

September 6, 2001

KEITH STRANGE
VICE PRESIDENT, PURCHASING AND MATERIALS

SUBJECT: Audit Report – Supplier Diversity Program for Supplies, Services, and Equipment Purchases (Report Number CA-AR-01-005)

This report presents the results of our audit of the Postal Service's Supplier Diversity Program for Supplies, Services, and Equipment Purchases (Project Number 00RA010CA000). This report responds to a request from the Governors to review the Postal Service's Supplier Diversity Program. The objectives of our audit were to assess the accuracy of fiscal year (FY) 1999 supplier diversity statistics and to evaluate the Postal Service's effectiveness in achieving supplier diversity spending plans.

We found that supplier diversity statistics for FY 1999 were unreliable because prime contracting dollars awarded to small, minority, and woman-owned businesses were overstated and subcontracting statistics were unsupported and unverified. While we did not determine the accuracy of FY 2000 statistics, we noted they were overstated because some suppliers were incorrectly classified as small, minority, or woman-owned businesses. Because statistics were unreliable, it was unclear whether the Postal Service achieved its supplier diversity spending plans for FYs 1999 or 2000.

We made nine recommendations that will improve supplier diversity data reliability and correct errors we identified. Management agreed with all of our recommendations and has taken or planned specific actions to address issues we identified. However, management did not agree with all of our conclusions regarding data reliability. While acknowledging statistical inaccuracy, they pointed out some level of error was inherent and inevitable, cited mitigating factors, and cited our observation that they were continually working to improve data integrity. They also asserted that supplier diversity statistics were useful for tracking general trends, management diagnostics, benchmarking, and reporting. We disagreed with management's perspective. In responding to management's comments, we pointed out that 22 percent of small business commitments, 48 percent of minority commitments, and 31 percent of commitments for woman-owned businesses were inaccurate or unsupported. We felt that because of the magnitude of these errors, the data is not useful for tracking general trends, management diagnostics, benchmarking, and reporting. Management's comments, and our evaluation of these comments, are included in the report.

The Office of Inspector General (OIG) considers all the recommendations significant and, therefore, requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective action(s) are completed. These recommendations should not be closed in the follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed. We appreciate the cooperation and courtesies provided by your staff during the audit. If you have questions or need additional information, please contact Kim Stroud, director, contracts, at (703) 248-2100 or me at (703) 248-2300.

Billy Sauls
Assistant Inspector General
for Business Protection

Attachment

cc: Richard J. Strasser, Jr.
Benjamin P. Ocasio
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EXECUTIVE SUMMARY

Introduction

The Postal Service implemented a Supplier Diversity Program to provide suppliers with equal access to purchasing opportunities. The program seeks to ensure that the supplier base reflects the diversity of the American supplier community and that no suppliers are excluded from competition on the basis of race, color, religion, sex, age, or national origin. The Postal Service has identified the program as a strategic business initiative vital to the success of the Postal Service.

Over the past few years, the Postal Service has identified initiatives to improve its Supplier Diversity Program. In 1998, the Office of Inspector General (OIG) conducted a review of the Postal Service's Supplier Diversity Program in response to a congressional request. We identified various factors that contributed to the Postal Service missing its targets for minority contract awards in fiscal year (FY) 1998.

This audit was initiated at the request of the Governors. Our audit objectives were to assess the accuracy of FY 1999 supplier diversity statistics for supplies, services, and equipment purchasing, and evaluate the effectiveness of the Postal Service in achieving supplier diversity spending plans.

Results in Brief

Supplier diversity statistics for FY 1999 were unreliable. Prime contract dollars may be overstated by at least \$43 million for small, \$.7 million for minority, and \$1 million for woman-owned businesses because contractors' socioeconomic status was incorrect. In addition, another \$13.5 million may have been overstated because the Postal Service included contract actions that occurred outside of FY 1999, or were attributable to basic pricing agreements, or terminated/closed contracts.

Further, \$99 million of minority, \$68 million of woman-owned, and \$370 million of small business subcontract actions could not be supported for supplies, services, and equipment purchases reported in FY 1999. Data in contract files could not be reconciled to the procurement database, and some data was not available for reconciliation. Contracting personnel did not determine whether subcontract data submitted by prime contractors was

reasonable and consistent with contract requirements as required by the Purchasing Manual. According to Postal Service officials, efforts to improve subcontract data are underway.

Due to issues identified in our audit regarding the quality of supplier diversity statistics, we could not determine if the Postal Service achieved supplier diversity spending plans. Although the Postal Service reported it exceeded small business spending plans by \$219 million in FY 1999, our audit identified \$370 million in subcontracts that could not be supported and over \$43 million that was awarded to suppliers incorrectly classified as small businesses.

In FY 2000, Postal Service statistics showed it exceeded small business spending plans by \$364 million and woman-owned spending plans by \$2 million. While we did not determine the accuracy of all FY 2000 statistics, we noted that \$59.5 million was awarded to suppliers incorrectly classified as small, minority, or woman-owned businesses. Further, we believe problems we observed with procurement data supporting FY 1999 statistics also impacted FY 2000 statistics. Consequently, current supplier diversity statistics cannot be used as a measure of current performance or serve as a benchmark for future performance. According to the Postal Service's Supplier Diversity Plan, small, minority, and woman-owned companies are driving the growth in the American economy; so doing business with them makes good business sense and should have a positive impact on the Postal Service's bottom line. The plan also asserts that the ability of the Postal Service to meet customer expectations will depend on its ability to achieve supplier diversity.

According to Postal Service management, supplier diversity statistics, while imperfect, are based on the best available data and noted errors are not significant. Postal Service management recognizes that improvements can be made in the area of data reliability. They stated that they would appreciate the OIG's help in a focused effort to stratify and sort data errors so that they can address the errors by relative importance.

Summary of Recommendations	We recommend the vice president, Purchasing and Materials, develop policies and procedures to ensure the accuracy of data in the procurement database and reported supplier diversity statistics. We also recommend that the vice president, Purchasing and Materials, correct errors and reports associated with actions identified in our audit.
Summary of Management's Comments	Management agreed with all of our recommendations but did not agree with all of our conclusions regarding the reliability of statistical data. Management suggested that in the context of commitments on small, minority, and woman-owned businesses totaling more than \$4 billion, prime contract overstatements by \$43 million on small businesses, \$.7 million on minority businesses, and \$1 million on woman-owned businesses were immaterial and consequently disagreed with our finding that supplier diversity statistics were unreliable. While acknowledging data inaccuracy, they pointed out that some level of error was inherent and inevitable. They asserted that their statistics were useful for tracking general trends, management diagnostics, benchmarking, and reporting. Management's comments, in their entirety, are included in Appendix C.
Overall Evaluation of Management's Comments	We disagree with management's perspective. Management stated that total supplier diversity commitments were about \$4 billion. That figure included commitments related to facilities and transportation, as well as commitments related to supplies, services, and equipment. However, our audit focused only on supplies, services, and equipment. Management also incorrectly suggested that data reliability problems were limited to commitments related to prime contracts. Data reliability problems associated with subcontracts also need to be included. When analysis is properly focused only on commitments for supplies, services, and equipment, and data reliability problems with subcontracts are properly included, the analysis is much more compelling. Specifically:

- \$413 million of \$1.87 billion (22 percent) in FY 1999 commitments to small business included errors.
- \$100 million of \$209 million (48 percent) in FY 1999 commitments to minorities included errors.
- \$69 million of \$219 million (31 percent) in FY 1999 commitments to woman-owned businesses included errors.

These percentages are clearly material, contradicting management's assertion. Consequently, we believe these program statistics are not useful for tracking general trends, management diagnostics, benchmarking, and reporting.

INTRODUCTION

Background

According to Section 3.2 of the Purchasing Manual, supplier diversity must be managed as a strategic business initiative because it is vital to the success of the Postal Service. In November 1996, the Board of Governors contracted for a special study to evaluate and assess the effectiveness of the Postal Service's diversity development program. The study was completed in October 1997 and offered various recommendations designed to improve supplier diversity. In January 1998, the Board of Governors directed Postal Service management to review the study's results and develop an action plan to address the findings. In response, the deputy postmaster general chartered a cross-functional diversity advisory team to develop a plan to improve supplier diversity at the Postal Service. In April 1998, the deputy postmaster general briefed the Board of Governors on its supplier diversity plan that included specific initiatives to ensure supplier diversity. An oversight committee at the Postal Service tracked and monitored these actions. In July 1999, the Postal Service reported that all supplier diversity initiatives resulting from the study were completed.

Objectives, Scope, and Methodology

The objectives of our audit were to: (1) assess the reliability of fiscal year (FY) 1999 supplier diversity statistics for supplies, services, and equipment purchasing, and (2) determine if the Postal Service has been effective in achieving its supplier diversity spending plan.

To assess the accuracy of supplier diversity statistics, we judgmentally selected and reviewed 638 supplies, services, and equipment contracts and modifications awarded during FY 1999. The sample was selected from contract actions with dollar values ranging from \$1,000 to over \$1 million. We reviewed contract files and supporting documentation from headquarters Purchasing, the Topeka Purchasing Service Center, and the ten purchasing and materials service centers. We also interviewed managers, supplier diversity coordinators, and contracting personnel at these locations.

To determine if the Postal Service has been effective in achieving its supplier diversity spending plan, we compared planned and actual contract dollars awarded to small, minority, and woman-owned businesses for FYs 1999 and 2000. In addition, we determined the impact of data reliability issues on

the Postal Service's achievement of its supplier diversity spending plan.

We conducted our audit between December 1999 and September 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 conclusions and observations with appropriate management officials.

Prior Audit Coverage

On September 30, 1998, the Office of Inspector General (OIG) issued a management advisory report on Supplier Diversity and Minority Contracting (Report Number CA-MA-98-003) that examined Postal Service contracts with minority businesses. This review disclosed: (1) the Postal Service did not enforce its requirement that contractors submit subcontracting plans that encourage and include minority contracts; (2) the Postal Service did not meet FY 1998 supplier diversity targets for minority contract awards; (3) minority contract awards declined from FY 1994 to 1995, increased from FY 1995 to 1996 and then declined again from FY 1996 to 1997; and (4) the Postal Service did not address all supplier diversity recommendations from the study conducted by Aguirre International.¹ Management generally agreed with the findings and took corrective actions responsive to the issues. The Postal Service indicated all recommendations from the Aguirre study were addressed; however, they did not adopt all of the recommendations.

¹ A special study conducted by Aguirre International to evaluate and assess the effectiveness of the Postal Service Diversity Development Program was completed in October 1997. The study offered 15 recommendations designed to improve supplier diversity.

AUDIT RESULTS

Fiscal Year 1999 Supplier Diversity Statistics Were Unreliable

Our audit disclosed supplier diversity statistics for FY 1999 supplies, services, and equipment contracts were unreliable. Specifically, prime contract dollars awarded to small, minority, and woman-owned businesses may be overstated by at least \$43 million for small, \$.7 million for minority, and \$1 million for woman-owned businesses. In addition, another \$13.5 million in overstatements may have occurred because the Postal Service included dollars from contract actions that occurred outside of FY 1999, basic pricing agreements, or terminated/closed contracts. Reported statistics for prime contracts also differed from amounts documented in contract files. Finally, documentation could not be found to support FY 1999 subcontract dollars totaling \$99 million for minority, \$68 million for woman-owned, and \$370 million for small businesses. Contracting personnel did not determine whether these amounts were reasonable and consistent with contract requirements. As a result, the Postal Service cannot accurately assess the extent to which program goals were achieved.

Postal Service managers acknowledged data reliability problems with their FY 1999 supplier diversity data. They stated that FY 1999 was a year of transitions. For example, the Postal Service changed its subcontracting policy in FY 1999, and implemented a new procurement system in supplies, services, and purchasing.

Prime Contracting Dollars May Be Overstated

Prime contracting dollars awarded to small, minority, and woman-owned businesses reported in the Purchasing Assessment Report FY 1999 may be overstated by at least \$43 million for small, \$.7 million for minority, and \$1 million for woman-owned businesses. Appendix A identifies the contracts we found involving suppliers whose socioeconomic status was incorrect in the procurement database. An additional \$13.5 million in overstatements included:

- \$3.8 million in contract actions that occurred outside of FY 1999.
- \$5.2 million in basic pricing agreements incorrectly recorded.

- \$4.5 million in unused dollars for terminated and closed contracts that were not deobligated.

We identified approximately \$59.5 million in overstatements in small businesses for FY 2000 as a result of incorrect socioeconomic coding. The contracts involved are listed in Appendix A.

According to Section 3.2.4 of the Purchasing Manual, purchases made from small, minority, and woman-owned businesses must be coded by socioeconomic classification. Postal Service policy does not require contracting officers to update the procurement database when changes occur to a supplier's socioeconomic status.

Overall, we identified 118 of 638 contract actions where the socioeconomic classifications differed between the procurement database and contract files. However, we were unable to determine which source was correct; and therefore, could not quantify the impact of such differences on the statistics.

We also identified \$3.8 million in overstatements for actions that occurred outside of FY 1999 that were included in supplies, services, and equipment purchasing for supplier diversity statistics. The data used in reporting the statistics was extracted from the procurement database 2 weeks after the end of FY 1999. Because the procurement database keeps a cumulative balance, a complete report of FY 1999 activity can only be obtained on the last day of the fiscal year.

Another \$5.2 million in overstatements comprised estimated or not-to-exceed amounts of 13 basic pricing agreements. These amounts represent the maximum amount of all orders that can be made under the agreement, and not actual commitments. According to headquarters Purchasing personnel, basic pricing agreements should be posted in the procurement database with zero dollar amounts and only include dollars committed through individual orders. Estimated or not-to-exceed amounts, in lieu of order amounts, were reported in supplier diversity statistics because no standardized procedures exist and contracting officers we interviewed were unclear on which amounts to record in the procurement database.

Lastly, terminated and cancelled contracts with unused dollars totaling over \$4.5 million were inappropriately included in supplier diversity statistics. These funds should have been deobligated in the procurement database. However, contracting officers were not deobligating unused funds on terminated and cancelled contracts. Some contracting officers explained this was an oversight. Although the Procurement Handbook² required contracting officers to deobligate unused funds on terminated and cancelled contracts, it was superseded by the Purchasing Manual that does not require funds to be deobligated.

Recommendation

We recommend the vice president, Purchasing and Materials:

1. Develop and implement contract administration procedures on updating the procurement database and contract files when changes occur in a supplier's socioeconomic status.

**Management's
Comments**

Management generally agreed with our recommendation. They stated that they would address the recommendation by issuing a Purchasing and Materials Administrative Instruction within approximately 120 days.

Recommendations

2. Correct the socioeconomic classification in the procurement database of the suppliers of the 14 contracts identified in our report (See Appendix A).
3. For the remaining 104 contract actions identified in our report, reconcile contract files to the procurement database and correct errors in socioeconomic status of suppliers.

**Management's
Comments**

Management generally agreed with recommendations 2 and 3. They stated that they would correct current and active contracts in the procurement database within approximately 60 days.

² Procurement Handbook AS-707, TL 4 dated February 1, 1992, Section 6.2.2-241.

Recommendation	4. Archive the procurement database at the end of the fiscal year as support for annual supplier diversity statistical reports.
Management's Comments	Management agreed with our recommendation. They stated that they would document and retain data as of each fiscal year.
Recommendations	5. Establish and implement standard criteria for recording basic pricing agreement amounts in the procurement database. 6. Revise the <u>Purchasing Manual</u> to include policy requiring contracting personnel to deobligate unused funds from contracts and the procurement database when contracts are terminated or cancelled.
Management's Comments	Management generally agreed with recommendations 5 and 6. They stated that they would address the recommendation by issuing a Purchasing and Materials Administrative Instruction within approximately 120 days after we issue our final report.
Recommendation	7. In developing the <u>Purchasing Assessment Report FY 2001</u> , include corrections to FYs 1999 and 2000 statistics for small, minority, and woman-owned businesses.
Management's Comments	Management agreed with our recommendation. They stated that they would include a footnote in the <u>Purchasing Assessment Report FY 2001</u> providing specific corrections of errors identified during the audit of FYs 1999 and 2000 statistics and that the report and footnote would be published during or near April 2002.
Evaluation of Management's Comments	Management's comments were responsive to recommendations 1 through 7. We believe the actions taken and planned should correct the issues that were the focus of the recommendations. However, management made additional comments not necessarily associated with specific recommendations and with which we do not agree. We summarized and evaluated those comments at the end of the following section.

Subcontracting
Statistics are
Unsupported and
Unverified

Our audit disclosed that \$99 million of minority, \$68 million of woman-owned, and \$370 million of small business subcontract actions could not be supported for supplies, services, and equipment purchases reported in FY 1999. The supporting documentation at 15 of the 16 offices we visited did not reconcile to reported statistics. At the remaining office, no quarterly reports were available.³

The OIG noted that the Postal Service revised the subcontracting policy in February 1999 and adopted a new subcontracting reporting system in June 1999. As a result, FY 1999 subcontract reporting was a combination of the old and new reporting formats.

Due to the combination of the old and new reporting formats, we could not reconcile reported dollars. We could not match reported statistics to quarterly subcontracting reports submitted by prime contractors at 15 offices. Quarterly reports varied in form, content, and reporting periods, which made data aggregation difficult and irreconcilable. For example, periods overlapped and actions were double counted.

Reported statistics were also unverified. Contracting personnel did not review the subcontracting data submitted by suppliers for reasonableness and consistency with contract requirements. Section 6.2.3 of the Purchasing Manual states that reviewing supplier submittals is an important method of enforcing contract requirements. Contract terms requiring submission and approval should be strictly enforced. Subcontracting reports ensure compliance with contract terms regarding the subcontracting plan.

However, we found that the supplier diversity coordinator at each purchasing office was collecting data from the prime suppliers and preparing summary reports on dollars awarded to small, minority, and woman-owned businesses. The supplier diversity coordinators then submitted this summary report to a management analyst at headquarters to compile each office's subcontract summary into one report to be included in the Purchasing Assessment Report.

³ Supplies, services, and equipment purchasing includes the 10 purchasing and materials service centers, Topeka Service Center, Automation Purchasing, Information Technology Purchasing, Services Purchasing, Printing Purchasing, and Operational Equipment Purchasing.

Neither contracting officers nor supplier diversity coordinators interviewed reviewed data for reasonableness and consistency with contract requirements. A flowchart of the subcontracting reporting process is contained in Appendix B.

Consequently, FY 1999 supplier diversity statistics cannot be used as a measure of current performance, or serve as a benchmark for future performance. According to the Postal Service Supplier Diversity Plan, small, minority, and woman-owned companies are driving the growth in the American economy, so doing business with them makes good business sense and should have a positive impact on the Postal Service's bottom line.

Since 1999, the Postal Service has been continually improving subcontract data integrity. Current efforts include continuous communication between the management analyst at headquarters, contracting officers, and supplier diversity coordinators to ensure that everyone understands what they should be looking for in the quarterly subcontracting reports, common mistakes made, and the importance of the reports. The management analyst also distributed samples of properly completed reports and tips in catching errors before reports are forwarded. In addition, the management analyst recommended contracting officers communicate with suppliers to ensure subcontracting reports are interpreted correctly to ensure accurate reporting. Contracting officers and coordinators were instructed to encourage suppliers to use electronic report forms and instructions. Finally, the management analyst encouraged contracting officers to follow-up with suppliers and coordinators to ensure subcontract data is properly reviewed.

Recommendations	<p>We recommend the vice president, Purchasing and Materials:</p> <ol style="list-style-type: none">8. Advise contracting officers that Section 6.2.3 of the <u>Purchasing Manual</u> extends to subcontracting submittals and require contracting personnel to review subcontract data submitted by prime suppliers.9. Require that quarterly subcontracting reports submitted by suppliers be maintained.
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Management's Comments	<p>Management agreed with recommendations 8 and 9. They stated that the recommendations are in accordance with their existing policy and that during their Purchasing Review for Excellence Program they would reinforce the requirement to maintain reports in contract files. They also stated that the Purchasing Review for Excellence process would be completed within approximately 30 days.</p>
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Other Management Comments	<p>Although, management agreed with all of our recommendations, they disagreed with some of our findings and conclusions. Specifically, management suggested that in the context of commitments on small, minority, and woman owned businesses totaling more than \$4 billion, prime contract overstatements by \$43 million on small businesses, \$.7 million on minority businesses, and \$1 million on woman-owned businesses were immaterial. Because management felt overstatements were immaterial, they disagreed with our finding that supplier diversity statistics were unreliable, and stated that the statistics were useful for tracking general trends, management diagnostics, benchmarking, and reporting.</p>
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Evaluation of Management's Comments	<p>We disagree with management's perspective. In their response, management erroneously expanded the scope of our audit and sample, and also discounted data problems associated with subcontracts. Management stated that total supplier diversity commitments were about \$4 billion. However, our audit only focused on commitments for supplies, services, and equipment. The \$4 billion cited by management erroneously included commitments for</p>
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transportation and facilities. Further, management incorrectly suggested data reliability problems were limited to commitments for prime contracts. Data reliability problems with subcontracts also need to be included in the analysis. When the analysis is properly focused on commitments for supplies, services, and equipment, and data reliability problems with subcontracts are properly included, the analysis is much more compelling. Specifically:

- \$413 million of \$1.87 billion (22 percent) in 1999 commitments to small business included errors.
- \$100 million of \$209 million (48 percent) in 1999 commitments to minorities included errors.
- \$69 million of \$219 million (31 percent) in 1999 commitments to woman-owned businesses included errors.

These percentages are clearly material, contradicting management's assertion. Consequently, we believe supplier diversity statistics are not useful for tracking general trends, management diagnostics, benchmarking, and reporting.

**Management's
Comments**

Management took exception to our finding that \$3.8 million in contract actions issued outside of 1999 were improperly included in 1999 statistics. Although they acknowledged their error, they calculated it as \$260,000.

**Evaluation of
Management's
Comments**

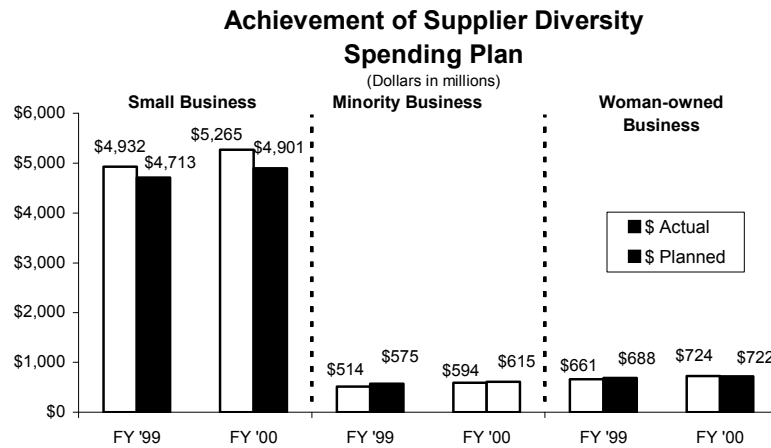
We disagree with management's assertion. Management acknowledged that they did not properly cut off their FY 1999 database at the end of the fiscal year and were almost 2 weeks late in accomplishing that requirement. During our audit we identified six contract actions, specified in Appendix A, that were awarded after the end of FY 1999, but prior to the database cutoff date identified by Postal Service data analysts. Therefore, management did not properly archive or retain a "snapshot" of the data at the cutoff date. Consequently, they were unable to provide sufficient documentation necessary to establish that the six contracts were excluded from FY 1999 statistics.

Management's Comments	Management took exception to our finding that 13 basic ordering agreements totaling \$5.2 million were improperly included in FY 1999 supplier diversity statistics. We reported that the amounts were improperly included because they represented estimates—not actual commitments. Management suggested that the practice of including basic ordering agreements in supplier diversity statistics was customary and practical.
Evaluation of Management's Comments	We disagree with management's assertions. Postal Service policy specifically states that basic ordering agreements are not contracts, and as we pointed out in our report, officials we talked to indicated basic ordering agreements should not be included in supplier diversity statistics. The practice of including basic ordering agreements in supplier diversity statistics could cause double counting when actual contracts are issued.
Management's Comments	Management took exception to our finding that four terminated or cancelled contracts valued at over \$4.5 million were inappropriately included in FY 1999 statistics. Management generally agreed that terminated contracts should not be included in supplier diversity statistics, and acknowledged that three of the contracts, valued at about \$2.4 million may have been improperly included in FY 1999 statistics in error. However, management stated that the largest contract, valued at more than \$2.3 million was active, and that deobligation was not warranted. We noted management commented they believed the overstatement should be about \$100,000 instead of the stated \$4.5 million. However, that number is inconsistent with their acknowledgement that three of the four contracts were erroneous entries.
Evaluation of Management's Comments	We noted management's comments regarding the error and disagree that the largest contract, valued at \$2.3 million, should not have been deobligated. Prior to our audit, only \$138,000 had been expended. At the time of our audit, the contracting officer could not locate the file and told us the contract had been cancelled. Records we subsequently reviewed revealed no activity for a period of approximately 1 year until the contract was reactivated and modified in

February 2001. We do not agree that funds committed since the contract was reactivated in 2001, were properly included in FY 1999 supplier diversity statistics.

**Achievement of
Supplier Diversity
Spending Plan is
Unclear**

The Postal Service was not always effective in achieving its supplier diversity spending plan. The following chart, which is based on the Postal Service's Supplier Diversity Plan and Purchasing Assessment Reports, summarizes the Postal Service's progress in meeting its supplier diversity spending plan:⁴



Note: Spending Plan dollar amounts were obtained from the Supplier Diversity Plan, FYs 1999-2003. According to the manager, Supplier Development and Diversity, the spending plan was premised on a growth in spending over the prior year. Spending was curtailed in FY 2000 and was significantly below spending for FY 1999.

In the Purchasing Assessment Report FY 1999, the Postal Service reported it exceeded its FY 1999 spending plan for small businesses by \$219 million. However, our audit identified \$370 million in subcontracts to small businesses that could not be supported. Additionally, we determined that over \$43 million was awarded to three suppliers who were large businesses. Also, as previously stated in our report, we believe another \$13.5 million in prime contracting dollars may be overstated, to include small business awards.

The Postal Service also reported that it missed the spending plans for minority and woman-owned businesses for FY 1999 by \$61 million and \$27 million, respectively. However, due to data reliability issues we could not verify

⁴ Achievement of Supplier Diversity Spending Plan Chart includes supplier diversity statistics for Facilities, Transportation, and Supplies, Services and Equipment Purchasing and credit card activity.

whether the Postal Service missed these spending plans. Any socioeconomic misclassifications could impact these numbers positively as well as negatively.⁵

In the Purchasing Assessment Report FY 2000, the Postal Service reported actual dollars awarded to small, minority, and woman-owned businesses. According to these actuals, the Postal Service exceeded small business and woman-owned business spending plans by \$364 million and \$2 million, respectively, but missed minority spending plans for FY 2000 by \$21 million. While we did not determine the accuracy of all of the FY 2000 statistics, we noted that \$59.5 million was awarded to suppliers whose socioeconomic status was incorrect. Further, we believe problems we observed with procurement data supporting FY 1999 statistics also impacted the FY 2000 statistics.

We believe recommendations to improve data reliability made in the previous section of this report and continuing improvements being made by the Postal Service will address the findings discussed here. Therefore, no additional recommendations are needed.

⁵ In the Purchasing Assessment Report FY 1999, the Postal Service reported “deltas” between the FY 1999 supplier diversity plan and FY 1999 actuals. However, the reporting format changed in the Purchasing Assessment Report FY 2000 and the report does not include a comparison between the supplier diversity plan and actuals.

APPENDIX A. PRIME CONTRACT DOLLAR OVERSTATEMENTS

1. Contract actions totaling approximately \$43 million for small, \$.7 million for minority, and \$1 million for woman-owned businesses reported in FY 1999 that had incorrect socioeconomic classifications.

FY 1999

Contract No.	Small	Minority	Woman-owned
102590-95-B-2240 *	\$27,025,630		
102590-96-B-2652 *	\$14,414,260		
089480-99-M-0558	\$11,448	\$11,448	\$11,448
089480-99-M-0523	\$21,718	\$21,718	\$21,718
089480-99-M-0517	\$25,328	\$25,328	\$25,328
102590-99-Z-1392	\$1,608,382		
475630-99-M-0911		\$4,831	
475630-99-M-0243		\$23,289	
475630-99-M-1016		\$87,000	
475630-99-M-1017		\$156,000	
475630-99-M-0172		\$345,126	
102591-99-M-2346			\$17,800
102591-99-D-2071			\$161,740
102590-99-D-1125			\$853,322
Totals	\$43,106,766	\$674,740	\$1,091,356

We identified approximately \$59.5 million in FY 2000 that had incorrect socioeconomic classifications.

FY 2000

Contract No.	Small
102590-95-B-2240 *	\$23,168,958
102590-99-Z-1392	\$36,383,430
Total	\$59,552,388

* Represents modifications to contracts.

APPENDIX A. PRIME CONTRACT DOLLAR OVERSTATEMENTS (Continued)

2. Contract actions totaling approximately \$3.8 million were issued outside of FY 1999.

Contract Number	Action Date	Action Amount
363199-99-B-0044	9/22/99	\$ 2,467,920
483083-99-P-0065	9/15/99	\$ 180,500
363199-99-B-0006	9/21/99	\$ 27,000
102595-99-B-2310	9/24/99	\$ 1,000,000
335660-99-P-0098	9/20/99	\$ 76,000
475630-99-F-0132	9/24/99	\$ 51,000
Total		\$ 3,802,420

*These contract actions are modifications.

3. Contract actions totaling approximately \$5.2 million in basic pricing agreements were incorrectly recorded.

Contract Number	Amount
052684-99-R-0506	\$ 62,500
052684-99-R-0109	\$ 250,000
052684-99-R-0672	\$ 275,000
335660-99-R-0001	\$ 150,000
475630-96-R-0266	\$ 15,000
483083-97-R-0201	\$ 50,000
052684-99-R-0736	\$ 100,000
102595-99-R-1775	\$ 2,000,000
102595-99-R-1811	\$ 2,000,000
052684-97-R-0332	\$ 100,000
052684-99-R-0294	\$ 60,000
102590-97-R-1663	\$ 100,000
412735-95-R-1502	\$ 9,438
Total	\$ 5,171,938

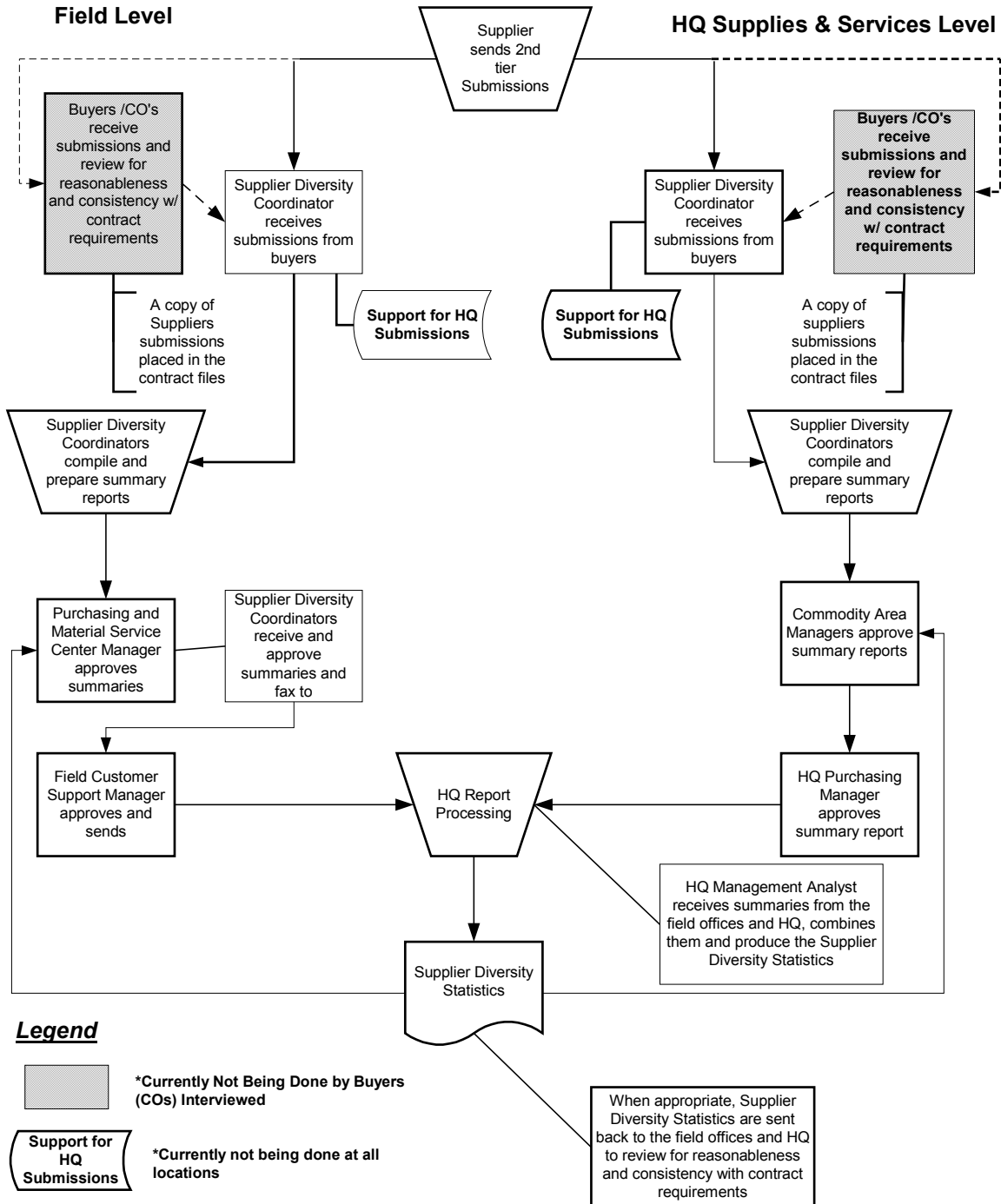
* Contract establishes a Basic Pricing Agreement

**APPENDIX A. PRIME CONTRACT DOLLAR OVERSTATEMENTS
(Continued)**

4. Terminated and cancelled contracts with approximately \$4.5 million in unused funds were not deobligated.

Contract Number	Amount
102590-99-B-1134	\$ 2,361,001
*102590-99-M-0508	\$ 2,060,440
475630-99-P-0211	\$ 30,360
475630-99-R-0655	\$ 69,004
Total	\$ 4,520,805
* HQ deleted contract from SNAPS.	

APPENDIX B. THE SUBCONTRACTING REPORTING PROCESS



APPENDIX C. MANAGEMENT'S COMMENTS

KEITH STRANGE
VICE PRESIDENT, PURCHASING AND MATERIALS



August 30, 2001

BILLY SAULS

SUBJECT: Draft Audit Report—Supplier Diversity Program for Supplies, Services, and Equipment Purchases (Report Number CA-AR-01-DRAFT)

Thank you for your draft audit report and for the opportunity to respond.

Attached you will find two documents, the response to the specific recommendations in the audit (Attachment A), and the formal management response to the findings (Attachment B).

We are generally in agreement with the recommendations and believe that, as we implement them, they will help us improve our overall data. As we discuss in more detail in the attached response, we are not in complete agreement with all the underlying findings.

One central point we must make is that we believe that the overall supplier diversity data is reliable for the purposes we use it -- tracking general trends, management diagnostics, benchmarking and reporting. Considering how we must derive the data, we have never contended that it is perfect or error free. It is the best data that we have, and we do find it useful. The audit report confirms that we make extensive efforts to review and correct errors. We acknowledge that the OIG devoted extensive time and effort to its review. Not surprisingly, those efforts did identify errors. Those errors, we believe, do not significantly change the broad picture of our supplier diversity program, or its overall effectiveness.

Given the limitations we face with systems compatibility, and data entry, extraction, and compilation, we certainly would appreciate continued assistance from the OIG in making our supplier diversity data as accurate as we can. We will be pleased to cooperate in sharing what we have learned about the data to help identify areas where the OIG could be most helpful.

We do not believe that this report contains any proprietary or business information that is exempt from disclosure. Further, if any of the dollar amounts cited in this report are to appear in the Inspector General's Semi-Annual Report to Congress, we would appreciate advance notice on how they will be discussed or characterized.

If you have any questions regarding this response or the proposed course of action, please contact Marie Martinez at (202) 268-4117 or Cynthia Kincaid at (202) 268-5173.

A handwritten signature in cursive script that reads "Keith Strange".

Attachments

cc: Richard J. Strasser, Jr.
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Attachment A
Purchasing and Materials Response

Draft Audit Report – Supplier Diversity Program for Supplies,
Services, and Equipment Purchases
(Report Number CA-AR-01-DRAFT)

RESPONSE TO RECOMMENDATIONS

OIG Recommendation 1: Develop and implement contract administration procedures on updating the procurement database and contract files when changes occur in a supplier's socioeconomic status.

OIG Recommendation 5: Establish and implement standard criteria for recording basic pricing agreement amounts in the procurement database.

OIG Recommendation 6: Revise the Purchasing Manual to include policy requiring contract personnel to deobligate unused funds from contracts and the procurement database when contracts are terminated or cancelled.

P&M Response: We generally agree with these recommendations. The specific areas covered in recommendations 1, 5, and 6 are procedural, and, as such, will be addressed by issuing a Purchasing and Materials Administrative Instruction (AI). This AI will apply to all purchasing activities, not just Supplies, Services and Equipment. The multiple stakeholders will require extensive input and review. We anticipate this process will require 90-120 days to complete after the final report. Responsible individual(s): Marie Martinez and Michael Harris, Purchasing Policies and Programs. Kim Stroud of the I.G.'s office will be copied on the distribution of the Administrative Instruction.

OIG Recommendation 2: Correct the socioeconomic classification in the procurement database of the suppliers identified in our report.

OIG Recommendation 3: For the 104 contract actions identified in our report, reconcile contract files to the procurement database and correct errors in socioeconomic status of suppliers.

P&M Response: We generally agree with these recommendations, with the understanding that we will make the corrections for current, active contracts only. The effort is underway. We anticipate this process will require 60 days to complete after the issuance of the final report. Responsible individual(s): Marie Martinez and Cynthia Kincaid, Purchasing Policies and Programs. Kim Stroud will be copied on this correspondence.

OIG Recommendation 4: Archive the procurement database at the end of the fiscal year as support for annual supplier diversity statistical reports.

P&M Response: We agree with this recommendation. A snapshot of the data is being taken of the data at the end of each accounting period, which includes the end of the fiscal year. Responsible individual: Christy Souter, Systems Integration.

OIG Recommendation 7: In developing the FY 2001 Purchasing Assessment Report, include corrections to the FY 1999 and 2000 statistics for small, minority and woman-owned businesses.

P&M Response: We agree with this recommendation. A footnote will be included in the 2001 Purchasing Assessment Report (PAR), noting corrections to the FY 1999 and 2000 statistics as reflected in the audit. Marie Martinez has the action on this item. The PAR will be published on or near April 2002.

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OIG Recommendation 8: Advise contracting officers that Section 6.2.3 of the Purchasing Manual extends to subcontracting submittals and require contracting personnel to review subcontract data submitted by prime suppliers.

OIG Recommendation 9: Require that quarterly subcontracting reports submitted by suppliers be maintained [in contract files].

P&M Response: We agree with these recommendations, and, in fact, believe they are existing policy. Supplier Development and Diversity has been instructing contracting personnel to review and maintain supplier submissions in contract files. This guidance has been included in training sessions since October 1999. All training materials will continue to cover these issues. Additionally, cascading this report through our Purchasing Review for Excellence Program (PREP) to our operational purchasing managers for self-assessment will provide meaningful reinforcement of the existing policy requiring review of subcontract reports and maintaining those reports in the contract files. This PREP self-assessment cascade process will be completed within 30 days following receipt of the final report. Responsible individual(s): Marie Martinez, Purchasing Policies and Programs and Charles Hochstein, Supplier Development and Diversity.

Attachment B
Purchasing and Materials Management Response
Draft Audit Report – Supplier Diversity Program for Supplies, Services, and Equipment Purchases
(Report Number CA-AR-01-DRAFT)

**Management Response
To
O.I.G. Draft Audit Report CA-AR-01-Draft, 8/14/01**

Statistical Reliability

1. **Finding:** "[S]upplier diversity statistics for FY 1999 supplies, services, and equipment contracts were unreliable." This finding is buttressed by the claim that "prime contract dollars awarded to small, minority and woman-owned businesses **may be overstated** . . ." (emphasis supplied).

We have long been collecting and tracking purchasing statistics and supplier diversity results. We review trends, we look at ratios and relationships, and we report on results. We collect our data from several different "legacy" systems, each dependent on input from multiple and geographically dispersed users. None of these systems integrate well, and the compilation of the data has required extensive manual effort.¹ Nevertheless, as the audit report notes, we have been taking, and continue to take incremental steps to improve the systems and the overall reliability of the information or data they provide.

The auditors found instances of data input error. In some cases, the errors appear to be keystroke errors. In other cases, they appear to represent misunderstanding (or a lack of clear instruction) on what is wanted.² Finally, they may represent carry-overs from the migration of data from the "old" to the "new" system. Clearly there are errors. We have been, and will continue to work to reduce them.

But to assess the extent of the asserted error, one needs to have a context. The audit reports that the year-end statistics "may be overstated" by as much as \$43 million for small, \$.7 million for minority, and \$1 million for woman-owned businesses." We reported that direct transactions worth \$4.1 billion went to small business in 1999. Looking just at the I.G.'s reported figures, we note that the \$43 million the I.G. finds "may be overstated" represents about 1 percent of that figure, and correcting our reported number by that amount changes our report to indicate that \$4.08 billion went to small business in 1999. Similarly, reducing the amount we reported as going to minority businesses that year by the \$0.7 million the I.G. questioned, changes the percentage of total dollars going to minority business by nearly two tenths of one percent -- from \$363.6 to \$362.9 million. Deducting the \$1 million "overstatement" for woman-owned business changes the percentage of total dollars we reported as going to Woman-Owned business in FY 1999 from 5.2 percent to 5.1 percent.

The fact is that some level of error in data systems such as these is inherent and inevitable.³ We do not yet have a mechanism for gauging a composite data accuracy rate for the systems we use. We believe

¹ The extent of manual effort has decreased somewhat in the last few years. We attribute the decrease to SNAPS, the upgraded WIN-FMS system, and the new process for reporting subcontracting results.

² See Twidale & Marty, "An Investigation of Data Quality and Collaboration," (U. Ill. Champagne-Urbana, 1999), particularly at page 4 characterizing input error and differentiating between "slip" and "misconception."

³ See, generally, Redman, "Data Quality for the Information Age", (U. Mass. 1996), Mathieu & Khalil, "Data Quality in the Data Base System," *Data Quality Journal*, Vol. 4, No. 1, (1998). The General Services Administration conducted an "accuracy audit" on data entry in the Federal Procurement Data System for Fiscal Year 1997. They looked at 10 data elements and found accuracy rates on those 10 ranging from 90.5 percent to 98.3 percent.

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that the quality and reliability of the data has been improving, year over year. The statistical data we reported in 1999 (and in 2000) was at least as accurate and reliable as they were for prior years - indeed, we believe it was substantially improved, particularly for Supplies and Services and for Facilities.

Prime Contracting:

2. **Finding:** "Prime contracting dollars...[reported for FY 1999]...may be overstated by as much as \$43 million for small, \$.7 million for minority, and \$1 million for woman-owned businesses."

We do not take issue with this finding. The I.G. identifies 14 transactions for which the contract socioeconomic coding had become incorrect in the procurement database. Two of them were contracts. The other twelve were orders placed against three "master" contracts awarded in the 1994 to 1996 timeframe. We provide information about the 14 transactions below.

Contract Number	Supplier Name/Issue	Original Status	New Status	Action Taken
102590-99-Z-1392	New Breed – Increased in size	Small	Large	Correction completed
102590-95-B-2240	Lee Hill - Acquired by Draft Worldwide	Small	Large	Correction completed
Orders against three contracts (1994 – 1996)	I-Net – Acquired by Wang	Minority/Woman-owned	Large	Correction completed

These coding errors occurred when buyers did not update the procurement database when the status of the supplier changed during contract performance. We will take steps to reinforce the need for buyers to update socioeconomic codes when they become aware of a change in supplier status [see Attachment A].

3. **Finding:** "\$3.8M in contract actions that were issued outside of 1999."

We do take issue with this finding. The audit report lists six contracts and asserts they were awarded after the close of FY 1999, but counted in that year. That was not the case, based on our review, for at least four of these six contracts.

At the end of each fiscal year, we essentially take a snapshot of the database from which we derive our year-end reports.⁴ For fiscal 1999, we were slightly late in doing this, principally because of the transition to SNAPS. We derived our year-end statistics on September 22.⁵

Contract 363199-99-B-0044, the largest of the six at \$2,467,920, was actually awarded on September 22, 1998. While modification 7 to that contract for another \$2.4 million was entered on September 22, 1999, the value of the modification was not included in our FY 1999 statistics, given the process used in making the year-end "run."

Contract 102595-99-B-2310, the second largest in this group, was awarded on July 29, 1999. The initial value was \$878,300. There have been several modifications to this contract, the first of which was on September 24, 1999, for an additional \$1,000,000. The I.G. asserts that the at \$1,000,000 modification

⁴ Since the database is dynamic, it's important to take the "snapshot" within a narrow window of time.

⁵ We are advised that the auditors believed that the PSR was "run" on September 24.

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value was counted in FY 1999. It was not. We carried the initial award amount in our 1999 statistics. The subsequent September 24, 1999 modification was not included in our end-of-year FY 1999 statistics.

Of the remaining four contracts listed by the I.G., only two of them, together valued at about 256,500, may have been counted with the FY 1999 results due to the fact that we did not "run" the PSR until September 22 -- a one time event.

According to our reckoning, the I.G.'s \$3.8 million figure is overstated—the amount may be more like \$260,000.

4. **Finding** - *"Another \$5.2 million in overstatements comprised estimated or not-to-exceed amounts of 13 basic pricing agreements . . . [representing] . . . the maximum amount of all orders that can be made under the agreement, and not actual commitments."*

The thirteen contracts listed in this section (see appendix A-3) are all types of Basic Ordering Agreements (BOA) coded as "R." It has been the customary practice to assign a dollar value to these "R" coded agreements when they are established to assure that the supplier is paid. Finance needs committed funds to issue a payment check. This committed value is posted in Finance's accounts payable system and used as a declining balance to track the cumulative value of orders being placed against each agreement, serving as a control mechanism to insure that the ordering agreement is not overspent. The dollar values used in these thirteen transactions represent the funding being provided by the "customer" organization(s). These were fiscal year funds that the customer fully expects to expend during the fiscal year. Typically, the authorized funds committed as described above, are actually spent—or expended during that FY. If and when the committed funds are depleted, either additional funding is secured from the "customer," or no further orders are processed.

The use of these initial commitment amounts seems to us a logical and practical approach, and it introduces little if any error (certainly nothing material) to the supplier diversity statistics. If these BOAs were entered at a zero dollar level, an "understatement" would be built into our year-end figures.

We do agree with the I.G. that our guidance to the buyers could be better, more clearly stated. We will take steps to clarify this process [see Attachment A].

5. **Finding** - *[T]erminated and cancelled contracts with unused dollars totaling over \$4.5 M were inappropriately included in supplier diversity statistics.*

We agree, in general, that surplus funds should be deobligated when contracts end, but the instances in which they are not are relatively rare and the amounts are rarely material.

The highest value contract identified by the I.G. in this section, is contract 102590-99-B-1134, which the IG valued at \$2,361,001. It is an active contract; therefore, a deobligation of funds is not warranted.

Contract 102590-99-M-0508, the second large contract in the four cited by the I.G., was an erroneous entry that was cancelled. This is not an instance where funds should have been deobligated. It is an instance where an erroneous entry should have been promptly corrected. It was corrected, but only after the turn of the year, and the amount may have been erroneously included in the FY 1999 figures. We believe this example is an isolated anomaly, probably attributable to user unfamiliarity with the then new SNAPS system.

The remaining two, both relatively small contracts, evidence attempts on the part of the users, to

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deobligate the funds. In one case, the user failed to use the minus sign in making the entry; in the other, the user referred to the body or text of the contract modification rather than entering the amount to be deobligated.

We will, however, again reinforce with our buyers, the need to promptly deobligate unused funds when contracts end [see Attachment A].

Revised for the reasons discussed above, we believe the amount identified for this finding should be about \$100,000 instead of the stated \$4.5 million.

Subcontracting:

6. **Finding** - *Our audit disclosed that \$99 million of minority, \$68 million of woman-owned, and \$370 million of small business subcontract actions could not be supported*

FY 1999 was a year of change and improvement; specifically with regard to the revision of our subcontracting policy in February 1999, and the development and initial roll-out of new subcontract reporting processes and formats later in the year. We included, for the first time ever, subcontracting statistics in our reports to top management. In doing so, we noted that the figures represented a mixture of the old system and the new requirements being rolled out.⁶

We are using the concededly inexact "baseline" figures reported for FY 1999, and the somewhat improved FY 2000 figures as a gauge for assessing our progress. We are tracking—and seeing—continuing improvement in:

- The number of suppliers reporting;
- The number of reports being received;
- The use of "postal-specific" data; and,
- The dollars flowing to the SMW communities.

As the I.G. acknowledges, we are working with our buyers to solidify their abilities to critically review the data reflected in the reports as they are received. We are also working with select suppliers to assist them in transitioning to our (as opposed to the usual federal) requirements.

The I.G. specifically acknowledges in its report, that the FY 1999 data was "a combination of the old and new reporting formats . . ." and that the reports "varied in form content and reporting period, which made data aggregation difficult and irreconcilable . . ." We generally agree with those observations. We nevertheless, would maintain that the data we collected and reported, for both FY 1999 and 2000, proved valuable to us in assessing the subcontracting approaches, identifying needs, and prioritizing effort.

Further, in our judgment, given our familiarity with the overall program, our reports of subcontracting activity with SMW firms in 1999 and in 2000, are probably understated, if anything. We were not then, and are still not receiving reports on long-term contracts that predated the adoption of the new policy. Other suppliers are still being brought into line with our "new" requirements. And we continue to work with several suppliers on how they can best comply with our needs, given limitations in their own systems.

The I.G. report acknowledges that "[s]ince 1999, the Postal Service has been continually improving subcontract data integrity." The report outlines a number of steps we are currently taking. It also outlines

⁶ See e.g., Feb. 3, 2000, memorandum to CFO and COO, co-chairs, Div. Oversight Committee. We furnished a copy of this letter to the IG audit team by cc:mail on March 1, 2000.

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the effort we have underway to improve our processes. We have, also, taken steps to define accountability. The primary responsibility for insuring that: 1) the appropriate subcontracting clauses are included in contracts; 2) a plan is secured and negotiated where called for; and, 3) subcontracting reports are received and reviewed, rests with the contracting officer.⁷

Gauging Performance

7. **Finding** - *"Achievement of Spending Plan Is Unclear. The Postal Service was not always effective in achieving its supplier diversity spending plan."*

In May 1997, the Postal Service issued a Supplier Diversity Operating Plan. In it, for the first time, the then prevalent growth trend in annual commitments was extrapolated out for 5 years. Numeric targets were then developed for SMW business sectors. In January 1999, the plan was revised. It begins with a foreword from the Chief Executive Officer, the Chief Operating Officer, and the Deputy Postmaster General articulating the premise that "supplier diversity is everyone's responsibility." It also sets out the Supplier Diversity Statement of Commitment and other supportive material. The 5-year "spend plan" it contained graphed prospective trend lines for SMW participation, based on the anticipated increases in overall USPS spending. By design, this revision does not address numeric goals or targets.

At the same time, we were receiving legal guidance to the effect that the establishment of numeric goals or targets was not legally permissible. On April 20, 2000, Mr. Strange, Vice President, Purchasing and Materials, issued a letter and guidelines on "accountability" to officers and buyers. The letter indicated that numeric goals or targets were not to be used, and included guidance on establishing "effort" based goals.

In the FY 1999 Purchasing Assessment Report, we included a chart depicting the projections contained in the revised January 1999 Supplier Diversity Plan and compared those to FY 1999 results. This was the material the I.G. relied on for this section of the audit report.

Since receipt of the legal guidance and the release of Mr. Strange's April 20, 2000, letter, we have avoided conduct that might be construed as establishing goals or targets or measuring performance against goals or targets, including the spending plan in the Supplier Diversity Plan.

Additionally, the commitment trends that had been projected for both the 1997 Supplier Diversity Operating Plan and the January 1999 Supplier Diversity Plan failed to materialize, making the spending plan component irrelevant. Commitments fell in FY 2000 by 21 percent - approximately \$2 billion - from the FY 1999 commitment level. Commitment levels appear to be declining further during this fiscal year.

It is not legally permissible for the Postal Service to measure its supplier diversity performance results against numeric goals. It is more efficient and effective to benchmark ourselves against private and public sector organizations—as we have been striving to do over the past several years . . . and, adopt best practices in our supplier diversity efforts.

⁷ It is difficult to substantively review subcontracting reports submitted in those instances where no plan was required. The review, in those cases, is necessarily more cursory.