



May 23, 2007

SUSAN BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT

SUBJECT: Audit Report – Audit of Compliance with the Use of MSC Industrial Supply Co., Inc. and W. W. Grainger, Inc. National Contracts
(Report Number CA-AR-07-004)

This report presents the results of our audit of the compliance with the use of MSC Industrial Supply Co., Inc. (MSC) and W. W. Grainger, Inc. (W.W. Grainger) national contracts (Project Number 06YG035CA000). This is the first in a series of reports under our Value Proposition Agreement covering compliance with the terms and conditions of selected contracts.

Background

In November 2002, U.S. Postal Service officials developed Supply Management's 5-Year Strategic Plan. One of the goals of the plan was to reduce costs and furthering competitive and business objectives. To meet this goal, the Postal Service developed a corporate-wide management strategy for procuring maintenance, repair, and operating (MRO) supplies.

On March 31, 2003, the Dallas Category Management Center (CMC)¹ awarded national contracts to MSC and W. W. Grainger for the purchase of MRO supplies.² The period of performance for the two contracts was 4 years with two 3-year renewal options for a total of 10 years. Material Logistics Bulletin (MLB) number MLB-CO-03-010, *Mandatory National Sources for Maintenance, Repair & Operating (MRO) Supplies*, dated May 28, 2003, states the mandatory sources for the purchase of MRO supplies are MSC and W. W. Grainger. From April 1, 2003, through September 30, 2006, the Postal Service spent more than \$106 million for MRO supplies through the two contracts.

¹ The Dallas CMC is responsible for managing and monitoring contracts for MRO supplies for the entire Postal Service.

² Two contracts were awarded to encourage competition, sustain customer choice, and provide the Postal Service with quality products and service at the best value.

Objectives, Scope, and Methodology

Our overall objectives were to determine whether Postal Service employees are complying with contract terms and conditions.

To accomplish our objectives, we interviewed Dallas CMC contracting officers and reviewed contract file documentation, responses received from questionnaires sent to Postal Service personnel, and guidance establishing the use of the mandatory national contracts as a priority source of MRO supplies. We obtained database information from the Electronic Maintenance Activity Reporting System (eMARS)³ on all local purchase transactions for the period of June 1, 2005, through May 31, 2006. We also obtained all price lists from MSC and W.W. Grainger that were in effect at the time of the purchases. Finally, we obtained all eBuy⁴ purchase transactions for the period of June 1, 2005, through May 31, 2006.

We conducted this audit from May 2006 through May 2007 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. We did not audit or comprehensively validate the eMARS and eBuy systems; however, we noted control weaknesses that constrained our work. For example, some eMARS transactions did not include key data such as the Primary Equipment Manufacturing Number (OEM) and National Stock Number (NSN).⁵ Even though these data limitations constrained our work, we were able to compensate by applying alternate audit procedures, as discussed in the report. We discussed our observations and conclusions with management officials on February 28, 2007 and included their comments where appropriate.

Prior Audit Coverage

There were two prior reports related to compliance with the terms and conditions of national contracts. The Government Accountability Office (GAO) issued a report titled, *Postal Service's National Office Supply Contract Has Not Been Effectively Implemented* (Report Number GAO-030230, dated January 2003), which concluded the Postal Service had not been successful in implementing its national-level contract to purchase most office supplies and, as a result, has not realized its estimated annual savings of \$28 million. Additionally, the Postal Service Office of Inspector General (OIG) issued *Estimated Supply Chain Management Impact Associated with National Office Supply Contract* (Report Number CA-MA-05-002, dated September 7, 2005), which concluded

³ eMARS is a computerized maintenance management information system that provides field maintenance personnel with the ability to schedule maintenance and personnel, track labor and material costs, maintain a spare parts inventory, and report on maintenance.

⁴ eBuy is an electronic commerce portal that provides Postal Service employees with electronic requisitioning, approval, and invoice certification capability. The Postal Service makes its national contract purchases from MSC and W.W. Grainger through eBuy.

⁵ These data items are necessary to ensure exact item comparison.

the Postal Service avoided costs of \$3.4 million in fiscal year (FY) 2004 by using the national office supply contract.

Results

Postal Service personnel were placing orders for MRO supplies outside of the MSC and W. W. Grainger national contracts. The Postal Service needs enhanced communications and process improvements to increase its monetary benefits from these contracts. Specifically, we identified 11,395 MRO supply purchases Postal Service employees made outside of the national contracts, 7,100 of which were at prices exceeding those established in the contracts. As a result, the Postal Service incurred unrecoverable costs of approximately \$217,113. We project the Postal Service will incur over-expenditures of \$651,339 in the next 3 years if this practice continues. In addition, Postal Service contracting officers could save an additional \$1,099,773 by renegotiating prices for selected MRO supplies found at a lower price than in the national MRO contracts. We will report \$217,113 of unrecoverable questioned costs and \$1,751,112 in funds put to better use in our *Semiannual Report to Congress*. See Appendix A for a summary of the monetary impact.

Mandated National Maintenance, Repair, and Operating Supply Contracts Were Not Always Used

Postal Service personnel did not always order MRO supplies using the MSC and W. W. Grainger national contracts. Originally, we identified 283,263 eMARS transactions with a total dollar value of \$208,526,508 for the period June 1, 2005, through May 31, 2006, that appeared to be for MRO supplies that should have been ordered through the national contracts. We excluded 240,344 transactions because some of the transactions were for non-MRO items (e.g., office and cleaning supplies) and because in some cases key data — such as OEMs and NSNs — were different or not present and could not be matched exactly. Thus, we defined our universe to be the 42,919⁶ exact matches for MRO supplies valued at \$10.4 million. We compared the eMARS purchase price to the eBuy catalog price in effect at the time of the purchase and identified 7,100 purchases made at prices higher than the eBuy catalog price.

⁶ The 42,919 exact matching transactions consisted of the following: 27,414 transactions were made at the same price as the eBuy catalog price and may have been made using the national contract; 7,100 transactions were made at prices higher than those in the eBuy catalog; and 4,295 transactions were made at prices less than eBuy catalog prices (reported in finding number two below).

Items and Dollars Overpaid

Item	Quantity	Purchase Price	National Contract eBuy Price	Total Overpaid
1				
2				
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We determined some of these purchases were actually made through local MSC and W.W. Grainger vendors outside of the eBuy ordering system. Buyers, in some cases, believed they were making their purchases through the national contracts and were not aware the prices were more than the eBuy catalog price. In addition, Supply Management contracting officers manage the MRO contracts; however, the employees purchasing MRO supplies report to various organizations throughout the Postal Service. Specifically, most personnel ordering MRO supplies report to district and area managers who report to the Senior Vice President, Operations. Unless these personnel use the national MRO contracts, the Postal Service cannot strategically leverage its total purchase volume to achieve the lowest total cost.

⁷ We calculated our monetary projections using the sum of all transactions with a price difference of 50 cents or greater.

transactions, the Postal Service may also be incurring over-expenditures on the remaining 85 percent of the transactions, which we were unable to review.

Recommendation

We recommend the Vice President, Supply Management:

1. Coordinate with the Senior Vice President, Operations, to direct Postal Service headquarters, area, and district personnel to use mandatory national maintenance, repair, and operating contracts to maximize potential supply chain management savings.

Management's Comments

Management agreed with our finding and recommendation, and with part of the associated monetary savings. They indicated that they were not in a position to assess the portion of the monetary savings projected over the next 3 years.

To address the recommendation, Supply Management indicated they would coordinate with Operations to identify the most effective method to implement our recommendations. Supply Management's National Contract Compliance Team and the MRO Category Management Team will alert cognizant personnel to this finding and recommendation. Supply Management plans to complete these actions in the third quarter of FY 2007. Management's comments, in their entirety, are included in Appendix B of this report.

Evaluation of Management's Comments

Management's comments are responsive to the audit finding and recommendation. Management's actions taken or planned should correct the issues identified in the finding. Although management stated they could not validate our estimate for monetary savings, we believe the method used to calculate savings (as described in the finding) provides a conservative estimate of the costs the Postal Service could save by making better use of the national MRO contracts over the next 3 years. Thus, we will report the \$651,339 as funds put to better use along with the \$217,113 in unrecoverable questioned costs associated with this finding in our *Semiannual Report to Congress*.

Renegotiation of Contract Prices Could Achieve Greater Savings

The Postal Service missed an opportunity to decrease MRO expenditures by approximately \$1.1 million. This condition occurred because Postal Service personnel did not always inform responsible contracting officers of lower prices found outside of the national contracts. According to the contracting officer, MLB-CO-03-010 requires

We identified 20,804 eBay transactions that did not benefit from lower prices. To accomplish this, we extracted all MRO purchases from eMARS to obtain the item OEM or NSN. We then used this list to identify similar purchases made through eBay from June 1, 2005, through May 31, 2006. Once we identified similar items, we compared the actual price paid from the eBay system to the average eMARS price. The following table shows examples of items and prices that could be renegotiated based on lower prices found outside of the national contracts.

Item	Quantity	Purchase Price	Catalog Price	Total Potential Price Savings
1	1	1	1	0
2	1	1	1	0
3	1	1	1	0
4	1	1	1	0
5	1	1	1	0
6	1	1	1	0
7	1	1	1	0
8	1	1	1	0
9	1	1	1	0
10	1	1	1	0
11	1	1	1	0
12	1	1	1	0
13	1	1	1	0
14	1	1	1	0
15	1	1	1	0
16	1	1	1	0
17	1	1	1	0
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20	1	1	1	0
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22	1	1	1	0
23	1	1	1	0
24	1	1	1	0
25	1	1	1	0
26	1	1	1	0
27	1	1	1	0
28	1	1	1	0
29	1	1	1	0
30	1	1	1	0
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39	1	1	1	0
40	1	1	1	0
41	1	1	1	0
42	1	1	1	0
43	1	1	1	0
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91	1	1	1	0
92	1	1	1	0
93	1	1	1	0
94	1	1	1	0
95	1	1	1	0
96	1	1	1	0
97	1	1	1	0
98	1	1	1	0
99	1	1	1	0
100	1	1	1	0

Recommendations

2. Coordinate with the Senior Vice President, Operations, to direct personnel who purchase maintenance, repair, and operating supplies to notify responsible contracting officers when they find lower prices elsewhere.
3. Direct contracting officers responsible for managing the two national maintenance, repair, and operating (MRO) supply contracts to renegotiate contracted prices for the selected MRO supplies where lower prices have been identified.

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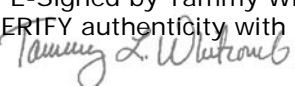
Management's Comments

Management agreed with our finding and recommendations, but stated that they were not in position to assess the potential monetary savings. To address our recommendations, Supply Management indicated that, in coordination with Operations, they would communicate these issues to the cognizant staff. They also indicated that Supply Management personnel have already started efforts to review MRO supplies pricing for negotiation purposes. Supply Management plans to complete these actions in the fourth quarter of FY 2007.

Evaluation of Management's Comments

Management's comments are responsive to the audit finding and recommendations. Management's actions taken or planned should correct the issues identified in the finding. Although management stated they could not validate our estimate for monetary savings, we believe the method used to calculate savings provides a reasonable estimate of costs the Postal Service could save by renegotiating selected MRO prices. Since management stated they routinely renegotiate prices, we believe the potential savings are applicable, and we will report the \$1,099,773 of funds put to better use associated with this finding in our *Semiannual Report to Congress*.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions, or need additional information, please contact Judy Leonhardt, Director, Supply Management, or me at (703) 248-2100.

E-Signed by Tammy Whitcomb
VERIFY authenticity with ApproveIt


Tammy L. Whitcomb
Deputy Assistant Inspector General
for Support Operations

Attachments

cc: William P. Galligan
Marie K. Martinez
Katherine S. Banks

APPENDIX A

SUMMARY OF MONETARY IMPACT

Finding	Unrecoverable Questioned Costs	Funds Put To Better Use
Mandated National Contracts Were Not Used	\$217,113	\$651,339
Monetary Savings Could Increase by Renegotiating Prices for Selected MRO Items		\$1,099,773
TOTALS	\$217,113	\$1,751,112

NOTES

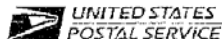
QUESTIONED COSTS – A cost that is unnecessary, unreasonable, or unsupported; or an alleged violation of law, regulation, or contract.

UNRECOVERABLE COSTS – A cost that perhaps should not have been incurred and is not recoverable.

FUNDS PUT TO BETTER USE – Funds that could be used more efficiently by implementing recommended actions.

APPENDIX B MANAGEMENT'S COMMENTS

Subject: A. B. Brown
Value Proposition: Supply Management



April 26, 2007

JUDY LEONHARDT

SUBJECT: Draft Audit Report—Audit of Compliance with the Use of MSC Industrial Supply Co, Inc. and W. W. Grainger, Inc. National Contracts (Report Number CA-AR-07-DRAFT)

Thank you for your efforts associated with providing this first report under our Value Proposition agreement to improve national contract compliance. This type of audit work will help us improve our processes, reduce organization costs and ultimately, achieve higher Supply Chain Management (SCM) impact results. We agree with the report's three recommendations and concur that increased communications covering the required use of these national contracts should help improve compliance. The attachment to this response provides detailed replies to these recommendations and our plans for implementation.

The report also advises that you plan to report \$217,263 in unrecoverable questioned costs and \$1.7 million in funds to be put to better use in your next *Semiannual Report to Congress*. Considering the unrecoverable cost calculation was based on a small sample, and that the cost of noncompliance is much higher, we concur with this figure. While we agree that renegotiation of contract prices identified by this report could decrease overall expenditures for maintenance, repair, and operating (MRO) supplies, we are not in a position to assess the \$1.7 million dollar figure. First, we must review identified items with the suppliers and the basis for the lower prices. There may be legitimate reasons for lower local dealer pricing that would not necessarily transfer to the national contract price and value-added components of our contracts. And second, we currently are unable to accurately predict future needs and item pricing associated with your 3-year projection.

We look forward to working with your team on the next national contract compliance value proposition project. As you may know, Supply Management's new three-year strategic plan also focuses on cost reductions that will return quantifiable dollar savings to the Postal Service's bottom line and a project team was recently chartered with increasing national contract compliance. The findings in this report will provide valuable input to this team.

We do not believe that this report contains any proprietary or business information and may be disclosed pursuant to the Freedom of Information Act. You may contact Marie Martinez, Supply Management, if you have any questions regarding actions taken to satisfy the report's recommendations. She can be reached at (202) 268-4117.

Marie K. Martinez
Acting Director, Supply Management

Attachment

cc: H. Glen Walker (all w/attachment)
William Galtigan
Marie K. Martinez
Deborah A. Kendall

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ATTACHMENT
Supply Management Response
OIG Report CA-AR-07-DRAFT
Page 1 of 1

RESPONSES TO OFFICE OF INSPECTOR GENERAL (OIG) REPORT RECOMMENDATIONS

We recommend the Vice President, Supply Management:

1. Coordinate with the Senior Vice President, Operations, to direct Postal Service Headquarters, area, and district personnel, to use mandatory national maintenance, repair, and operating contracts in order to maximize potential supply chain management savings.

Management Response: Management agrees with this recommendation. The Vice President, Supply Management, will coordinate with the Senior VP, Operations, to determine the most effective method to implement this recommendation. At a minimum, Supply Management's National Contract Compliance Team and the MRO Category Management Team will alert identified personnel to this report's findings and recommendations through direct and indirect communications. This will include (1) one-on-one email communication with a request to cascade the message and report further within their respective organizations to require use of these MRO contracts, and (2) a Postal Bulletin article. Copies of these communications will be shared with the OIG. Implementation is targeted during Postal Quarter 3.

2. Coordinate with the Senior Vice President, Operations, to direct personnel who purchase maintenance, repair, and operating supplies to notify responsible contracting officers when they find lower prices elsewhere.

Management Response: Management agrees with this recommendation. Supply Management will cover this issue in the communications discussed in the response to recommendation 1 above. Implementation is targeted during Postal Quarter 3.

3. Direct contracting officers responsible for managing the two national maintenance, repair, and operating (MRO) supply contracts to renegotiate contracted prices for the selected MRO supplies where lower prices have been identified.

Management Response: Management agrees with this recommendation. The Contracting Officer routinely renegotiates prices of selected high-volume items identified through analysis of contract sales. Additional compliance will increase sales volumes and strengthen the Contracting Officer's negotiating leverage. Supply Management personnel have already started to review the identified MRO supplies with the suppliers. Results of this effort will be shared with the OIG upon completion. Implementation is targeted on or before the end of Postal Quarter 4.