



Office of Inspector General | United States Postal Service

Audit Report

Controls Over Time and Materials and Labor Hour Contracts

Report Number SM-AR-18-002 | March 26, 2018



Table of Contents

Cover	
Highlights.....	1
Objective	1
What the OIG Found.....	1
What the OIG Recommended	1
Transmittal Letter	2
Results.....	3
Introduction/Objective	3
Background.....	4
Finding #1: Ceiling Price Not Communicated to Supplier	4
Recommendation #1	5
Finding #2: Clause 2-38 Not Included in Contract.....	5
Recommendation #2	5
Finding #3: Ceiling Price Exceeded Without Justification.....	6
Recommendation #3	6
Finding #4: 5 Percent Retainage Provision Not Exercised	6
Recommendation #4	7
Management's Comments.....	7
Evaluation of Management's Comments	8
Appendices	9
Appendix A: Additional Information.....	10
Scope and Methodology.....	10
Prior Audit Coverage	10
Appendix B: Management's Comments.....	11
Contact Information	13

Highlights

Objective

Our audit objective was to determine if U.S. Postal Service contracting officers (CO) are administering Time and Materials (T&M) and Labor Hour Contracts in accordance with Supplying Principles and Practices (SP&P).

A T&M contract is most commonly used when the exact work to be done cannot be predicted in advance. A labor hour contract is a variant of the T&M contract, differing only in that the supplier does not provide the materials. Due to the inherent risks, these contract types are the least preferred as they do not encourage effective cost control or labor efficiency by the supplier. As such, the Postal Service requires COs to establish and communicate a ceiling price to the supplier, include mandatory clauses, and document justification for increases to the ceiling price for T&M and Labor Hour contracts.

As of July 2017, there were 105 open T&M and Labor Hour contracts awarded during fiscal years (FY) 2006 – 2017, valued at \$432 million. Our statistical sample included 70 contracts totaling over \$294 million.

What the OIG Found

COs did not consistently administer T&M and Labor Hour contracts in accordance with SP&P. Specifically, we identified the following exceptions:

- Fifty-one percent (36 of 70) of the contracts – or 54 contracts projected over the universe – the CO did not explicitly communicate ceiling prices in writing to suppliers.
- Twenty-four percent (17 of 70) of the contracts – or 25 contracts projected over the universe – the CO did not include mandatory Clause 2-38, which establishes the requirements for payment submission and reviews, hourly

“As of July 2017, there were 105 open T&M and Labor Hour contracts awarded during FY 2006 – 2017, valued at \$432 million.”

rates, supplier payment withholdings, allowable costs, allowances, and ceiling prices.

- Ten percent (seven of 70) of the contracts – or 10 contracts projected over the universe – the CO did not document justification for ceiling price increases.
- Sixty-one percent (43 of 70) of the contracts – or 64 contracts projected over the universe – the CO did not withhold 5 percent of the supplier’s payment or waive the withholding as required in Clause 2-38.

These issues occurred due to inconsistent practices and interpretation of the SP&Ps among COs related to the use of ceiling price and contract funded amount; the lack of adhering to the process to ensure applicable clauses were included in contracts; inadequate contract administration practices among COs; and COs determination that the retainage requirement was not applicable due to the services provided.

When COs do not adhere to policy, there is an increased risk of cost overruns, disputes, or not achieving the objective or intent of that policy. Additionally, without applicable clauses in the contract, COs may not be able to enforce the terms and conditions established and intended to manage the risks associated with T&M and Labor Hour contracts. Unsupported contract costs totaled an annual average of \$52 million for the two-year period.

What the OIG Recommended

We recommended management revise policy to better define ceiling price and the requirement to document the ceiling price in the Schedule; bring contracts missing required clauses into compliance and establish a process to promote adherence and accountability for contracting officers. We also recommended management emphasize through formal communication, requirements on documenting ceiling price changes and requirements to formally waive or withhold retention payments in T&M and Labor Hour contracts.

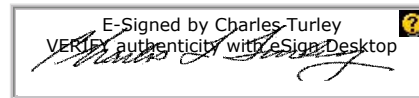
Transmittal Letter



OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

March 26, 2018

MEMORANDUM FOR: SUSAN M. BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT



FROM: Charles L. Turley
Deputy Assistant Inspector General
for Supply Management and Human Resources

SUBJECT: Audit Report – Controls Over Time and Materials and
Labor Hour Contracts (Report Number SM-AR-18-002)

This report presents the results of our audit of the Controls Over Time and Materials and Labor Hour Contracts (Project Number 17SMG027SM000).

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

Attachment

cc: Postmaster General
Corporate Audit Response Management





Results

Introduction/Objective

This report presents the results of our self-initiated audit of the U.S. Postal Service's Controls Over Time and Materials (T&M) and Labor Hour Contracts (Project Number 17SMG027SM000). Our objective was to determine if contracting officers (CO) are administering T&M and Labor Hour Contracts in accordance with the Postal Service's Supplying Principles and Practices (SP&P).

As of July 2017, there were 105 open T&M and Labor Hour contracts¹ awarded during fiscal years (FY) 2006 – 2017, valued at \$432 million. Our statistical sample included 70 contracts totaling over \$294 million (see Table 1) across four portfolios: Commercial Products and Services (CP&S), Facilities, Mail and Operational Equipment (MOE), and Technology Infrastructure (TI).

Table 1. Open T&M and Labor Hour Contracts by Portfolio

 Portfolio	Universe		Sample	
	 No. of Contracts	 Net Committed Amount	 No. of Contracts	 Net Committed Amount
 CP&S	51	\$253,961,949	34	\$202,610,015
 Facilities	2	\$820,000	1	\$500,000
 MOE	37	\$134,506,379	25	\$670,069,854
 TI	15	\$42,533,591	10	\$23,461,425
 Transportation ²	-	-	-	-
Total	105	\$431,821,919	70	\$293,641,294

Source: EDW data as of June 2017.

¹ Data pulled from the Enterprise Data Warehouse (EDW), a repository used to manage the Postal Service's corporate data assets. CAMS is one of the source systems providing program data.

² There were no open T&M transportation contracts open in CAMS.

“Our statistical sample included 70 contracts totaling over \$294 million across four portfolios: CP&S, Facilities, MOE, TI.”

Background

Postal Service COs play an essential role in the solicitation, award, and management of contracts. COs work with the Purchase/Supply Chain Management team to decide what type of contract to award to a supplier. The nature of a purchase will determine the appropriate contract type.

A T&M contract is most commonly used when the exact work to be done cannot be predicted in advance.³ A labor hour contract is a variant of the T&M contract, differing only in that the supplier does not provide the materials. In both T&M and Labor Hour contracts, the Postal Service and supplier agree on an hourly fixed rate for each labor category, which includes overhead and profit. T&M and Labor Hour contracts are higher risk contract types as they do not encourage effective cost control or labor efficiency by the supplier. T&M and Labor Hour contracts are the least preferred contract types, but they may play an important role in helping the Postal Service meet its needs in certain situations. Before using a T&M or Labor Hour contract, the CO must establish that no other contract type is suitable. Our audit scope was limited to assessing compliance with applicable policy in the administration of T&M and Labor Hour contracts.

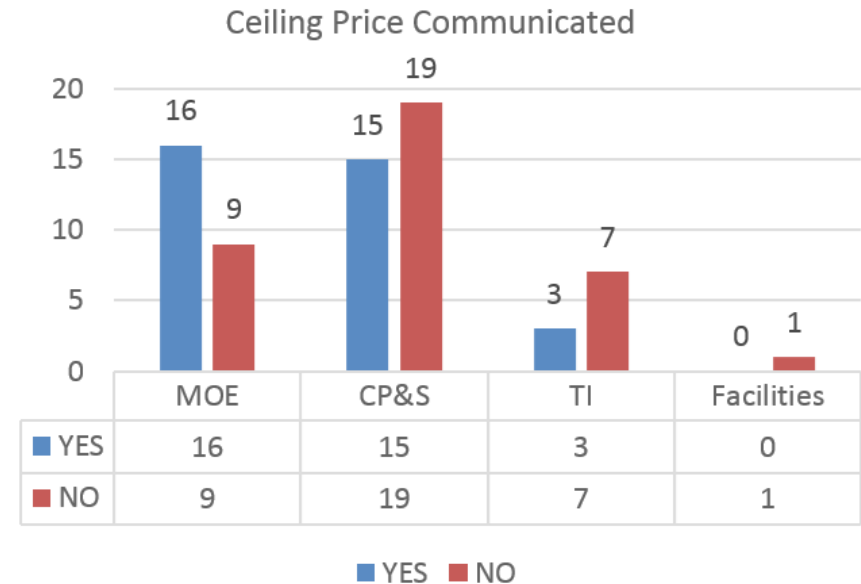
Finding #1: Ceiling Price Not Communicated to Supplier

COs did not consistently communicate the ceiling price to suppliers in writing. Specifically, 36 of 70 contracts, or 54 contracts projected over the universe, did not explicitly state the ceiling price on the schedule to suppliers (see Figure 1).

The SP&P state that, “All T&M and Labor Hour contracts must establish a ceiling price that the supplier exceeds at their own risk.”⁴ The SP&P also state that “the Postal Service is not obligated to pay the supplier any amount more than the ceiling price in the schedule.”⁵ The requirement to establish a

ceiling price to help control costs in T&M and Labor Hour contracts has been in the SP&P since 2006.

Figure 1. T&M and Labor Hour Ceiling Not Communicated – By Portfolio



Source: U.S. Postal Service Office of Inspector General (OIG) analysis.

These issues occurred because there was an inconsistent practice among COs to use the contract funded amount as the ceiling price and not explicitly state a “ceiling price” on the schedule. As the SP&P do not specifically differentiate between ceiling price and contract funded amount, at times COs were interpreting the contract funded amount as the ceiling price. In addition, there were instances where COs documented the ceiling price on the award recommendation, which is an internal document that is not provided to the supplier.

³ SP&P, Section 2-18.7.1(a): T&M Contracts. September 30, 2016.

⁴ SP&P, Section 2-18.7.1(b): T&M Contracts. September 30, 2016.

⁵ SP&P, Clause 2-38, (d) Ceiling Price.

If the ceiling price is not explicitly documented on the schedule, the supplier may not be aware of the agreed upon maximum value and the Postal Service could be at risk of the supplier not being able to support the entire scope of work, and associated costs. Additionally, unclear communication of contract terms could result in contract disputes.⁶ By not adhering to policy and including the ceiling price on the schedule, there were unsupported questioned costs valued at \$99 million.⁷

Recommendation #1

We recommend the **Vice President, Supply Management**, revise policy to better define ceiling price and the requirement to document the ceiling price in the Schedule; reiterate the requirement to contracting officers when executing Time and Materials and Labor Hour contracts.

Finding #2: Clause 2-38 Not Included in Contract

COs did not consistently include mandatory Clause 2-38: Payment (T&M and Labor Hour Contracts) in the terms and conditions of T&M and Labor Hour contracts. Specifically, 17 of 70, or 25 contracts projected over the universe, were missing Clause 2-38 (see Figure 2).

The SP&P state that, “All time and materials and labor hour contracts must include Clause 2-38: Payment (T&M and Labor Hour Contracts).”⁸

The reviews and approval process in place does not ensure applicable clauses are included in contracts. Additionally, there were instances where COs assumed responsibility for contracts that did not include the applicable clauses at the time of ownership transfer; however, once the CO assumed responsibility, the applicable clauses were still not included via a contract modification.

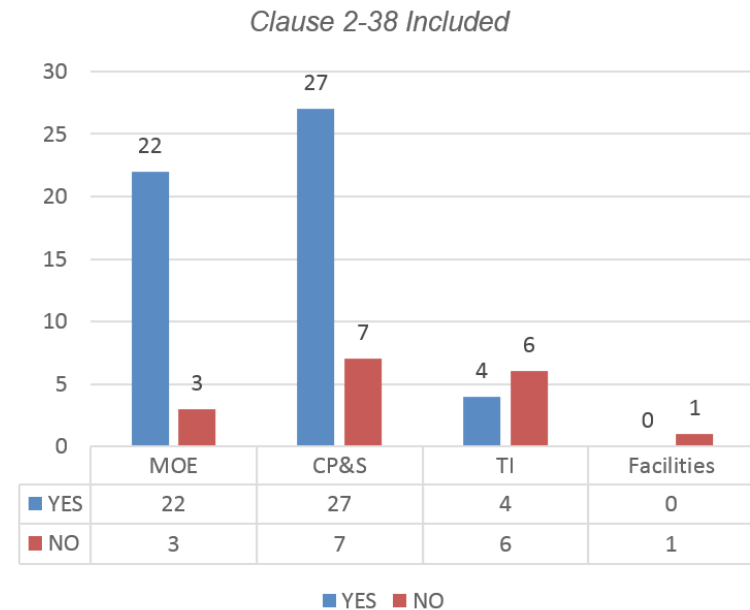
Without applicable clauses in the contract, COs may not be able to enforce the terms and conditions established and intended to manage the risks associated with T&M and Labor Hour contracts. By not adhering to policy and including Clause 2-38 in the contract, there were unsupported questioned costs valued at over \$6 million.

⁶ The scope of this audit did not include the determination of actual disputes.

⁷ Unsupported questioned costs are claimed because of failure to follow policy or required procedures, but does not necessarily connote any real damage to the Postal Service.

⁸ SP&P, Section 2-18.7.1(d): T&M Contracts, September 30, 2016.

Figure 2. T&M and Labor Hour Clause 2-38 Included – By Portfolio



Source: OIG analysis.

Recommendation #2

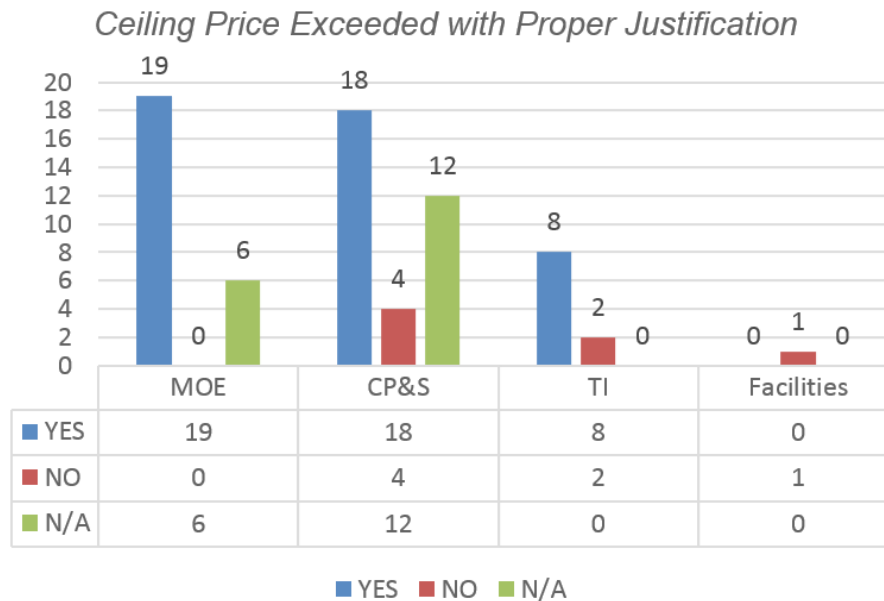
We recommend the **Vice President, Supply Management**, assess the universe of Time and Materials and Labor Hour contracts and bring those contracts without Clause 2-38 into compliance; reiterate through formal communication, and refresher training, the proper inclusion of required contract clauses in the contract language for Time and Materials and Labor Hour contracts, and revise the current review and approval process to ensure adherence and accountability for contracting officers.

Finding #3: Ceiling Price Exceeded Without Justification

COs did not consistently document justification for ceiling price increases. Specifically, seven of 70, or 10 contracts projected over the universe, did not include documentation justifying ceiling price increases (see Figure 3).

The SP&P state that “The contracting officer must document the contract file to show the basis for any change in the ceiling.”⁹

Figure 3. T&M and Labor Hour Ceiling Price Exceeded with Proper Justification – By Portfolio



Source: OIG analysis.

These issues occurred due to inadequate contract administration practices by select COs, either the contract originator or the current CO. When COs do not appropriately document justification for ceiling changes, there is no support to validate the basis for the change. As such, contracts may be more susceptible to unnecessary expenditures or potential fraudulent activity.

Recommendation #3

We recommend the **Vice President, Supply Management**, emphasize to contracting officers, through formal communication, requirements on documenting ceiling price changes in Time and Materials and Labor Hour contracts.

Finding #4: 5 Percent Retainage Provision Not Exercised

COs did not consistently withhold or modify the 5 percent retention payment as required in the terms and conditions of the contracts. Specifically, 43 of 70, or 64 contracts projected over the universe, did not have either the 5 percent retention payment withheld or document why it was not withheld in the contract file (see Figure 4).

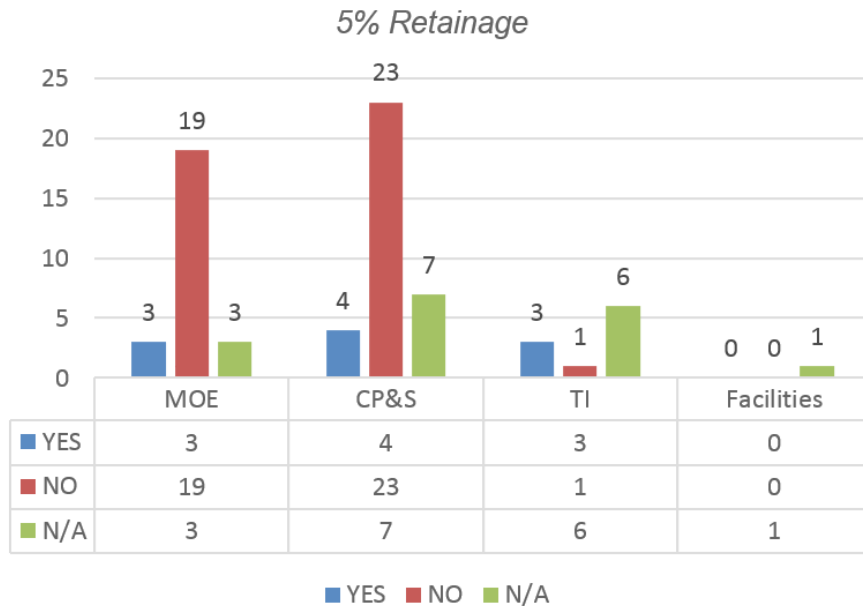
The SP&P state that, “Unless otherwise prescribed in the schedule, the CO will withhold 5 percent of the amounts due. The amounts withheld should be retained until the execution and delivery of any required release by the supplier.”¹⁰

“43 of 70 contracts did not have either the 5 percent retention payment withheld or document why it was not withheld in the contract file.”

⁹ SP&P, Section 2-18.7.1(b): T&M Contracts, September 30, 2016.

¹⁰ Clause 2-38 Payment (T&M and Labor Hour Contracts), Section a (2).

Figure 4. T&M and Labor Hour 5 Percent Retainage – By Portfolio



Source: OIG analysis.

COs stated they did not withhold the 5 percent retainage due to the services provided. As these contracts were primarily service contracts for staff augmentation, COs believed these services did not qualify for the 5 percent retainage. They further communicated that the retainage would be more applicable to fixed deliverables or construction-related contracts.

When COs do not adhere to policy, there is an increased risk of not achieving the objective or intent of that policy. In this circumstance, the objective of the policy was to withhold a percentage of the supplier's payment to ensure all services were provided satisfactorily. When the services do not lend themselves to these circumstances, the CO should, per policy, document that information in the schedule.

Recommendation #4

We recommend the **Vice President, Supply Management**, emphasize to contracting officers, through formal communication, the requirements for proper application of the Clause 2-38 payment retainage provision.

Management's Comments

Management agreed with the findings and recommendations; however, disagreed with a portion of the monetary impact, but agreed with the remainder.

Management stated the claimed monetary impact of \$98,482,250 is for T&M and Labor Hour contracts that are performed on a level of effort basis or are incrementally funded. The price for these contracts functions as the ceiling price, as this is the limit of obligated funding available to the supplier in performance. Management agreed with the monetary value of \$6,402,254, but noted that the amount is an extrapolated value.

Regarding recommendation 1, management stated that Supply Management will provide COs and purchasing staff with a Supply Management Communication Purchasing Policy Tip regarding the requirements for incorporating a ceiling price within the schedule for T&M and Labor Hour contracts. The target implementation date is March 2019.

Regarding recommendation 2, management stated that Supply Chain Management Strategies will prepare a report of those open T&M and Labor Hour contracts that do not include Clause 2-38, and Portfolio managers will manage incorporation of the clause with their staffs. Supply Management Infrastructure will provide a Supply Management Communication Purchasing Policy Tip regarding the requirement to include Clause 2-38 in T&M and Labor Hour contracts. The target implementation date is November 2018.

Regarding recommendation 3, management stated that Supply Management Infrastructure will provide formal communication through a Supply Management Communication Purchasing Policy Tip to COs and purchasing staff on the

requirements for documenting any ceiling price changes within the schedule for T&M and Labor Hour contracts. The target implementation date is May 2018.

Regarding recommendation 4, management stated that Supply Management Infrastructure will provide formal communication through a Supply Management Communication Purchasing Policy Tip to COs and purchasing staff on the requirements for proper application of the Clause 2-38 payment retainage provision. The target implementation date is May 2018.

See [Appendix B](#) for management's comments in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendations and the corrective actions should resolve the issues identified in the report.

We disagree with management's assertion that the contract funding is the same as the ceiling price because of incremental funding. We based the monetary impact claimed on COs not following policy that requires a ceiling price to be explicitly stated in the contract schedule.

All recommendations require OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. Recommendations should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

Appendices

Click on the appendix title below to navigate to the section content.

Appendix A: Additional Information.....	10
Scope and Methodology.....	10
Prior Audit Coverage.....	10
Appendix B: Management’s Comments.....	11

Appendix A: Additional Information

Scope and Methodology

Our audit scope included Postal Service T&M and Labor Hour contracts in CAMS that are in an open status and were awarded during FY 2006 and 2017. Based on the data we collected from the EDW on July 27, 2017, there are 105 open T&M and Labor Hour contracts with a total committed amount of \$432 million. Our statistical sample included 70 T&M and Labor Hour contracts, valued at over \$294 million.

To accomplish our objective, we:

- Reviewed applicable federal practices, SP&P, and relevant management instructions to gain understanding of current criteria in administering T&M and Labor Hour contracts.
- Interviewed compliance and policy managers to gain an overall understanding of T&M and Labor Hour contracts.
- Interviewed Portfolio managers to gain an understanding of T&M and Labor Hour contracts specific to their portfolio.
- Determined a statistical sample of open contracts for review.
- Interviewed COs overseeing contracts selected for review.
- Reviewed applicable contract supporting documentation to determine whether:
 - The contract contains the appropriate clauses.
 - The ceiling price was established or increased.
 - The contract files contain appropriate documentation to support ceiling increases.
 - COs analyzed proposed hours.

- Analyzed causes for increasing the ceiling price to determine if there are any systemic issues.
- Determined whether the Postal Service established a process for monitoring the contract and did they follow that practice.

We conducted this performance audit from September 2017 through March 2018, in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We discussed our observations and conclusions with management on February 22, 2018, and included their comments where appropriate.

We assessed the reliability of EDW data by comparing it to reports extracted from CAMS and source documents and interviewing Supply Management personnel involved in T&M and Labor Hour contracts. To further validate the data, we provided it to Postal Service management to confirm the information was accurate. We determined the data were sufficiently reliable for the purposes of this report.

Prior Audit Coverage

The OIG did not identify any prior audits or reviews related to the objective of this audit within the last five years.

Appendix B: Management's Comments

SUSAN M. BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT



March 15, 2018

LORI LAU DILLARD

SUBJECT: Controls Over Time and Materials and Labor Hour Contracts
(Report Number SM-AR-18-DRAFT)

Thank you for providing the United States Postal Service with an opportunity to review and comment on the subject Office of the Inspector General (OIG) draft audit report, "Controls Over Time and Materials and Labor Hour Contracts." Management agrees with the report's findings and recommendations except where noted below. Management disagrees with \$98,482,250 of the claimed monetary impact, but agrees with the remainder.

Regarding the report's Finding #1 and the claimed monetary impact of \$98,482,250, the OIG has included all instruments reviewed that did not explicitly state a ceiling price within the contract schedule. As discussed, where a Time and Material (T&M) or Labor Hour Contract (LHC) is being performed on level of effort basis or is being incrementally funded, the contract price functions as the ceiling price as this is the limit of obligated funding available to the supplier in performance. Additionally, the OIG has confirmed that the subject audit did not find any circumstance where a supplier exceeded the established contract value. Management agrees with the Recommendation #2 monetary impact of unsupported questioned costs, but notes that the value of \$6,402,254 is an extrapolated value.

Management's response to the recommendations included in the draft report may be found below.

We recommend the Vice President, Supply Management:

Recommendation 1: Revise policy to better define ceiling price and the requirement to document the ceiling price in the Schedule; reiterate the requirement to contracting officers when executing Time and Materials and Labor Hour contracts.

Management Response to Recommendation 1: Management agrees that policy revisions on the use of a ceiling price in T&M and LHCs are required. An SM Communication will be provided as a Purchasing Policy Tip to contracting officers and purchasing staff on the requirements concerning the incorporation of a ceiling price within the schedule for T&M and LHCs, as applicable.

Target Implementation Date: March 2019

Responsible Official: Manager, Supply Management Infrastructure

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Recommendation 2: Assess the universe of Time and Materials and Labor Hour Contracts and bring those contracts without Clause 2-38 into compliance; reiterate through formal communication, and refresher training, the proper inclusion of required contract clauses in the contract language for Time and Materials and Labor Hour contracts, and revise the current review and approval process to ensure adherence and accountability for contracting officers

Management Response to Recommendation 2: Management agrees that Clause 2-38 is required for inclusion within T&M and LHCs. SCM Strategies will prepare a report of open T&M and LHCs that do not include Clause 2-38. Portfolio Managers will manage incorporation of the clause with their staffs. Supply Management Infrastructure (SMI) will provide for formal communication through an SM Communication Purchasing Policy Tip regarding the requirement to include Clause 2-38 in T&M and LHCs. The communication will remind and train contracting officers and purchasing staff to ensure the inclusion of the clause during solicitation drafting and in the review and the approval process for new contract awards.

Target Implementation Date: November 2018

Responsible Officials: Manager, SCM Strategies, and Manager, Supply Management Infrastructure

Recommendation 3: Emphasize to contracting officers, through formal communication, requirements on documenting ceiling price changes in Time and Materials and Labor Hour contracts.

Management Response to Recommendation 3: Management agrees with this recommendation. SMI will provide for formal communication through an SM Communication as a Purchasing Policy Tip to contracting officers and purchasing staff on the requirements for documenting any ceiling price changes within the schedule for T&M and LHCs, as applicable.

Target Implementation Date: May 2018

Responsible Official: Manager, Supply Management Infrastructure

Recommendation 4: Emphasize to contracting officers, through formal communication, the requirements for proper application of the Clause 2-38 payment retainage provision.

Management Response to Recommendation 4: Management agrees with this recommendation. SMI will provide for formal communication through an SM Communication as a Purchasing Policy Tip to contracting officers and purchasing staff on the requirements for proper application of the Clause 2-38 payment retainage provision.

Target Implementation Date: May 2018

Responsible Official: Manager, Supply Management Infrastructure

Susan M. Brownell



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