determine its future direction. The analysis was performed on January 12, 2000, and included all on-going mail transport equipment service center contracts. The analysis indicated the Postal

Service would incur an estimated \$24.7 million in costs to terminate the portion of the project involving the three noncompetitive contracts with Contractor A.

Based on the Postal Service's termination analysis, the Postal Service would not realize savings if the noncompetitive contracts for clusters seven and eight were terminated and recompeted. Conversely, the OIG did a comparison of what the Postal Service could potentially receive in the form of cost reductions if they were able to renegotiate contract rates with Contractor A to be consistent with the rates in the competitive contracts. Under this scenario, we determined the Postal Service could potentially receive about \$10.6 million in cost reductions for cluster seven. See Appendix B for our comparative analysis.

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**Recommendations**

We offer the following recommendations.

We recommend the vice president, Purchasing and Materials:

1. Renegotiate Contractor A's rates for cluster seven.

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**Management's  
Comments**

Management agreed to raise the report's findings on pricing with the supplier and to work with the supplier on supply chain management opportunities for cost reductions. However, management questioned the validity of the \$53 million more that it may pay Contractor A than the competitive contractors because management stated that competition for clusters seven and eight were not feasible and Contractor A's proposed prices were audited by the Inspection Service. Management believes Contractor's A's prices were more likely higher than competitive prices because Contractor A operated in higher cost labor areas resulting in higher fringe benefit rates and lease costs.

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**Evaluation of  
Management's  
Comments**

Management's comments are responsive to our recommendations. However, The OIG does not agree with management's comments and believes that the \$53 million is valid and supported. In addition, during the course of our audit, we shared the details of our analysis with the logistics manager, Mail Transport Equipment Service Center program manager, and operational equipment purchasing manager, to validate our findings. Our analysis included:

- Comparing Contractor A's prices with competitive prices and factoring in volume and local cost adjustments on a five-year contract period of performance.
- Comparing Contractor A's contract volumes and cost for the predominately utilized labor category with that of competitive contractors.
- Assessing what it would cost the competitive contractor to perform the same services

In addition, the OIG disagrees with the assessment that competition for clusters seven and eight were not feasible, because the Postal Service awarded cluster seven noncompetitively at the same time it prequalified 17 competitive sources. The fact that the 17 sources were prequalified at the time of award of cluster seven proved that the Postal Service was aware of other sources that could provide the requested services. Therefore, the OIG does not believe the noncompetitive justification for award to contractor A is accurate.

In conclusion, we determined that Contractor A's prices would likely result in \$10.6 million in potential savings if the Postal Service renegotiated the noncompetitive rates for cluster seven to be more in line with competitive rates.

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**Recommendation**

We recommend the vice president, Purchasing and Materials:

2. Ensure contracting officers adequately seek competition in the award of contracts whenever possible, in accordance with the Purchasing Manual and Management Instruction AS-710-97-1, Justification for Noncompetitive Purchases.

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**Management's  
Comments**

While management agreed with our recommendation to seek competition in the award of contracts whenever possible, management stated that competition was not feasible for clusters seven and eight although they realize that noncompetitive purchases generally result in higher pricing than competitive pricing.

In addition, management believes that our statement “. . . that all of the contracts to operate clusters could have been awarded competitively, resulting in more fair and reasonable contract prices overall” is misleading because it does not consider the timing of the noncompetitive awards and the benefits obtained by doing them. Management also indicated that nowhere in the detailed justification for clusters seven and eight do they base noncompetitive awards on an exchange for writing the Statement of Work used by them to award the competitive contracts, as the report indicates. They also indicated that it appears that a single piece of correspondence was used to arrive at this conclusion.

Additionally, management indicated the fact that none of the sites would have been operational at the time the Greensboro operating and research contract with Contractor A expired, shows that there were no inconsistencies with the noncompetitive award of cluster seven and eight, and the competitive award of clusters one through six.

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**Evaluation of  
Management's  
Comments**

While management believes competition was not feasible for clusters seven and eight, we question their position based on the timing of the contract awards, documentation reviewed, and interviews conducted. The OIG disagrees with the assessment that the OIG did not consider the timing of the award of cluster seven, because the Postal

Service awarded cluster seven noncompetitively at the same time it prequalified 17 competitive sources. The fact that the 17 sources existed at the time of award of cluster seven, proves that the Postal Service did not meet its requirement for noncompetitive justification on the basis that only one source was capable of providing this service. Further, after awarding six clusters competitively, the Postal Service awarded cluster eight noncompetitively to Contractor A. Therefore, the OIG did consider the timing of the award of clusters seven and eight.

Finally, we disagree that the award was not made to compensate the contractor for writing the Statement of Work for the competitive contracts, and that our conclusion is based on a single piece of correspondence. This conclusion was based on:

- Documented information obtained during a meeting with Contractor A's Chief Executive Officer.
- Electronic correspondence between contracting officer, program manager, and legal counsel.
- Information obtained during interviews with the contracting officer and procurement specialists.
- Documentation included in the contract file.

Even though the Postal Service does not believe there were inconsistencies in the award of cluster seven and eight, the OIG has overwhelming evidence corroborated by several sources that support our conclusion on the noncompetitive awards to Contractor A.

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**Use of Letter  
Contracts**

We also determined the three noncompetitive contracts for Contractor A were issued as letter contracts, which were not definitized within the time frames required by Postal Service policy. Postal Service's Purchasing Manual requires that letter contracts be definitized within 180 days of initiating contractor performance, except in extreme cases. In these cases the manual requires contract definitization before completion of 40 percent of the work. According to contracting personnel, a lack of procurement personnel and inadequate procurement planning caused the contracts to remain undefinitized until after the contractor began performance. The following chart shows the dates the letter contracts were awarded and the number of months it took to definitize them.

Letter Contract Date	Contract Definitization Date	Number of Months to Definitize
12-24-97	6-2-99	18 months
2-13-98	9-3-99	19 months
5-10-99	2-12-00	9 months

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**Recommendations**

We recommend the vice president, Purchasing and Materials, implement the following corrective actions that he agreed to in response to our March 31, 2000, report:

3. Develop a process to ensure buyers comply with the 180-day time period for definitizing contract terms and conditions.
4. Include required controls in letter contracts to reduce cost and performance deficiencies.
5. Document contract risk when using letter contracts.

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**Management's  
Comments**

Management agreed with our findings and recommendations for letter contracts but stated that the three letter contracts awarded to Contractor A were justified and executed before they implemented improvements as a result of our prior report, Contract Audit Practices, issued March 31, 2000. Management stated that approvals are now required before issuing undefinitized actions and that contracting officers must document the reasons for using undefinitized actions, including associated risks and



appropriate controls. Further, management stated that a risk assessment is now required in all requests to enter into letter contracts.

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**Evaluation of  
Management's  
Comments**

Management's comments are responsive to our recommendations. While our report does not question whether the letter contracts were justified, we determined that it took from 9 to 19 months to definitize letter contracts, well beyond the 180-day requirement. Because of cost and performance risks associated with letter contracts, Postal Service should minimize its use and include required controls in letter contracts.

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**Unauthorized  
Commitments**

As part of the audit, we also determined that the manager of the mail transport equipment service center program directed all five contractors to perform \$12.5 million in additional work without the contracting authority required by Postal Service purchasing regulations. The additional services included improved order fulfillment, such as expedited production, expanded personnel substitutions, travel, additional shift coverage, additional information systems, upgraded products and forms, and other upgrades. These services were added prior to negotiations to definitize the February 1998 letter contract for integration services.

Postal Service officials stated the contracting officer was present at status meetings when additional work had been discussed with the contractor, but could not support their statements through documented meeting notes or discussions with the contracting officer. In fact, the contracting officer told us she attended some of the meetings, but did not recall discussions of any changes. Regardless, on September 30, 1999, the Postal Service issued modification 12 allowing Contractor A to be paid \$1.3 million in incurred costs for the additional services, and to bill the Postal Service potentially for \$11.2 million for unauthorized work requested by the program manager.

The program manager also requested all five contractors to acquire additional warehouse space to store Postal Service equipment without the required contracting authority. The equipment was to be used by all contractors performing work in support of the mail transport equipment service centers and resulted in over \$2.9 million in unauthorized commitments. Subsequently, the contracting officer approved the added \$2.9 million in warehouse space through a modification to the contracts.

The following table presents the billings submitted by all five contractors.

Contractor	Cluster Number	Billings For Additional Warehouse Space
C	2	\$141,480
D	3	\$866,880
E	4	\$161,376
D	5	\$540,540
		\$261,096
B	6	\$382,500
A	7	\$585,114
<b>Total</b>		<b>\$2,938,986</b>

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Contracting Authority

The Purchasing Manual vests contracting authority in the contracting officer, and not in the program manager. The program manager is responsible for the project and is the supervisor of the contracting officer's representative. In this capacity, he assists the contracting officer in managing the contracts and has authority to provide technical direction to the contractor.

Section 6.1.1 of the Purchasing Manual states that the contracting officer may appoint a representative to perform any administrative function that does not involve a change in the scope of work, specifications, or cost or duration of contract performance. Further, section 6.2.3 of the manual states that the contracting officer may authorize one or more representatives to provide technical direction, but the authorization must specifically alert them to the prohibition on ordering changes in the work affecting schedule, price, or quality.

Purchasing specialists indicated that Postal Service contracting staff believed the program manager could, in fact, request contractors to perform additional work outside the scope of contracts. Thus, confusion among Postal Service officials about who can direct contract changes may have led to the unauthorized commitments.

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Audit Assistance	The Postal Service is in the process of determining how much of the \$11.2 million in additional unauthorized work it will accept and fund. To assist in this determination, the OIG initiated an audit of Contractor A's proposal for unauthorized work. However, the audit has been delayed because the contractor's proposal does not adequately segregate costs between the statement of work for the original contract and the additional unauthorized services being performed.
<b>Recommendations</b>	We recommend the vice president, Network Operations Management:  6. Notify the program manager that he is in violation of purchasing regulations and instruct him to cease making unauthorized contract commitments.
<b>Management's Comments</b>	Management agreed with our findings and recommendations. Management stated it has instructed the program manager to comply with Postal Service purchasing regulations.
<b>Evaluation of Management's Comments</b>	Management's comments are responsive to our recommendations.
<b>Recommendation</b>	We recommend the vice president, Purchasing and Materials.  7. Clarify to Postal Service employees the existing policy on the roles, responsibilities, and authorities of participants in the procurement cycle.
<b>Management's Comments</b>	Management agreed to remind purchasing specialists of contracting officer and contracting officer's representative authorities and to address contract authority in every post award meeting with contractors.
<b>Evaluation of Management's Comments</b>	Management's comments are responsive to our recommendations.

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<b>Recommendation</b>	<p>We recommend the vice president, Purchasing and Materials:</p> <p>8. Direct the contracting officer to require the noncompetitive contractor to segregate costs between integration services included in the statement of work and additional services being performed by the contractor.</p>
<b>Management's Comments</b>	<p>Management agreed and stated it has already required Contractor A to segregate its costs and that Postal Service's Contract Pricing Division is currently auditing the costs to ensure fair and reasonable pricing is obtained.</p>
<b>Evaluation of Management's Comments</b>	<p>Management's comments are responsive to our recommendations.</p>
<b>Recommendation</b>	<p>We recommend the vice president, Purchasing and Materials:</p> <p>9. Consider the results of our audit in deciding whether to ratify the unauthorized commitments and take appropriate action in accordance with Management Instruction AS-710-1999-2.</p>
<b>Management's Comments</b>	<p>Management agreed, stating they would ensure that the unauthorized commitments are properly ratified.</p>
<b>Evaluation of Management's Comments</b>	<p>Management's comments are responsive to our recommendations.</p>

## APPENDIX A. PRIOR AUDIT COVERAGE

The following audits were conducted by the Postal Inspection Service:

1. Developmental Audit on Mail Transport Equipment Service Centers, Case Number 019-1223382-AX(1), dated March 26, 1999. The audit was conducted to determine the adequacy of planning and development of the Mail Transport Equipment Service Centers network. The audit revealed that processes and procedures had not been developed for monitoring and evaluating project performance relative to the reported Decision Analysis Review savings. The audit recommended that management implement an effective project performance measurement system to gauge management's performance in achieving reported Mail Transportation Equipment Service Center project benefits. Management concurred with the finding and agreed to implement a method to measure customer satisfaction in achieving the project benefits.
2. Review of Mail Transportation Equipment Service Center Program, Case Number 072-1290929-SI(2) dated July 7, 1999. The review was performed to test the reasonableness of projected costs and/or savings presented in the Decision Analysis Report. The review reflected an error rate for transportation trips. The audit recommended the contractor maintain a database of each order and facility where an error occurred in transportation. Management agreed with the recommendations, and to implement procedures that will enable them to reduce the transportation errors.
3. Audit of Mail Transport Equipment Service Center Systems Integration and Management Price Proposal, Contract Number 102590-98-Z-0871, Case Number 181-1238483-AC(1), dated August 26, 1998. The audit was conducted to determine if proposed costs were acceptable for negotiating a fair and reasonable price. The audit resulted in \$6.8 million of questioned costs. The contracting officer considered the audit results in negotiating a contract price.

4. Audit of Mail Transport Equipment Service Center Cluster eight Price Proposal Submitted for Contract Number 102590-98-A-0125, Case Number 181-1266103-AC(1), dated April 23, 1999. The audit was conducted to determine if proposed costs were acceptable for negotiating a fair and reasonable price. The audit resulted in \$6.7 million of questioned costs and \$1.7 million of unsupported costs. The contracting officer considered the audit results in negotiating a contract price.
5. Audit Report on the Evaluation of Price Proposal Submitted for Contract Number 102590-97-Z-1699, Case Number 181-1226701-AC(1), dated June 10, 1998. The audit was conducted to determine if proposed costs were acceptable for negotiating a fair and reasonable price. The audit resulted in \$24.6 million of questioned costs and \$4.8 million of unsupported costs. The contracting officer considered the audit results in negotiating a contract price.

## APPENDIX B. Mail Transport Equipment Service Centers Potential Cost Reduction For Contractor A’s Operation of Cluster Seven

Year 4 <sup>3</sup>						
Contractor	Site/Location	Cluster	Estimated Contract Cost	Potential Cost Reductions	Estimated Volumes	Material Handling Laborer - Federal
A	Secacus, NJ	7	\$13,927,918		60,711,357	\$9.75
B	Springfield, MA	1	\$10,766,878		61,793,093	\$9.08
			\$11,358,960	\$2,568,958	0.982	1.074 <sup>4</sup>
A	Los Angeles, CA	7	\$15,473,500		70,958,338	\$13.64
D	Cincinnati, OH	3	\$12,333,674		69,603,624	\$12.91
			\$13,284,713	\$2,188,787	1.019	1.057
A	Chicago, IL	7	\$20,414,197		91,371,948	\$12.30
B	Minneapolis, MN	6	\$7,231,915		26,867,252	\$13.26
B	San Francisco, CA	6	\$12,894,263		65,878,774	\$12.04
			\$20,126,178		92,746,026	\$12.39
			\$19,678,542	\$735,655	0.985184508	0.992462348

**Table 1**

<sup>3</sup> From the overall list of all contracts, we identified several contracts that were roughly similar in volume to the contracts for Contractor A. We tried to stay in the general range on volume, in case there are, unknown to us, major differences in proposal pricing between large and small workload requirements. We were unable to find a direct comparison for the largest Contractor A volume, and we had to combine two contracts to get into the same volume range. Then, we examined the local labor rate for the material handling laborer to try to choose places that might nominally have similar location-related cost factors.

<sup>4</sup> The methodology for this table is an adjustment of the “comparable” contract to allow a direct comparison to the actual contract value for each Contractor A site. The adjustment factors are shown for each comparison. For example, the local cost factor, represented by the labor rate, for the Secacus contract was 1.074 times as large as that for Springfield, but the volume was considerably less for Secacus than for Springfield, by a factor of 0.982. Multiplying these two factors, the volume adjustment, and the local cost adjustment, by the Springfield contractor proposal cost suggests that the Springfield contractor’s competitive proposal for Secacus would likely have been on the order of \$11.4 million. This methodology was applied to each pairing to calculate a reasonable competitive contract cost for each of the Contractor A locations. In the case of the combined comparison to the Chicago location, the combined local cost factor is the weighted average of the Minneapolis and San Francisco rates; the individual volumes are the weighting factor. The potential cost reduction is the difference between the actual Secacus contract cost and the calculated competitive contract cost.



Year 5						
Contractor	Site/Location	Cluster	Estimated Contract Cost	Potential Cost Reductions	Estimated Volumes	Material Handling Laborer - Federal
A	Secacus, NJ	7	\$13,832,501		61,701,309	\$9.75
B	Springfield, MA	1	\$10,724,540		63,189,406	\$9.08
			\$11,244,692	\$2,587,809	0.976	1.074
A	Los Angeles, CA	7	\$15,476,377		72,992,650	\$13.64
D	Cincinnati, OH	3	\$12,451,115		71,816,512	\$12.91
			\$13,370,609	\$2,105,768	1.016	1.057
A	Chicago, IL	7	\$19,819,905		91,146,368	\$12.30
B	Minneapolis, MN	6	\$7,283,701		27,249,006	\$13.26
B	San Francisco, CA	6	\$12,968,870		67,585,406	\$12.04
			\$20,252,571		94,834,412	\$12.39
			\$19,322,720	\$497,185	0.961110699	0.992692363
<b>YEAR 4 &amp; 5 POTENTIAL REDUCTION</b>						
A	Secacus, NJ		2-yr potential reduction	\$5,156,768		
A	Los Angeles, CA		2-yr potential reduction	\$4,294,555		
A	Chicago, IL		2-yr potential reduction	\$1,232,840		
			<b>TOTAL</b>	<b>\$10,684,162<sup>5</sup></b>		

Table 2

<sup>5</sup> Contractor A's total potential cost savings for cluster seven in years four and five of the contract.

## APPENDIX C. MANAGEMENT'S COMMENTS

PAUL E. VOGEL  
VICE PRESIDENT, NETWORK OPERATIONS MANAGEMENT



December 29, 2000


BILLY SAULS 

SUBJECT: Audit – Contracting Practices for the Procurement of Mail Transport Equipment Services  
(Report Number CA-AR-01-DRAFT)

I appreciate the opportunity to work with you and your staff to develop a meaningful report. I would like to commend your staff on the professional manner in which this audit was conducted and the manner in which issues have been worked out.

We generally agree with the finding that has been tasked to the vice president, Network Operations Management. Attached is our response to recommendation six.

Should you require additional information, please contact Tony Pajunas, manager, Logistics, at (202) 268-4948.



Paul E. Vogel

Attachment

cc: Mr. Potter  
Mr. Strange  
Mr. O'Reilly  
Mr. Pajunas  
Mr. Seehaver

6. Recommendation

We recommend that the vice president, Network Operations Management, notify the program manager that he is in violation of purchasing regulations and instruct him to cease making unauthorized contract commitments.

We agree with the recommendation.

The program director has been reminded of postal purchasing regulations, which require that contracting officers exclusively provide direction to contractors regarding issues involving costs. He has been instructed and will comply with these regulations.

**Contracting Practices for the Procurement  
of Mail Transport Equipment Services**

**CA-AR-01-001**

NATIONAL MAIL TRANSPORTATION PURCHASING



January 31, 2001

BILLY SAULS

THRU: KEITH STRANGE

KS

SUBJECT: Transmittal of Draft Audit Report – contracting Practices for the Procurement of Mail Transport Equipment Services (Report Number CA-AR-01-DRAFT)

Thank you for your report on the contracting practices for the Mail Transport Equipment Service Centers (MTESCs). We agree with the report's nine general recommendations.

We do, however, believe that some of the underlying findings are incomplete or inaccurate and that the report does not provide an overall perspective on what has been accomplished through the MTEC program and the contracting approaches used.

Our information is that the MTESCs have been very successful in helping to alleviate shortages of mail transport equipment (MTE) for operations and our customers during peak mailing season and in reducing the quantity of MTE that had to be bought each year. For example, \$20 million less MTE was purchased in FY 2000 compared to the previous year.

To help achieve this success, Operations Support and Purchasing and Materials developed a plan in August 1997, while working the Cluster 7 purchase, to create a competitive supplier base for the MTESCs and expand the concept nationally. Prior to that point, attempts to obtain effective competition for just the initial pilot site had not been successful. In transitioning from a single source pilot site to a multiple national system established competitively, three noncompetitive contracts were awarded to either provide the basis for the future competitive environment or to capture the MTEC benefits sooner. Each of those noncompetitive contract awards were carefully considered with the information available at the time. While with the benefit of hindsight, one can always question if some of the numerous contracting decisions made on any large, complex, program were the best possible decisions, we believe these contracts were approved in accordance with the requirements of the Purchasing Manual and other applicable procedures and were reasonable business decisions.

Our detailed response is attached.

A handwritten signature in black ink, appearing to read "J. Dwight Young".

J. Dwight Young  
Manager

Attachment

cc: Mr. Strasser  
Mr. Vogel  
Mr. Pajunas

475 L'ENFANT PLAZA RM 4800  
WASHINGTON DC 20260-6210  
(202) 268-4314  
FAX: (202) 488-4313

Areas of OIG Audit Report Number CA-AR-01-DRAFT – Contracting Practices for the  
Procurement of Mail Transport Equipment Services

**Noncompetitive Contract Awards**

**1. Renegotiate Contractor A's rates for Cluster 7.**

Cluster #7 is a firm fixed price contract and no guarantees can be provided that the supplier will enter into contract renegotiations or reduce present contract rates as recommended by the report. Regardless, we will raise the report's findings on pricing with the supplier and we will also work with the supplier on supply chain management (SCM) opportunities for cost reductions. This contractor has claimed that they have saved the Postal Service significant dollars in SCM savings.

The report compares Cluster #7 pricing to pricing later obtained under the 18-site competitive awards. The report concludes that over a 5-1/2 year period, we could have saved over \$53 million if we used competitive pricing.

Though we do not have the details of the \$53 million analysis, we question its use since:

- (a) Competition for Cluster #7 was not feasible at the time we negotiated site pricing. For the record, competition was also not feasible for Cluster # 8. Cluster #7 site was appropriately awarded noncompetitively to Contractor A. It was the only supplier able to bring the three Cluster #7 sites up when needed by Operations and capture operational savings of between \$12.5 and \$19.7 million.
- (b) Even though competition was not feasible for Cluster #7, we realize that noncompetitive purchases generally result in higher pricing than competitive pricing.
- (c) Negotiated prices for Cluster #7 sites were based on two Inspection Service audits, dated June 10, 1998 and March 31, 1999, and detailed cost analyses performed by program and purchasing staff. Contractor A's pricing, though verified by the audits, was most likely higher than "competitive pricing" for the other clusters in the following areas:
  - (1) Direct Labor – Chicago, IL; Los Angeles, CA; and North Jersey are among the highest cost labor areas;
  - (2) Fringe benefit rates were higher to enable Contractor A to compete for labor in the three high cost areas; and
  - (3) Lease costs for the three sites were based on premium prices for these high cost areas.

Given the Inspection Service audits and the timing of Cluster #7 implementation and pricing obtained under the competitive purchase, we believe that it is misleading to project a \$53 million differential. The \$53 million also does not seem to have considered the benefits of proceeding with the implementation of cluster #7 noncompetitively.

**2. Ensure contracting officers adequately seek competition in the award of contracts whenever possible, in accordance with the Purchasing Manual and Management Instruction AS-710-97-1, Justification for Noncompetitive Purchases.**

We agree with the recommendation, but contrary to report findings, we believe that the noncompetitive purchases were justified according to Postal Service requirements. We also disagree with the report's conclusion that the basis for making the noncompetitive purchases was "in part, to compensate a contractor for preparing the statement of work used to award other competitive contracts for the MTE project." And, finally, the statement in the report, "... we think that all of the contracts to operate clusters could have been awarded competitively, resulting in more fair and reasonable contract prices overall" is misleading by not considering the timing of the noncompetitive awards and the benefits obtained by doing them.

All three noncompetitive awards were fully documented, justified, and approved, as required by Postal Service internal procedures and Postal Service purchasing regulations.

- System Integration Training and Cluster #7 awards were approved on May 1, 1997 by Keith Strange, vice president, Purchasing and Materials, and again on August 24, 1997 in an amended package. Those fully documented packages include all required postal program management and purchasing approvals, including the justification and endorsement of Allan Kane, then vice president of Operations Support.

The basis for making these awards was two-fold:

- PM 4.4.2.a.1, Demonstration, after adequate investigation of the existence of only one source capable of meeting Postal Service requirements, and
- PM 4.4.2.a.6, When competitive purchasing would not be in the interest of the Postal Service

The justification from Operations Support stated Contractor A was the only known source with the experience, knowledge, and necessary skills to assist in getting all of the sites operational within the required 17-month timeframe. Use of Contractor A would minimize the site operating learning curve, allowing the USPS to capture operational savings of between \$12.5 and \$19.7 million. Detailed operating benefits and other supporting rationale are contained in contract file documentation.

Nowhere in the detailed justification for these awards, nor in any agreement with the contractor, do we base our noncompetitive awards on an exchange for writing the Statement of Work used by the Postal Service to award the competitive contracts as the report indicates. It appears that a single piece of correspondence was used to arrive at this incorrect conclusion. This was not the justification used to support the noncompetitive purchases.

- The noncompetitive buy for Cluster #8 (Greensboro) was approved by the acting Vice president, Purchasing and Materials, on July 20, 1998. The Postal Service had a compelling need to continue both research and operational functions under the Greensboro Cluster #8 contract. Further, continuing performance of the production function was critical. The operating portion of the contract was needed to fill the demand for processed MTE in the mid-Atlantic section of the country. The loss or interruption of this source of supply for MTE would seriously impede our ability to provide to mail transport equipment to our customers and for our internal processing needs.

- Justifying rationale provided by Operations Support pointed to Contractor A's unique operational experience. "Contractor A is the only MTEESC currently operating. The responses to the solicitation for the other contract sites are currently being evaluated. None of the sites will be operational when the existing Greensboro operating and research contract with Contractor A expires." The fact that none of the competitive sites were operational shows there were no inconsistencies with the noncompetitive award of Cluster #7, the competitive solicitation for Clusters 1-6, and the noncompetitive award of Cluster #8. The report suggests otherwise. The contract file fully documents the justification for noncompetitive award. This includes all required postal program management and purchasing approvals, including the justification and endorsement of Allan Kane, then vice president of Operations Support.

**Use of Letter Contracts**

- 3. Develop a process to ensure buyers comply with the 180-day time period for definitizing contract terms and conditions.**

We agree with this recommendation. All contracting officers are required to obtain the approval of the appropriate Purchasing and Materials manager before an undefinitized contract action can be issued, explaining the compelling business reasons for their use. Discussion of associated risks and appropriate controls must be included. In addition, all buyers are now aware that all undefinitized contract actions must be definitized within 180 days. The subject letter contracts were executed before these controls were put in place as a result of the OIG report "Contract Audit Practices" (CA-MA-00-001), dated March 31, 2000.

- 4. Include required controls in letter contracts to reduce cost and performance deficiencies**

We agree with this recommendation. The use of letter contracts was appropriate for the three contracts at the time they were awarded. Contract files are documented with justification for making the letter contracts, e.g., MTEESC implementation was paramount, pricing was subject to audit and negotiation results. However, for various reasons, some pointed out in your report, the letter contracts were not definitized until well after the 180 days. Letter contract controls are now in place in Purchasing and Materials as noted above.

- 5. Document contract risk when using letter contracts**

We agree with this recommendation. Management will ensure that contracting officers document the risks of using letter contracts when they request their use, and this will be included in the contract file. A risk assessment is now required in all requests to enter into letter contracts. The contract type will be documented in the Purchase Plan included in the contract file. Again, the subject letter contracts were executed before these controls were put in place.

**Unauthorized Commitments**

- 6. We recommend that the vice president, Network Operations Management notify the program manager that he is in violation of purchasing regulations and instruct him to cease making unauthorized contract commitments.**

We agree with the findings and recommendations enumerated in the report. The program director has been reminded of postal purchasing regulations by the vice president, Network Operations, which require that contracting officers exclusively provide direction to contractors regarding issues involving costs within the contract scope. He has been instructed to comply with these regulations.

- 7. We recommend that the vice president, Purchasing and Materials clarify to Postal Service employees the existing policy on roles, responsibilities, and authorities of participants in the procurement cycle.**

We agree with this recommendation but are surprised at the audit report statement: "Postal Service contracting staff believed that the program manager could, in fact, request contractors to perform additional work outside the scope of contracts." Knowing that only contracting officers can direct contract actions affecting time and money, within the scope of the contract, is basic purchasing knowledge. We will remind purchasing specialists of the limits of contracting officer and contracting officer representative authority and address contract authority in every post award meeting with contractors.

- 8. Direct the contracting officer to require the noncompetitive contractor to segregate costs between integration services included in the statement of work and additional services being performed by the contractor.**

We agree with this recommendation. This involves contract work under the integration contract for about \$11.2 million. The contract modification for \$11.2 million has not yet been definitized. We have required that contractor A properly segregate costs between the Statement of Work for the original contract and the additional services now being performed. This information has been received from Contractor A and is now being audited by Contract Pricing to ensure fair and reasonable pricing. We will execute the modification using the appropriate purchasing authority.

- 9. Consider the results of our audit in deciding whether to ratify the unauthorized commitments and take appropriate action in accordance with Management Instruction AS 710-1999-2.**

We agree with this recommendation and will execute the integration modification using the appropriate purchasing authority. We will ensure that the commitments made by the program manager were in the best interest of the Postal Service, that all work was acceptably performed,<sup>8</sup> and the pricing for that work is fair and reasonable before ratification occurs.