

March 31, 2003

SUZANNE F. MEDVIDOVICH
SENIOR VICE PRESIDENT, HUMAN RESOURCES

KEITH STRANGE
VICE PRESIDENT, SUPPLY MANAGEMENT

SUBJECT: Audit Report – Postal Service’s Arrangement with a Preferred Provider Organization (Audit Report Number HK-AR-03-001)

This report is the first in a series of reports we plan to issue on selected aspects of the Postal Service’s Arrangement with a Preferred Provider Organization (Project Number 03YN003HK000). The report presents the results of our review, which was self-initiated and included in our fiscal year 2003 Audit Workload Plan. Our objective was to determine whether the Postal Service used proper contracting practices in its arrangement with the preferred provider organization.

Our audit revealed that the Postal Service did not use proper contracting practices in its arrangement with the preferred provider organization. However, as a result of our audit, the Postal Service is taking action to modify its contract with the preferred provider organization. We provided five recommendations to Postal Service management. Management agreed with all five recommendations, but did not agree with our finding or with other aspects of the report. Management agreed that the \$75,000 in contract funding should be deobligated and actions were taken to deobligate those funds. However, management disagreed with our plan to classify the deobligated funds as funds that could be put to better use. We disagree with management’s assessment since our classification is consistent with the definitions contained in the Inspector General Act. We do not plan to pursue this issue through the formal audit resolution process. Management’s comments and our evaluations of these comments are included in the report.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have any questions or need additional information, please contact Erica Blackman, director, Health Care, at (703) 248-2100 or me at (703) 248-2300.

B. Wayne Goleski
Assistant Inspector General
for Core Business

Attachment

cc: Richard J. Strasser, Jr.
Sylvester Black
Ronald E. Henderson
James J. Rowan, Jr.
Susan M. Duchek

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EXECUTIVE SUMMARY

Introduction

On March 1, 2001, the Postal Service entered into a contract with a preferred provider organization to provide managed care services. The 2-year contract, which was set to expire on February 28, 2003, was designed to help the Postal Service achieve annual medical cost savings in its injury compensation program. The preferred provider organization estimated medical cost savings approximating \$30 million from this contract. This self-initiated audit is the first in a series of reports on the Postal Service's contract with the preferred provider organization. The overall objective of this audit was to determine whether the Postal Service used proper contracting practices in its arrangement with the preferred provider organization.

Results in Brief

Our audit revealed that Postal Service officials did not use appropriate contracting practices in its arrangement with the preferred provider organization. For example, we found that required contract documentation was lacking, the contract contained provisions that were unfavorable to the Postal Service, and the contract lacked standard Postal Service clauses and provisions. As a result, this contract exposed the Postal Service to unnecessary risks from legal claims, protests, adjustments, and contract termination. Moreover, the former contracting officer did not timely deobligate \$75,000 for contract services not used.

In response to our audit, the current contracting officer has been actively working to revise the contract to ensure that the Postal Service receives maximum benefit and protections. Those efforts include negotiations with the preferred provider organization to refine the contract's terms and conditions. Although the current contracting officer has initiated corrective action to revise the contract, those actions have not been finalized. The contract, which was set to expire on February 28, 2003 has been extended to allow negotiations to completely revise the contract.

**Summary of
Recommendations**

We recommended management instruct the contracting officer to continue efforts to develop contract documentation including negotiations, justification for noncompetitive purchases, and cost analysis. For future actions on this contract, we recommended that all noncompetitive purchase requests be developed and have written approval prior to submission to Supply Management. In addition, management should negotiate with the contractor to modify the contract to include appropriate standard contract clauses and delete clauses that restrict the Postal Service. Finally, the Postal Service should renegotiate the contract to increase its percentage of medical cost savings.

**Summary of
Management's
Comments**

Management agreed, in effect, with all five of the reported recommendations, but did not agree with our finding or with certain other aspects of the report. Management disagreed with the classification of the contract as being a "sole source contract" and considered the contract to be a low value "noncompetitive contract." Even though management stated that the contractor's share might exceed \$10 million in the future, management considered the contract to be valued at only \$75,000, and noted that the amount fell within the former contracting officer's approval authority. Management also disagreed that the former contracting officer's actions left the Postal Service vulnerable to claims and protests. However, in contrast, management stated that even though the future contract will be issued at no cost, the current contracting officer plans to obtain the vice president, Supply Management, approval since the contract is of significant interest and importance to the Postal Service.

Management also disagreed and stated that the Purchasing Manual policy pertaining to anticompetitive provisions was taken out of its proper context. As per management, anticompetitive practices typically occur between suppliers who include schemes to deprive the Postal Service of the benefits of competition. Consequently, the provision included in the contract was not unusual, particularly for a pilot program, and for indefinite delivery contracts, provisions of this nature are included.

Management disagreed and stated that because of the nature of the requirement, the contracting officer would

typically use price analysis methods versus cost and pricing data to determine that the deal was fair and reasonable for both the contractor and the Postal Service. Management also expressed concerns that the depiction of the actions taken by the former contracting officer on her last day of employment were not entirely above board and requested removal of those statements from the report. Finally, even though management agreed that the \$75,000 in contract funding, which was obligated in fiscal year (FY) 2001, should be deobligated, management disagreed that those funds be classified as funds that could be put to better use in future Office of Inspector General (OIG) reports to Congress.

Management did agree that negotiation discussions should normally be documented in the contract file. Management also agreed with the intent of the report's section that Postal Service clauses and provisions be included in this type of contract. Management's comments, in their entirety, are included in the appendix of this report.

Overall Evaluation of Management's Comments

We evaluated management's comments to the five reported recommendations and found that management actions were responsive to each of our recommendations. In addition, we acknowledge the clarifications management provided in their comments and have revised statements in the report, as we deemed necessary. However, we take exception to management's comments to the finding and discussions of report details. Specifically, we do not agree with management's opinion regarding the value of the contract. Further, we strongly support the report's assertions regarding the lack of documentation for the noncompetitive award as well as the Postal Service's acceptance of unfavorable contract provisions. Without adequate documentation and the use of Postal Service terms and provisions, protections cannot be assured. Finally, we continue to support the classification of the \$75,000 in deobligated funds as funds that could have been put to better use.

The value of the contract stemmed from an unsolicited proposal that was designed to help the Postal Service achieve annual medical cost savings of \$30 million. Although management stated that the contractor's future share might exceed \$10 million, management still

considered the contract to be valued at only \$75,000. It is not logical that the contract could potentially save millions and yet be valued at such a low amount. Postal Service management cannot have it both ways. Specifically, the \$75,000 in contract funding was never the real value of the contract. The value of the contract resided in the contractors' ability to generate millions of dollars in medical cost savings.¹

Further, the former contracting officer did not develop adequate contract file documentation to support contract actions associated with the noncompetitive award or for contract actions that should have been followed when Postal Service management accepted the contractor's unsolicited proposal. Along with a proper determination of contract value, the Purchasing Manual, Issue 1, provides specific actions that must be followed when a noncompetitive contract is awarded or an unsolicited proposal is accepted.

In addition, the unfavorable contract provisions addressed in the report were allowed because the former contracting officer accepted the contractor's written statement of work. That written statement of work became the contract that is discussed in this report. In essence, the contractor unilaterally developed the anticompetitive provisions and the resulting restrictive language was accepted by the Postal Service when the former contracting officer used the contractor's statement of work as the contract. Without adequate documentation and the inclusion of specific Postal Service terms and provisions, protections cannot be assured.

Finally, the \$75,000 contract option represented funds that were not executed or used in this contract. As a result of the audit, the OIG requested that the \$75,000 obligation made in FY 2001 be deobligated and the Postal Service deobligated the funds in January 2003. Therefore, we continue to support the classification of the \$75,000 in deobligated funds as funds that could have been put to better use. Further, although Postal Service management disagreed that the funds be classified as funds that could be put to better use, we disagree with management's

¹The OIG plans to comment on the valuation of contracts in future reports.

assessment. Our classification is consistent with the definitions contained in the Inspector General Act. However, we are not planning to pursue this issue through the formal audit resolution process.

INTRODUCTION

Background

Medical costs associated with injured Postal Service employees have been increasing in an accelerated and uncontrolled manner. In fiscal year (FY) 1998, medical costs were \$189 million and subsequently escalated to \$308 million as of FY 2002, which represents an increase of 63 percent.² During a shorter period from FYs 2000 through 2002, the Postal Service sustained net operating losses. To minimize the impact of increasing medical costs on its operating position, the Postal Service has worked to identify ways to reduce or control the impact of those costs. In April 2000, representatives from the preferred provider organization (the contractor) submitted an unsolicited proposal to reduce medical costs associated with injured Postal Service employees. The unsolicited proposal provided no direct or extra costs to the Postal Service.

On March 1, 2001, the Postal Service entered into a 2-year contract, which was set to expire on February 28, 2003³, to test a program to provide managed care services, through the contractor's network, to Postal Service employees with job-related injuries. The purpose of the test program was to substantially slow rapidly increasing medical costs incurred by the Postal Service. The contractor projected medical cost savings from taking advantage of the contractor's network of fee schedule discounts, which were negotiated by the contractor with its providers. These discounts were presumed to be lower than fee schedule⁴ amounts paid by the Department of Labor, Office of Workers' Compensation Programs. The contractor estimated the Postal Service's portion of medical cost savings to be as high as \$30 million annually when the test program was fully implemented.

The medical cost savings were to be achieved from submitting all medical bills to the contractor before those bills were submitted to the Department of Labor, Office of Workers' Compensation Programs for payment. From the medical bill submissions, the contractor would identify providers who belonged to their network. After medical bills

²This is equivalent to a 13 percent average annual growth rate.

³ The contract, which was set to expire on February 28, 2003 has been extended to allow negotiations to completely revise the contract.

⁴The Federal Employees Compensation Act fee schedule, Title 20, Code of Federal Regulations Part 10, is used by the Department of Labor, Office of Workers' Compensation Programs, to reimburse providers of medical services.

were submitted, the Department of Labor, Office of Workers' Compensation Programs, processed the bills and issued a check to the contractor. Upon check receipt, the contractor applied their fee schedule discount, issued a check to their network provider, retained their fee, and, on a quarterly basis, remitted the net savings to the Postal Service.

The contract term from March 1, 2001, through February 28, 2003, included the following supplements:⁵

- Supplement A - Medical Review Programs.
- Supplement B - Office of Workers' Compensation Programs.
- Supplement C - Postal Contract Clinic Program Services.

Funding for contract supplements was as follows:

- For Supplement A, no fee schedule amounts were established in the contract. However, if the contract action for Supplement A were extended, then Supplement B fees to the contractor would be increased by 3.1 percent.
- For Supplement B, from March 1, 2001, through August 31, 2002, the fee to the contractor for their share of medical cost savings was 32.7 percent. From September 1, 2002, through February 28, 2003, the fee to the contractor for their share of medical cost savings was 30.9 percent.
- For Supplement C, additional funding was established in the amount of \$75,000 to process first aid injury claims.

The contract also included two modifications, the first of which expanded the number of states submitting medical bills to the Department of Labor, Office of Workers' Compensation Programs. The second modification expanded the program nationwide and changed the Supplemental B fee provided the contractor to 60 percent retroactive from the March 1, 2001, program inception date. Consequently, the second modification reduced the Postal

⁵Contract supplements provide specific contract services and fees for those services.

Service's share of medical cost savings from the previous 67.3 and 69.1 percent, respectively, to 40 percent.⁶

Objective, Scope, and Methodology

The objective of this audit was to determine whether the Postal Service used proper contracting practices in its arrangement with the contractor.

To accomplish our objective, we reviewed Postal Service purchasing policies and procedures. We also reviewed contract files and other contract proposals similar to this one. Further, we interviewed Postal Service officials, including representatives for the vice president, Supply Management, as well as contractors, program, and procurement personnel.

Our audit was conducted from November 2002 through March 2003 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 and included their comments, where appropriate.

Prior Audit Coverage

We found no prior Office of Inspector General (OIG) audits of this contractor. However, in our audit report on Confirm (Report Number DA-AR-02-007, dated September 10, 2002), we noted that the Postal Service did not fully document contract negotiations, which resulted in uncertainty as to whether the contractual relationship protected the Postal Service's interest. Management agreed and stated that they planned to propose to the Purchasing policy committee that additional coverage for required contract file documentation be included as policy by the end of FY 2003. Management's actions taken or planned were responsive and should correct the issues identified in the report.

⁶Based on the unsolicited proposal's estimated \$30 million annual medical cost savings to the Postal Service and the mathematical application of the initial rates paid to the contractor, the second modification effectively reduced the Postal Service's estimated share from \$30 million to \$18 million annually.

AUDIT RESULTS

Contracting Practices

The contract provides the Postal Service with a unique opportunity to reduce its annual medical costs from fee schedule savings that could only be achieved through discounted network fee schedule providers. Postal Service management recognized the potential value provided by the unique contractual relationship with the contractor. However, our audit revealed that the Postal Service did not use appropriate contracting practices in this contract with the contractor. Specifically, the former contracting officer did not document the use of noncompetitive award and ultimately awarded the contract with provisions that were unfavorable to the Postal Service. Further, the contract lacked:

- Negotiation documentation.
- Documentation of cost and pricing data.
- Postal Service standard contract clauses and other provisions.

As a result, the contract as awarded exposed the Postal Service to risks from legal claims, protests, equitable adjustments, and contract termination. Additionally, the former contracting officer did not timely deobligate \$75,000 representing contract funds for services not used.

Documentation of Noncompetitive Award

The former contracting officer did not document the use of a noncompetitive award that resulted from an unsolicited proposal. In accordance with the Purchasing Manual, Issue 1, Section 3.5.4.d, pertaining to "Unsolicited Proposals,"⁷ and in accordance with the Purchasing Manual, Issue 1, Section 3.5.5.d, pertaining to "Noncompetitive Purchases," all requests for noncompetitive purchases must be justified by the requesting organization and reviewed by a contracting officer with delegated authority. After reviewing the contract files and interviewing the present contracting officer, we determined that the contract file did not include an approved justification for noncompetitive purchase for the contract with the contractor.

⁷Unchanged in Purchasing Manual, Issue 2, dated January 31, 2002.

The contract file contained a draft noncompetitive justification that was never approved by the contracting officer. The draft contained language that stated, in part, "the contractor was the only source available, was the largest medical service provider network in the country, and would allow program analysis on a Postal Service-wide basis." It also stated, "no benefit would be served in attempting to solicit competitive bids, since no other medical service provider is currently available which meets the Postal Service requirements." We found no documentation to support the statements made in the draft noncompetitive justification. Purchasing Manual, Issue 2, issued subsequent to this contract, makes a significant change that could have prevented this situation from occurring. Under Purchasing Manual, Issue 2, dated January 31, 2002, Section 2.1.6.c.4., the vice president, Supply Management, must review and approve all noncompetitive purchases valued at more than \$10 million.⁸

In contrast to the statements made in the noncompetitive justification, the OIG learned that other contractors in the medical service provider community could provide the same or similar services. To minimize risk, it is extremely important to have documentation that provides support in case a contractor files a protest or claim against the Postal Service. However, the former contracting officer's actions left the Postal Service vulnerable to claims by the contractor and possible protests by outside contractors because required documentation to support the noncompetitive contract award was not in the contract file.

Unfavorable Provisions

The former contracting officer agreed to a contract containing provisions unfavorable to the Postal Service. The Postal Service entered into a contract with the contractor that provides exclusivity and does not allow the Postal Service an opportunity to enter into any other contract arrangement with other contractors. In the contract, Supplement B, Article 2, Duties of the United States Postal Service (USPS), Section 2.1 states "USPS exclusively offer access to the Network to its Claimants within the Geographic Areas set out in Appendix II of the

⁸Although the Postal Service only obligated \$75,000 for this contract, the value of the anticipated savings exceeded \$10 million.

contract. USPS will not enter into any agreement with any other providers, medical networks or other entity, directly or indirectly, to provide Medical Services to its Claimants." Therefore, for the entire contract period ending February 28, 2003, the Postal Service could not enter into a contract for similar services with any other medical service provider. The former contracting officer did not document any rationale for such a restrictive contract provision, and during the audit, we found no evidence to support the need for such a provision.

Negotiation
Documentation

The former contracting officer did not document contract negotiations. We found no evidence that the contract was negotiated. The former contracting officer should have, in coordination with their representative, technical advisors, and cost or pricing specialists, developed a pre-negotiation objective. However, no evidence exists to document that such actions occurred. After negotiations were held between the former contracting officer and the contractor, the former contracting officer should have prepared a negotiation memorandum documenting the outcome that would have established the rationale for a best value determination. The negotiations should have addressed the purpose, scope, period of performance, the approach and deliverables, the schedule, standards, assumptions, price proposals, and any possible problems the contractor or the Postal Service may have.

As of this audit, the Postal Service does not have guidance to ensure that contracting officers' adhere to documenting contract negotiations. In a previous OIG report,⁹ we noted that contract files must contain enough documentation to permit an outside party to review and understand the decisions made with respect to the major events of the purchase. In particular, each contract file should clearly demonstrate the fairness and reasonableness of the price paid and the business rationale for selecting the vendor. Without a negotiation memorandum, it is unclear whether the Postal Service accepted the best contractual value. Also, the Postal Service may not be able to legally support a contracting officer's decision if the contractor submits a

⁹ Confirm (Report Number DA-AR-02-007, dated September 10, 2002), Postal Service management stated that Administrative Instruction, HP-1-010, subject "Purchase Files," is no longer in existence and that the Purchasing policy committee plans to draft new language, to include appropriate policy on contract file documentation, in lieu of the above administrative instruction.

claim, requests equitable adjustment, or if a termination becomes necessary.

Documentation of Cost and Pricing Data

The contract lacked cost and pricing data; therefore, the OIG could not determine if this contract represented the best value for the Postal Service. The former contracting officer did not follow the Purchasing Manual's guidance¹⁰ with regard to obtaining cost and pricing data. As a result, the contractor was allowed a percentage of the medical cost savings as payment for their contracting services without a valid cost analysis. The percentage of the medical cost savings allowed the contractor was 32.7 percent and 30.9 percent for different timeframes throughout the contract term. A second modification¹¹ to the contract changed the contractors' percentage of medical cost savings to 60 percent and made it effective from contract inception. The second contract action signed on June 27, 2002, was the former contracting officer's last official act on this contract. She left the Postal Service on June 27, 2002.

The OIG is concerned that the contracting officer did not do the required research before changing the percentage of medical cost savings to a higher percentage for the contractor. In addition to the higher percentage of medical cost savings for the contractor, the retroactive change of percentage to the start of the contract was also a concern to the OIG. Without cost and pricing data, the OIG could not determine whether the modified rates reflect costs that were considered fair and reasonable for the Postal Service.

Postal Service Standard Clauses and Other Contract Provisions

We found that the former contracting officer did not use standard Postal Service clauses and other contract provisions. The Purchasing Manual requires the contracting officer to include standard contract clauses in the contract in order to protect its interest in the event of legal action or to provide an audit trail.

¹⁰In Purchasing Manual, Issue 1, Section 5.1.2.c, Cost Analysis, states that "cost analysis is the process of examining the separate elements of cost and profit in an offeror's or supplier's cost or pricing data, to form an opinion about the degree to which they represent what the contract should cost. It is normally done only when there is not adequate price competition and no method of price analysis will ensure that prices are fair and reasonable and will protect the Postal Service's interest."

¹¹Based on the unsolicited proposal's estimated annual medical cost savings of \$30 million to the Postal Service, the second modification effectively reduced the Postal Service's estimated share from \$30 million to \$18 million annually. However, the actual impact of the second contract modification will be determined during another phase of our audit of the Postal Service's arrangement with the contractor. In that audit and a subsequent audit report, we will determine whether the Postal Service achieved cost savings from reducing amounts paid on medical claims.

For instance, the termination provisions of the Purchasing Manual¹² provide standard language and protection for the Postal Service's interest if the contract were terminated. Those clauses are very specific and do not restrict either the Postal Service or the contractor. The contract includes a clause that is restrictive¹³ and does not adequately protect the Postal Service in the event of an actual termination.

Further, the indemnification clause as stated in the Purchasing Manual¹⁴ protects the Postal Service's interest. In the contract, the contractor states that the Postal Services agrees to indemnify and hold harmless and reimburse the supplier to the extent of any such costs or liabilities arising out of their defense of any claim that does not result from any negligence or intentional action or misconduct of the supplier. The clause, as presented in the contract, does not provide the Postal Service with the protection it needs in case a claim is submitted; instead, the clause protects the contractor.

Also, an examination of the records clause as stated in the Purchasing Manual shows "that the Postal Service and its authorized representatives will, until three years after final payment under this contract, or for any shorter period specified for particular records, have access to and the right to examine any directly pertinent books, documents, papers, or other records of the supplier involving transactions related to this contract."

Instead, the contract states that the Postal Service:

- May examine the suppliers' records with not less than 30 days advance notice.

¹²Clause B-12 "Termination for Convenience and Termination for Default."

¹³Article 5, "Term and Termination," Section 5.2.3, states, "If USPS exercises its termination right under this Section 5.2.3, USPS will: 1) not use any other entity to provide managed care services similar to those provided by Supplier to its Claimants before March 1, 2003."

¹⁴ Clause B-39 "Indemnification" states "the supplier must save harmless and indemnify the Postal Service and its officers, agents, representatives, and employees from all claims, losses, damage, actions, causes of action, expenses, and/or liability resulting from, brought for, or on account of any personal injury or property damage received or sustained by any person, persons or property growing out of, occurring, or attributable to any work performed under or related to this contract, resulting in whole or in part from negligent acts or omissions of the supplier, any subcontractor, or any employee, agent, or representative of the supplier or any subcontractor." We found no reference in the Purchasing Manual that limits the use of this clause to a particular type of contract and in our view; an indemnification clause would be appropriate for this contract.

- Will continue to provide such right of examination for a period of not less than 2 years after the date of discharge, end of the treatment, or the end of suppliers services in relation to the specific episode of care.

As a result, if the Postal Service should find it necessary to do an audit of the contractor's records 3 years after the contractor has received final payment, the contract has bound the Postal Service and it will not allow such an audit to take place. In addition, the Postal Service is restricted to examining the records within not less than 30 days from such notice.

Without the above indemnification and record examination clauses, the Postal Service may not be able to protect its interest in the event that the contractor or any other outside entity submits a claim, equitable adjustment, protest, or lawsuit, or if the contract requires termination.

Contract Funds

The former contracting officer did not timely deobligate contract funds. Specifically, the former contracting officer did not monitor a contract action for which \$75,000 had been obligated. Upon contract award on March 1, 2001, \$75,000 in funds had been obligated for contract services that were never executed, and the funds should have been deobligated at the end of FY 2001. As of the end of FY 2001, the former contracting officer executed no such action. As a result of our audit, we asked the present contracting officer to take actions to deobligate the funds and on January 7, 2003; the present contracting officer deobligated \$75,000 in funds for contract services that were never used. As a result of the OIG audit, the current contracting officer has thoroughly reviewed the contract and initiated additional corrective actions.

Recommendation

We recommend for future actions on this contract the senior vice president, Human Resources:

1. Require that all noncompetitive purchase requests be developed and have prior written approvals before submission to Supply Management.

Management's Comments	Management indicated agreement with the recommendation and stated that future noncompetitive requests will be developed and have prior written approval before submission to Supply Management.
Recommendation	<p>We recommend for future actions on this contract the vice president, Supply Management:</p> <ol style="list-style-type: none">2. Direct the contracting officer to continue efforts to develop important contract documentation, to include:<ul style="list-style-type: none">• Justification for noncompetitive purchase.• Negotiation documentation.• Cost analysis.
Management's Comments	Management agreed with the recommendation and stated that the contracting officer will include appropriate documentation in the contract file for future actions related to this contract.
Recommendation	<ol style="list-style-type: none">3. Require that all noncompetitive purchase requests have prior written approvals before any processing is executed in Supply Management. In addition, require that all noncompetitive purchase requests be processed for final approval at the appropriate levels within Supply Management.
Management's Comments	Management agreed with the recommendation and stated that the contracting officer will follow <u>Purchasing Manual</u> , Issue 2, requirements for processing and documenting any future noncompetitive actions related to this contract.
Evaluation of Management's Comments	Management's comments are responsive to recommendations 1, 2, and 3. Management's actions taken or planned should correct the issues identified in the report.
Recommendation	<ol style="list-style-type: none">4. Direct the contracting officer to negotiate with the contractor a modification to eliminate unfavorable restrictions and include standard contract clauses as appropriate.

Management's Comments	Management agreed with the intent of the recommendation and stated that negotiations with the contractor have been completed, required Postal Service clauses were included, and the unfavorable provisions were removed.
Evaluation of Management's Comments	The insertion of required Postal Service clauses and the removal of the unfavorable provisions were responsive to our recommendation. Management's actions taken or planned should correct the issues identified in the report.
Recommendation	<p>We recommend for future actions on this contract the vice president, Supply Management:</p> <ol style="list-style-type: none">5. Direct the contracting officer to renegotiate the contract to increase the Postal Service's percentage of medical cost savings and document the negotiated rates using adequate cost and pricing data.
Management's Comments	Management agreed with the intent of the recommendation and stated that the contracting officer will always strive to achieve the best value for the Postal Service. However, in this particular effort, the contracting officer's efforts may or may not result in an increase to the Postal Service's savings percentage, as the share ratio must be fair and reasonable to both parties. Discussions in this matter will be based on price and/or cost data; the discussions will be documented; and discussions will be completed prior to the end of Postal Service quarter 3.
Evaluation of Management's Comments	Management's comments are responsive to the recommendation. Management's actions taken or planned should correct the issues identified in the report.

APPENDIX. MANAGEMENT'S COMMENTS

SUZANNE F. MEDVIDOVICH
SENIOR VICE PRESIDENT
HUMAN RESOURCES



March 24, 2003

B. WAYNE GOLESKI

SUBJECT: Transmittal of Draft Audit Report – Postal Service's Arrangement with a Preferred Provider Organization (Report Number HK- AR-03-Draft)

This responds to your February 26 memorandum regarding the Postal Service's arrangement with a preferred provider organization. Human Resources will respond to recommendation 1 and Supply Management will respond directly to you on recommendations 2 through 5.

Recommendation 1:

Require that all noncompetitive purchase requests be developed and have prior written approvals before submission to Supply Management.

Response:

We will ensure that future noncompetitive requests are developed and have prior written approval in a format designated by Supply Management. In the instant case, our request for noncompetitive purchase was initiated by a memorandum dated February 21, 2001, from Suzanne H. Milton, acting vice president, Employee Resource Management, to Philip Baldwin, manager, Headquarters Purchasing (attached). At that time, it was our belief that this memorandum along with a previously submitted justification met this requirement.

Thank you for the opportunity to comment on this report.


Suzanne F. Medvidovich

Attachment

cc: Richard Strasser
Sylvester Black
DeWitt Harris
James Rowan
Keith Strange
Susan Duchek

EMPLOYEE RESOURCE MANAGEMENT



February 21, 2001

PHILLIP BALDWIN

SUBJECT: Unsolicited Proposal from First Health

On April 26, 2000, the Postal Service received an unsolicited proposal from First Health to make their Preferred Provider Organization (PPO) network available as a component of our workers' compensation program to assist in curbing our increasing medical costs.

Savings will be accomplished by taking advantage of negotiated rates First Health has with their network providers. Negotiations with the Department of Labor, Office of Workers Compensation Program have been completed so that this program can go forward. First Health will be compensated by application of a negotiated commission rate applied to the savings to the USPS under the appropriate state workers' compensation fee schedule or, in non-fee schedule states, the usual and customary fee schedule maintained by Ingenix and recognized in the industry as a standard.

We also plan to take advantage of the savings offered by their PPO network to provide first aid medical care and fitness for duty medical examinations.

I endorse acceptance of the First Health unsolicited proposal to pilot test for up to two years, through graduated national roll out, utilization of their PPO network and associated services to reduce our workers' compensation medical costs and to expand the services to utilize their network to provide first aid and fitness for duty services on a more limited basis.

A handwritten signature in black ink, appearing to read "Suzanne H. Milton".

Suzanne H. Milton
Acting Vice President

475 L'ENFANT PLAZA SW
WASHINGTON DC 20390

PB.max

SUPPLY MANAGEMENT



March 24, 2003

B. WAYNE GOLESKI

THRU: KEITH STRANGE

*KS
3/24/03*

SUBJECT: Draft Audit Report – Postal Service's Arrangement with a Preferred Provider Organization
(Report Number HK-AR-03-DRAFT)

We appreciate the opportunity to review and comment on the subject draft audit report. The attachment responds to the report's findings and those recommendations directed to the Supply Management vice president. For the reasons detailed in the attached, we cannot concur with the Office of Inspector General (OIG) characterizing \$75,000 as "funds put to better use" in a future Semiannual Report to Congress.

We do not believe that this report contains any proprietary or business information and may be disclosed pursuant to the Freedom of Information Act (FOIA). If you have any questions about this response, please contact Marie Martinez at (202) 268-4117.

for Marie R. Martinez
Juanda J. Barclay, C.P.M., A.P.P.
Manager
Supply Management Infrastructure

Attachment

cc: Richard J. Strasser
Suzanne F. Medvidovich
Sylvester Black
James J. Rowan, Jr.
Susan M. Duchek

Comments on Report Executive Summary

Management issues with sections of the executive summary portion of the report are covered in other sections below and are not restated here.

Comments on Report Introduction

The OIG incorrectly refers to the Postal Service entering into a "sole source" contract. This was a noncompetitive contract, not a sole source contract. In March 2001, the governing policy was Purchasing Manual (PM), Issue 1, and policy for noncompetitive purchases is explained in section 3.5.5.

Comments on Audit Results/Report Findings

Contracting Practices: Management issues with this section of the report are covered in other sections below and are not restated here.

Documentation of Noncompetitive Award

From a policy perspective and in the interest of accuracy, we need to highlight several concerns with this section. This effort was intended to result in cost savings for the Postal Service. This type of arrangement, whether issued under PM Issue 1 or 2, did not require Supply Management vice president approval as explained in this section because the value of the contract during this pilot effort was only \$75,000. Further, payments are not made directly under this contract since the PPO receives reimbursement from the Office of Workers' Compensation Programs (OWCP), and in turn the Postal Service pays OWCP. However, we recognize that the supplier indirectly benefits through its share in savings and its share may exceed \$10 million in the future. Even though the future contract will be issued at no cost to the Postal Service, the contracting officer plans to obtain Supply Management vice president approval since the effort is of significant interest and importance to the Postal Service.

In addition, this section has contradictory language. First it states the CO did not document use of a noncompetitive award, and then later states that there was noncompetitive documentation, but that it was not approved. Further, the OIG implies the justification was not accurate, but fails to provide substantial evidence why the contracting officer's judgment should be questioned. As mentioned above, the purchase value of this effort at time of award was \$75,000 (funding for supplier services that subsequently were not needed or paid for), and approval by the contracting officer was sufficient. While we agree that the file documentation should have had an approval signature, the fact that the CO executed the contract, and had noncompetitive approval authority up to \$100,000 is sufficient.

Finally, based on the preceding, we do not agree with the OIG that the contracting officer's actions left the Postal Service vulnerable to claims and protests.

Anticompetitive Provisions

Within this discussion, PM policy covering anticompetitive practices has been taken out of its proper context. Anticompetitive practices typically occur between supplier's and include collusion, follow-the-leader pricing, rotating low price proposals, sharing of business, identical pricing, and any other device intended to deprive the Postal Service of the benefits of competition.

The provision included in this contract was not unusual, particularly for a pilot program designed to test the benefits of this type of business arrangement. In fact, when we issue indefinite delivery contracts, contract provisions of this nature are included.

Negotiation Documentation

While we agree that discussions (negotiations) with the supplier should normally be documented in the contract file, because of the low value, type of agreement, being based on an unsolicited proposal, and no policy requirement to do so, it is not unreasonable that the OIG found no formal documentation covering supplier discussions.

Documentation of Cost and Pricing Data

We disagree with this finding in that a requirement of this nature may not include cost and pricing data. Generally, for low dollar requirements and efforts similar to this (no cost to USPS), contracting officer's would typically use price analysis methods versus cost and pricing data to determine that the resulting deal was fair and reasonable for both the Postal Service and its supplier.

The report also discusses actions taken by the contracting officer on the last day of employment. We question the relevancy of this section and are concerned that it may incorrectly imply that the contracting officer's actions were not entirely above board. Without a clear basis for inclusion, this information should be removed from the report.

Postal Service Standard Clauses and Other Contract Provisions

We generally agree with the intent of this section that clauses and provisions required by the Purchasing Manual should be included in the contract. However, the indemnification clause referred to by the OIG would not be included in this type of contract. Clause B-39 is unique to design and construction contracts and is normally not used when purchasing supplies and services.

Contract Funds

We agree that the \$75,000 should be de-obligated so that the contract face value in our purchasing and payment systems is properly stated. The \$75,000 does not represent funds available or funds that could be put to better use and should not be characterized this way by the OIG in future reports. The funds were obligated in FY 2001 and even if they were de-obligated in FY 2001, with Finance required budget reductions it is highly questionable if re-use of the funds by the requiring activity for another project could have been made in FY 2001. Further, it is now FY 2003, so putting the funds to better use is a moot point.

OIG Recommendations and Management Responses

Note: *The OIG did not identify any of the recommendations as significant, so follow up documentation will not be provided and is not discussed below. The contracting officer has or will be acting on all recommendations included in this report to the extent discussed. Copies of applicable documentation can be provided by the contracting officer if requested by the OIG.*

Recommendation 2:

We recommend for future actions on this contract the vice president, Supply Management: Direct the contracting officer to continue efforts to develop important documentation, to include:

- *Justification for noncompetitive purchase.*
- *Negotiation documentation*
- *Cost Analysis*

Management agrees with the recommendation. In accordance with PM Issue 2, the contracting officer will include appropriate documentation in the contract file for future actions related to this contract.

Recommendation 3:

We recommend for future actions on this contract the vice president, Supply Management: Require that all noncompetitive purchase requests have prior written approvals before any processing is executed in Supply Management. In addition, require that all noncompetitive purchase requests be processed for final approval at the appropriate levels within Supply Management.

Management agrees with the recommendation. In accordance with PM Issue 2, the contracting officer will follow requirements for processing and documenting any future noncompetitive actions related to this contract.

Recommendation 4:

We recommend for future actions on this contract the vice president, Supply Management: Direct the contracting officer to negotiate with the contractor a modification to eliminate anticompetitive restrictions and include standard contract clauses as appropriate.

Management agrees with the intent of this recommendation. Negotiations have been completed and required clauses are included and the provision the OIG took exception to, although not "anticompetitive," was removed by the contracting officer.

Recommendation 5:

We recommend for future actions on this contract the vice president, Supply Management: Direct the contracting officer to renegotiate the contract to increase the Postal Service's percentage of medical cost savings and document the negotiated rates using adequate cost and pricing data.

Management agrees with the intent of this recommendation in that the contracting officer will always strive to achieve the best value for the Postal Service. This may or may not result in an increase to the Postal Service's savings percentage because the share ratio must be fair and reasonable for both the supplier and the Postal Service. Discussions will be based on price and/or cost data and will be documented in the contract file. Discussions with the supplier will be completed prior to the end of Postal quarter 3.