



May 26, 2006

SUSAN BROWNELL  
VICE PRESIDENT, SUPPLY MANAGEMENT

SUBJECT: Audit Report – Controls Over Noncompetitive Contracts Awarded to Former Postal Service Employees (Report Number CA-AR-06-002)

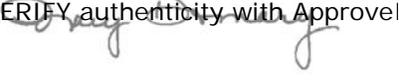
This report presents the results of our self-initiated audit of the controls over noncompetitive contracts awarded to former U.S. Postal Service employees (Project Number 05BG014CA000). Our overall objective was to determine the effectiveness of controls over noncompetitive personal services contracts awarded to former Postal Service employees.

The audit confirmed that the effectiveness of controls over noncompetitively awarded contracts to former Postal Service employees needed improvement. Specifically, we determined that market research was inadequate, contract statements of work needed improvement, and employees were misclassified as independent contractors when, according to Internal Revenue Service guidance, these individuals should be classified as employees and have the appropriate payroll taxes withheld. It was estimated that the Postal Service could have saved about \$137,636 by improving controls over the personal services contracts and ensuring the more favorable prices were negotiated. We will report the \$137,636 as unrecoverable costs in our *Semiannual Report to Congress*. We made five recommendations to address the situations identified during the audit.

Management agreed with our recommendations and has initiatives in progress, completed, or planned addressing the issues in this report. However, management did not agree with the calculation of the \$137,636, stating they do not agree with the General Services Administration (GSA) labor categories selected because they did not match the work being performed under contract. In addition, it was stated that the U.S. Postal Service Office of Inspector General analysis did not consider the cost benefit associated with using former employees with specific Postal Service knowledge and experience. During the course of this audit, however, we considered prior Postal Service experience, former salaries, pay grades, and employee position descriptions, in an effort to fairly evaluate each individual's experience. We also obtained GSA's contracted rates for like jobs at applicable locations. The exceptions were used to calculate unrecoverable costs.

Management's comments and our evaluation of these comments are included in the report.

We appreciate the cooperation and courtesies provided by your staff during the review. If you have any questions or need additional information, please contact Judy Leonhardt, director, Supply Management and Facilities, or me at (703) 248-2300.

E-Signed by Mary Demory   
VERIFY authenticity with Approve!  


Mary W. Demory  
Deputy Assistant Inspector General  
for Headquarters Operations

#### Attachments

cc: Anthony J. Vegliante  
Robert J. Pedersen  
Marie K. Martinez  
Steven R. Phelps

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## EXECUTIVE SUMMARY

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### Introduction

The U.S. Postal Service Office of Inspector General conducted a self-initiated audit of controls over noncompetitive contracts awarded for personal services, including justifications, approvals, market research, and pricing. Our overall objective was to determine the effectiveness of these controls over noncompetitive personal services contracts awarded to former U.S. Postal Service employees. Specifically, we determined whether Postal Service management properly justified and approved noncompetitive purchases. Additionally, we evaluated the adequacy of pricing procedures.

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### Results in Brief

The Postal Service could have saved about \$137,636 by improving controls over the award, administration, and pricing of noncompetitive personal services contracts. Additionally, contract Statements of Work (SOWs) did not always provide sufficient detail to establish a measure of performance or appropriately classify the personal services contractors, as required by *Interim Internal Purchasing Guidelines* (IIPG) and Internal Revenue Service (IRS) guidelines.

These conditions occurred because purchasing teams did not always perform market research and price analyses or fully adhere to formal Postal Service purchasing guidelines. In addition, the current IIPG and Supply Management Administrative Instruction 2004-013, *Personal Services Contracts*, do not provide sufficient information about the classification and/or treatment of independent contractors versus employees. As a result, the Postal Service paid more than necessary for the services contracted, did not always clearly state performance measures to assess contractors' performance, and inconsistently classified personal services contractors for tax- and labor-related issues.

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### Summary of Recommendations

We recommended the vice president, Supply Management, instruct purchasing teams to always perform thorough market research and price analyses as part of the noncompetitive contract award process; consider using multiple sources for determining price reasonableness — including comparing proposed rates with independent sources, such as General Services Administration

Schedules — to determine fair and reasonable pricing during the market research; and review all contracts and related SOWs awarded to individuals to ensure contractor status is appropriately reflected and taxes are withheld as outlined in Supply Management Instruction SM 2004-013 and the IIPG. We recommended the vice president, Supply Management, instruct purchasing teams to reinforce to clients seeking professional or technical services from individuals that SOWs must clearly identify the scope of the personal services to be performed within the IIPG definition at 4.5.4.a and include methods for measuring performance under the contract; and update IIPG paragraph 4.5.4.a to ensure that the purchasing teams understand they may apply any of the elements that define a personal services contract when classifying an individual's contract as a personal services type. This update would also improve compliance with relevant IRS information on the identification of employees versus independent contractors.

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**Summary of  
Management's  
Comments**

Management agreed with the recommendations and has initiatives in progress, completed, or planned addressing the issues identified in this report. Management's comments, in their entirety, are included in Appendix C.

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**Overall Evaluation of  
Management's  
Comments**

Management's planned actions are responsive to the recommendations and should correct the issues identified in the findings.

## INTRODUCTION

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### **Background**

The primary goal of U.S. Postal Service purchasing is to support its business and competitive objectives. To meet this mandate, purchasing teams — headed by a contracting officer — determine the most effective business practices for a given purchase. These business practices include the determination as to whether management should make a purchase competitively or noncompetitively. According to former and current Postal Service guidelines, generally, purchasing teams should make purchases valued at more than \$10,000 on the basis of adequate competition; however, they may decide that the most effective business practice is to make the purchase noncompetitively.

In some cases, the business and competitive objectives of the Postal Service may best be met through the noncompetitive purchase method. The four business scenarios in which the noncompetitive method may prove the most effective are:

- Compelling business interest.
- Industry structure or practice.
- Single source.
- Superior performance.

*Interim Internal Purchasing Guidelines* (IIPG), paragraph 2.1.4.a, state market research is central to sound purchase planning. Market research helps determine what supplies or services are available, what suppliers are available, how to best state requirements, and whether price or cost estimates are realistic. In addition, purchasing guidelines require purchasing teams to ensure that contract prices are fair and reasonable by evaluating proposed prices using price or cost analysis methods.

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### **Objectives, Scope, and Methodology**

Our overall objective was to determine the effectiveness of controls over noncompetitively awarded contracts. Specifically, we determined whether Postal Service management properly justified and approved noncompetitive purchases. Additionally, we evaluated the adequacy of procedures for pricing noncompetitive purchases.

To accomplish our objectives, we interviewed contracting officers at Postal Service Headquarters and the Aurora Purchasing Services Center and obtained and reviewed contract file documentation and position descriptions. We obtained data from the Contract Administration Management System, applicable Employee Master Files, and pay history files. We also consulted with the U.S. Postal Service Office of Inspector General (OIG) statisticians and OIG Legal services.

To define the scope of our audit, we requested a list of all active noncompetitive contracts from the Contract Administration Management System database.<sup>1</sup> We received a total of 3,303 contracts valued at more than \$5,133,792,543. Because of the number of contracts with individuals, we then requested the Computer Assisted Assessment Techniques team to compare the Taxpayer Identification Number and Social Security Number (TIN/SSN) field in the contracts file to the SSN field of the current and prior Employee Master Files. This comparison identified 205 noncompetitive contracts the Postal Service awarded to former employees, valued at \$11,595,406. From this population of 205 contracts, we excluded 45 contracts awarded to former Postal Service inspectors.<sup>2</sup> In addition, we excluded 16 contracts awarded for renting personal vehicles because we considered them to be outside the scope of this audit and excluded one contract that had been transferred to Dallas, Texas.

We statistically sampled the remaining 143 contracts. For each contract sampled, we evaluated such items as the noncompetitive justification, statements of work, market research, price analysis, and overall contract approval.

We conducted this audit from September 2005 through May 2006, 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 rely on any computer-generated

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<sup>1</sup> The OIG Computer Assisted Assessment Techniques team extracted data.

<sup>2</sup> We provided the list of former Postal Service inspectors to the director, Oversight of Investigative Activities, for review.

data to support the opinions or conclusions in this report. We discussed our observations and conclusions with management officials and included their comments where appropriate.

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**Prior Audit Coverage**

We identified one prior audit report related to the objective of this audit:

OIG Management Advisory, *USPS Management of Personal Services Contracts* (Report Number QR-MA-99-001, dated March 29, 1999), stated that management used contractors to supplement the career workforce dating back to 1992. Corporate restructuring reduced corporate staffing levels, resulting in the retirement or departure of many Postal Service career employees. As a short-term fix, the Postal Service contracted with many former employees to complete unfinished programs and projects.

The report also stated the use of contractors may circumvent staffing levels, be more costly, and expose the Postal Service to tax and legal liabilities. Specifically, contract personnel may be construed under the law as employees because of the requirements in their contracts, comparability of their work with career Postal Service employees, and length of their contract terms.

According to Internal Revenue Service (IRS) guidance, an individual who performs services for an organization is an employee if the organization can control “what will be done and how it will be done.” Furthermore, it is the relationship — not the label — that governs a worker’s status. This relationship can result in a contractor being what the IRS refers to as a “common-law” employee. The IRS requires employers to withhold and pay taxes on income, Social Security, and Medicare taxes for wages they pay to “common-law” employees, whereas they generally do not have to withhold or pay any taxes on payments to independent contractors. In addition, if independent contractors are later judged as having been “common-law” employees, the employer is liable for taxes and penalties.

Management agreed with the observations and suggestions made in the management advisory report. On March 11, 1999, the Postmaster General issued a letter to all officers expressing concern about the Postal Service’s growing

reliance on consulting services and other contracting methods used to supplement the administrative workforce. This letter announced the establishment of a new Consulting Services Review Committee to review all requests for new or renewal of existing contracts to ensure their necessity.

## AUDIT RESULTS

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### **Controls Over Noncompetitive Personal Services Contracts Need Improvement**

Overall, we found that controls over the award, administration, and pricing of noncompetitive personal services contracts need improvement. Specifically, we determined that purchasing teams did not always:

- Negotiate the best price for contracted services.
- Provide sufficient detail in contract statements of work (SOWs) to define contractor roles and duties.
- Follow IRS guidelines when determining the appropriate classification of the contractor's employment status.

These conditions occurred because purchasing teams did not always perform market research and price analyses or fully adhere to formal Postal Service purchasing manuals. In addition, the current IIPG and Supply Management Administrative Instruction 2004-013, *Personal Services Contracts*, December 14, 2004, do not provide sufficient information about the classification and/or treatment of independent contractors versus employees.

As a result, the Postal Service paid more than necessary for the services contracted and SOWs did not contain sufficient detail to establish a standard measure of contractor performance or establish a contractor or employee relationship. In addition, management inconsistently classified personal services contractors for tax- and labor-related issues.

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### **Inadequate Market Research**

Purchasing teams did not always negotiate the best price for contracted services. This occurred because purchasing teams did not always perform market research and price analysis prior to awarding noncompetitive contracts.

IIPG, paragraph 2.1.4.a, states market research is central to sound purchase planning. Market research helps determine what supplies or services are available; what suppliers are available; the best way to state requirements; and whether price or cost estimates are realistic, fair, and reasonable.

Specifically, 29 out of 53 statistically selected contracts reviewed indicated market research was either identified as not necessary, shown as not applicable, or insufficiently performed by the purchasing team. In addition, 30 of the 53 contracts reviewed did not have adequate documentation supporting the price analyses the teams performed.

We compared the hourly rates of the 53 contracts with the hourly rates established in the General Services Administration (GSA) Schedule<sup>3</sup> for similar services. There were five contracts where the Postal Service's hourly rates were higher than the rates available in the GSA Schedule. Had the purchasing team included a comparison with the GSA Schedule rates in their market research, they could have negotiated lower rates.

As a result, we determined that the Postal Service paid higher hourly rates to five out of 143 contractors. When projected to the universe of 143 noncompetitive contracts with former employees, the unnecessary expenditure was \$137,636.

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<b>Recommendation</b>	We recommend the vice president, Supply Management, direct the purchasing teams to:  1. Always perform thorough market research and price analyses as part of the noncompetitive contract award process.
<b>Management's Comments</b>	Management agreed with the recommendation since Supply Management's guidelines/practices include performing these activities. Management will cascade the report to all managers within Supply Management under Supply Management's Review for Excellence Program (SM REP). In turn the managers will be required to review the report and further cascade it within their organization to ensure that, when appropriate, the recommendation is followed. The SM REP will be issued within 30 calendar days following receipt of the final report.

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<sup>3</sup> GSA establishes long-term government-wide contracts with commercial firms to provide access to over 10 million commercial supplies and services that can be ordered directly from GSA Schedule contractors.

Management generally concurred with the OIG findings of insufficient documentation in the five contracts; however, they did not agree with the reported monetary amount of \$137,636. Management stated they did not agree with the GSA labor categories selected because they did not match the work being performed under contract. In addition, they felt the OIG did not consider the cost benefit associated with using former employees with specific Postal Service knowledge and experience.

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<b>Evaluation of Management's Comments</b>	<p>Management's comments are responsive to the recommendation and actions planned should correct the issue identified in the finding.</p> <p>As to the monetary amount of \$137,636, we considered prior Postal Service experience, former salaries, pay grades, and employee position descriptions in an effort to fairly evaluate each individual's experience. We also obtained GSA's contracted rates for like jobs at applicable locations. We used the exceptions to calculate these unrecoverable costs which will be reported in our <i>Semiannual Report to Congress</i>.</p>
<b>Recommendation</b>	<p>We recommend the vice president, Supply Management, direct the purchasing teams to:</p> <ol style="list-style-type: none"><li>2. Consider using multiple sources for determining price reasonableness — including comparing proposed rates with independent sources, such as General Services Administration Schedules — to determine fair and reasonable pricing as part of the market research.</li></ol>
<b>Management's Comments</b>	<p>Management agreed with the recommendation since this is one of the pricing techniques contained in their guidelines/practices. Management will disseminate this recommendation as discussed in recommendation 1.</p>
<b>Evaluation of Management's Comments</b>	<p>Management's comments are responsive to the recommendation and actions planned should correct the issues identified in the finding.</p>
Contract Statements of Work Need Improvement	<p>Contract SOWs did not always provide enough detail to establish a measure of performance or distinguish whether or not management should classify an individual as an</p>

employee or an independent contractor. Instead, management wrote contract requirements that sounded like employee position descriptions.

This occurred because the purchasing team did not always write contract SOWs with sufficient detail to measure performance or ensure a best value decision. For example, one SOW identified only two elements of work: (1) assist product development with the certification of invoices and general project management; and (2) provide training to candidates for this position in the future. This SOW did not define the time required to perform the tasks, the performance measurements the tasks would be held to, or the deliverable that was expected.

Another contract SOW required the contractor to:

- Provide consulting services on the USPS intellectual property and patent program.
- Provide consulting services on patent contracts.
- Assist in developing a patent program for the Postal Service Licensing Group.
- Provide guidance on patent and contractual negotiations.

Again, the SOWs did not identify time frames, performance measurement, and the expected deliverable.

In addition, the SOWs reviewed did not always establish whether the individual worked in a Postal Service facility, used Postal Service equipment, and was supervised by a Postal Service employee. These elements, as well as others, are needed to properly classify a contractor in accordance with IRS guidelines, as well as labor and antidiscrimination laws.

IIPG, paragraph 2.3.1.b, stated that SOWs are generally used when purchasing a service, rather than an end product. SOWs must describe the work as precisely as practicable and in enough detail to allow a best value decision. The IIPG also stated that SOWs are the standard for measuring performance and are used by both parties to determine rights and obligations under the contract.

Inadequate detail in the SOW may have contributed to invalid performance measurement standards and the inconsistent classification of independent contractor versus employee for tax- and labor-related issues.

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<b>Recommendation</b>	We recommend the vice president, Supply Management, direct all purchasing personnel to:  3. Review all personal services contracts awarded to individuals and the related Statements of Work awarded to ensure they appropriately reflect contractor status as outlined in Supply Management Instruction SM 2004-013, Personal Services Contracts, and the Interim Internal Purchasing Guidelines; and ensure taxes are being withheld.
<b>Management's Comments</b>	Management agreed with the recommendation. Process Review, Supply Management Infrastructure, under the SM REP program, will conduct a review of personal services contracts with individuals and the supporting guidelines. As appropriate, contracting officers will follow-up to ensure tax withholdings are in accordance with the Administrative Instruction and the Supplying Principles and Practices (SP&Ps) – effective May 1, 2006. Estimated completion for this action is on or before September 29, 2006.
<b>Recommendation</b>	4. Reinforce to clients seeking professional or technical services from individuals that Statements of Work must clearly identify the scope of the personal services to be performed within the Interim Internal Purchasing Guidelines definition at 4.5.4.a, and include methods for measuring performance under the contract.
<b>Management's Comments</b>	Management agreed with the recommendation and will disseminate it as discussed in recommendations 1 and 2. However, the guidelines mentioned in the OIG report were replaced by SP&Ps and, as such, the relevant practices will be discussed during the SM REP cascade.
<b>Evaluation of Management's Comments</b>	Management's comments are responsive to recommendations 3 and 4 and actions planned should correct the issues identified in the finding.

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Employees Versus  
Independent  
Contractors  
Classification

As part of this audit, we performed follow-up work regarding the conditions identified in the 1999 management advisory. This management advisory reported that some individuals were treated as independent contractors rather than employees. It also identified the associated risks and liabilities for the inconsistent classification of independent contractor versus employee on personal services contracts. The Postal Service agreed with the finding and took corrective action to effect appropriate changes. In addition, on March 11, 1999, the Postmaster General issued a letter to all officers expressing concern about the Postal Service's growing reliance on consulting services and other contracting methods used to supplement the administrative workforce.

Postal Service purchasing guidelines define a personal services contract as "a contract with an individual under the terms of which the individual will:

- Work under the direct supervision of postal personnel.
- Work on postal premises and use postal equipment.
- Perform duties similar in nature to those of postal employees."

The IIPG further states that a personal services contract may create the appearance of an employee-employer relationship and may result in additional costs, such as tax withholding. For this reason, purchasing teams should strive to use contracting vehicles other than personal services contracts, but, when deemed appropriate, they may use them, subject to the reviews and approvals described in the IIPG.

Supply Management Administrative Instruction 2004-013, *Personal Service Contracts*, issued December 14, 2004, provides procedures for the review and approval of personal services contracts. Paragraph 3 describes payment procedures for these contracts, how to determine whether the conditions exist for an "employee-employer" relationship, and how to process the record for payroll purposes.

The risks identified in the 1999 OIG management advisory are still an issue 6 years later. Even though the Postal Service revised the purchasing guidelines and issued an administrative instruction, the information still does not provide enough guidance to make a clear distinction between an independent contractor and an employee. For example, guidance does not address indicators such as:

- Whether or not the individual operates as a business.
- Whether the individual uses their SSN or a TIN.<sup>4</sup>
- Whether the individual works for other businesses or only the Postal Service.

IRS Publication 15a, *Employer's Supplemental Tax Guide*, addresses the employee versus independent contractor issue. It states that to determine whether an individual is an employee or an independent contractor under common law, the relationship of the worker and the business must be examined. All evidence of control and independence must be considered, including the degree of control and independence. This falls into three categories, as follows:

- Behavior control. Does the Postal Service have the right to direct and control how the worker performs assigned tasks? An employee is generally subject to the business's instructions about when, where, and how the work is accomplished.
- Financial control. This addresses how business expenses are reimbursed. Independent contractors are more likely to have unreimbursed expenses than are employees. In our audit sample, travel, where identified, was a reimbursable expense. And, lastly, does the individual make his or services available to the relevant market?
- Type of relationship. Are the services performed by the contractor a key aspect of the regular business of the Postal Service?

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<sup>4</sup> All of the contracts reviewed contained the individual's SSN as their TIN.

As a result of the inconsistent classification of independent contractors versus “common-law” employees, the Postal Service could be held liable for taxes and other penalties. In addition, the Postal Service could be held liable in lawsuits stemming from potential labor law and antidiscrimination violations.

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<b>Recommendation</b>	We recommend the vice president, Supply Management:  5. Update <i>Interim Internal Purchasing Guidelines</i> paragraph 4.5.4.a to ensure that the purchasing teams understand that any of the elements that define a personal services contract may be applicable when classifying a contract with an individual as a personal services type contract and to improve compliance with relevant Internal Revenue Service information on the identification of employees versus independent contractors.
<b>Management's Comments</b>	Management agreed with the intent of the recommendation. Effective May 1, 2006, the SP&Ps replaced the <i>Interim Internal Processing Guidelines</i> . As part of the SM REP review discussed in response to recommendation 3, management will review the practice covering personal services contracts in light of this report's findings and this recommendation for possible update to improve compliance. Any practice update will be subject to review and approval under the governing change process. Management will complete their actions by December 29, 2006.
<b>Evaluation of Management's Comments</b>	Management's comments are responsive to the recommendation and actions planned should correct the issue identified in the finding.

## APPENDIX A. ABBREVIATIONS

FOIA	Freedom of Information Act
GSA	General Service Administration
IIPG	Interim Internal Purchasing Guidelines
IRS	Internal Revenue Service
OIG	U.S. Postal Service Office of Inspector General
SOW	Statement of Work
SSN	Social Security Number
TIN	Taxpayers Identification Number

## APPENDIX B

### CALCULATION OF UNRECOVERABLE COSTS

#### STATISTICAL SAMPLING FOR CONTROLS OVER NONCOMPETITIVELY AWARDED CONTRACTS TO FORMER POSTAL SERVICE EMPLOYEES (Project Number: 05BG014CA000)

##### Purpose of the Sampling

The objectives of this audit were to determine whether controls over noncompetitively awarded contracts are effective and whether the Postal Service's management properly justified and approved noncompetitive purchases. Additionally, the audit team evaluated the adequacy of procedures for pricing noncompetitive purchases. In support of the objectives, the audit team employed a stratified sample to randomly select noncompetitive contracts for review.

##### Definition of the Audit Universe

The audit universe consisted of 143 open noncompetitive contracts as of September 7, 2005, awarded to active and former Postal Service Employees, within the Supply Portfolio and Information Technology Category Management Center (IT CMC). This list excluded former Postal Service inspectors. The total value of the 143 noncompetitive contracts was \$7,598,300.50. The OIG's CAATs team extracted the universe from the eBuy database.

##### Sample Design and Modifications

We chose a stratified sample design because we did not have prior knowledge whether the possible errors would be similar for contracts with active employees and former employees. We also considered that error types and rates might differ according to contract value. We defined the strata as the combination of the employee status (active versus former) and the contract's value (greater than or equal to \$100,000 versus less than \$100,000 versus no value listed). Within each stratum, we used simple random selection without replacement to randomly select noncompetitive contracts.

We found only 4 contracts awarded to active employees and 139 contracts awarded to former employees in the universe, and among them, there were

22 contracts with a value more than \$100,000: one for an active employee and 21 for former employees. In addition, there was only one contract, awarded to a former employee, without the contract value specified in the database.

We sized the sample based on testing compliance with various controls (attribute tests). Assuming an expected deviation rate of about 20 percent, we calculated the sample size for a two-sided 90 percent confidence interval with about +/- 7 percent precision for the attribute tests. We determined, for these parameters, we needed to sample approximately 53 contracts. We allocated these samples into five strata, as shown in the following table:

	Greater Than or Equal To \$100,000		Less Than \$100,000		No Contract Value Listed	
	Universe	Sample	Universe	Sample	Universe	Sample
Active Employee	1	1	3	2	0	0
Former Employee	21	15	117	34	1	1

The total sampled contracts are worth \$3,682,148.20, about 48 percent of the total value of noncompetitive contracts.

We made all noncompetitive contracts selections for the sample using the “randbetween” function in Excel to assign random numbers to the contracts in the universe listing.

**Results**

The audit team is not reporting any attribute test results; therefore we are making no projections for the attributes tested.

The sample size we selected for attribute testing was insufficient to achieve acceptable precision for dollar amounts. This occurred because there was too much variability in the sample results, which created a wide uncertainty interval: +/- 75 percent relative to the mean. A larger sample was necessary to achieve acceptable precision for reporting a point estimate for a dollar value projection. In such cases, we report the larger of (a) the lower bound (conservative projection), or (b) the actual amounts from the items reviewed. Because the actual excess cost found in the sampled contracts exceeded the projected lower bound, we report the actual amount: \$137,600.

## APPENDIX C. MANAGEMENT'S COMMENTS

SUSAN M. BROWNELL  
VICE PRESIDENT, SUPPLY MANAGEMENT



May 4, 2006

MARY W. DEMORY

SUBJECT: Draft Audit Report—Controls Over Noncompetitive Contracts Awarded to Former  
Postal Service Employees (Report Number CA-AR-06-DRAFT)

We appreciate the opportunity to review and comment on the subject draft audit report. The attached highlights a concern with the report's findings and our agreement with the report's five recommendations. Based on additional information provided by your office, we cannot agree with the \$137,636 in reported monetary impact (unrecoverable costs). While we generally concur with your findings of insufficient documentation in the five identified contract files, we did not reach the same conclusions of your evaluators with regards to this impact figure. Your price analysis for these five contracts included subjective selection of similar labor categories under contract schedules issued by the General Services Administration (GSA). We did not agree with the GSA labor categories selected because they did not adequately match the work being performed under the contracts. In addition, your analysis did not appear to consider the cost benefit associated with using former employees with specific postal knowledge and experience.

We do not believe this report contains any proprietary business information that would be exempt from disclosure under the Freedom of Information Act (FOIA). Marie Martinez of Supply Management will monitor implementation of applicable report recommendations. She can be reached at (202) 268-4117.

A handwritten signature in cursive script that reads "Susan M. Brownell".

Attachment

cc: Mr. Vegliante  
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Ms. Martinez  
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20260-4130:MKMartinez:SMResponseCA-AR-06-DRAFT:04/26/2006

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#### COMMENTS ON REPORT FINDINGS

##### Employees Versus Independent Contractors Classification

The prior Office of Inspector General (OIG) report recommendations covering this subject area were addressed through revisions to our guidelines and by defining a process for handling personal services contracts in a Supply Management Administrative Instruction. The OIG agreed to actions taken and closed out the prior report recommendations (report QR-MA-99-001). Despite satisfying the issues presented by the earlier report, this section of the current report states "the risks identified in the 1999 OIG management advisory are still an issue 6 years later." This statement is misleading. As the OIG points out, a set process for establishing personal services contracts exists. This includes a review by Corporate Personnel for consideration of any employment matters before approving issuance of a personal services contract. Thereafter, if this contractual relationship will be with an individual and creates an employee/employer relationship based on Internal Revenue Service (IRS) independent contractor or employee guidance, the Postal Service requires withholding federal income, social security, Medicare, and state income taxes. This guidance was determined sufficient by both postal management and legal counsel to ensure individual personal services contractors met IRS tax liabilities. Further, this report did not relay that a risk assessment was performed or present any details regarding incurred liabilities since management addressed the concerns outlined in the earlier 1999 report. Therefore, we must disagree with this finding. However, we do agree that when the established procedures are not followed by Supply Management personnel, there is potential risk exposure.

#### RESPONSES TO REPORT RECOMMENDATIONS

*We recommend the vice president, Supply Management, direct the purchasing teams to:*

- 1. Always perform thorough market research and price analyses as part of the noncompetitive contract award process.*

Management agrees with this recommendation since performing these activities is included in our guidelines/practices. To disseminate this recommendation, we will cascade your report under Supply Management's Review for Excellence Program (SM REP) to all managers within Supply Management. In turn these managers will be required to review the report and further cascade it within their organizations to ensure that when appropriate, your recommendation is followed. The SM REP cascade request will be issued within 30 calendar days following receipt of your final report.

- 2. Consider using multiple sources for determining price reasonableness—including comparing proposed rates with independent sources, such as General Services Administration Schedules—to determine fair and reasonable pricing as part of the market research.*

Management agrees with this recommendation since this is one of the pricing techniques contained in our guidelines/practices. We will disseminate this recommendation as discussed in our response to recommendation one.

*We recommend the vice president, Supply Management, direct all purchasing personnel to:*

- 3. Review all personal services contracts awarded to individuals and the related Statements of Work awarded to ensure they appropriately reflect contractor status as outlined in Supply Management Instruction SM 2004-013, Personal Services Contracts, and the Interim Internal Purchasing Guidelines; and ensure taxes are being withheld.*

Management agrees with this recommendation. Process Review, Supply Management Infrastructure, under the SM REP program, will conduct a review of personal services contracts with individuals and the supporting guidelines. As appropriate, we will direct contracting officer's follow-up to ensure tax withholdings in accordance with the Administrative Instruction and the Supplying Principles and Practices (SPs & Ps)—effective May 1, 2006. Estimated completion: The SM REP review will be completed on or before September 29, 2006.

- 4. Reinforce to clients seeking professional or technical services from individuals that Statements of Work must clearly identify the scope of the personal services to be performed within the Interim Internal Purchasing Guidelines definition at 4.5.4.a, and include methods for measuring performance under the contract.*

Management agrees with this recommendation and will disseminate this recommendation as discussed for recommendations one and two above. However, the guidelines mentioned in this OIG report is being replaced by SPs & Ps, and as such, the relevant practices will be discussed during our SM REP cascade.

*We recommend the vice president, Supply Management:*

- 5. Update Interim Internal Purchasing Guidelines paragraph 4.5.4.a to ensure that the purchasing teams understand that any of the elements that define a personal services contract may be applicable when classifying a contract with an individual as a personal services type contract and to improve compliance with relevant IRS information on the identification of employees versus independent contractors.*

Management agrees with the intent of this recommendation. Effective May 1, 2006, the Interim Internal Purchasing Guidelines were replaced with the SPs & Ps. As part of the SM REP review discussed in response to recommendation three, the practice covering personal services contracts will be reviewed in light of the report's findings and this recommendation for possible update to improve compliance. Any Practice update will be subject to review and approval under the governing change process. It is anticipated that all related actions will be completed by December 29, 2006.