



April 9, 2009

SUSAN M. BROWNELL  
VICE PRESIDENT, SUPPLY MANAGEMENT

SUBJECT: Audit Report – Management of Contract Changes: Convergys  
Government Solutions, LLC (Report Number CA-AR-09-004)

This report presents the results of our audit of the Management of Contract Changes for the contract with Convergys Government Solutions, LLC (Convergys), Contract Number 2APSER-03-P-2597 (Project Number 08YG003CA003). Our objective was to determine whether there were unnecessary or inappropriate increased costs due to changes to the U.S. Postal Service's contract with Convergys. Specifically, we reviewed contract modifications to determine the reasons for contract changes and determined whether those changes were necessitated by inadequate contract planning or inappropriate concessions to contractors. This audit was self-initiated as part of a series of reviews on the Postal Service's management of contract changes and addresses operational risks in the Postal Service's contracting process. See [Appendix A](#) for additional information about this audit.

## Conclusion

The Postal Service may have incurred unnecessary costs due to contract changes. Specifically, there is no evidence that management performed sufficient price and/or cost analyses for two contract line items (CLIN), International Task Force (ITF)<sup>1</sup> and Kahala Project Initiative,<sup>2</sup> with a value of \$12.7 million. In addition, we noted inadequate support for a \$2.5 million equitable adjustment payment to Convergys. Therefore, we are reporting disbursements at risk<sup>3</sup> totaling \$15,207,140. We will include this non-monetary impact in our *Semiannual Report to Congress*. See [Appendix B](#) for the calculation of disbursements at risk.

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<sup>1</sup> The ITF was created in 2004 to address concerns Postal Service customers and foreign postal administrations raised regarding the lack of timely response to international inquiries. The Postal Service added the ITF to the contact center managed by Convergys on September 16, 2005.

<sup>2</sup> The Kahala Project Initiative was added to the contact center on December 16, 2004. The Postal Service created the Kahala Project Initiative to increase international volume and revenue and improve delivery performance for Global Express Mail and Global Airmail Parcel Post.

<sup>3</sup> Disbursements made where proper Postal Service internal controls and processes were not followed.

## Contract Modifications Support and Management

Our audit identified issues regarding the management of several significant contract modifications. There is no evidence to indicate that management performed sufficient price and/or cost analyses for two significant modifications and adequately maintained support for an equitable adjustment payment. Specifically:

- Documentation does not exist to verify that sufficient price and/or cost analyses were performed for two significant modifications that added \$12,707,140 in funding for call center support for the ITF and the Kahala Project Initiative. [REDACTED]  
[REDACTED] stated there would have been a verbal conference regarding these additions, and involving the [REDACTED], at the time the modifications were made. In addition, they recently found some e-mails between the prior [REDACTED], the Vice President, Supply Management, and the client discussing the need for the work, the expedient timing of the work, and some general concerns about the overall price of the work, but they did not contain price and/or cost analyses. Without sufficient price and/or cost analyses, the Postal Service cannot be assured that it obtained the best value for goods and services delivered. The Postal Service's *Supplying Principles and Practices*<sup>4</sup> requires some form of price analysis for every purchase. Also, a cost analysis is appropriate when factors affecting the purchase will not ensure a reasonable price based on price analysis alone. We believe the significance of this purchase exemplifies the need for thorough, documented price and/or cost analyses. We identified a non-monetary impact of \$12,707,140 for disbursements at risk because the Postal Service did not apply the appropriate controls to ensure that pricing on these modifications was reasonable. (See [Appendix B](#).)
- The [REDACTED] stated that when technical work is added to the Convergys contract, Convergys submits a rough order of magnitude estimate to the program office for technical review. The [REDACTED] said that the program office does not always have the technical expertise to question the costs estimated by Convergys, and generally approves the rough order of magnitude estimate. Defense Contract Audit Agency (DCAA) audits of contractor rough order of magnitude cost estimates generally find that they are not well supported and often can be significantly reduced in price with sufficient price analysis. The U.S. Postal Service Office of Inspector General (OIG) provides proposal audit support through the DCAA that can assist in analyzing these rough order of magnitude cost proposals before negotiation.
- The Postal Service paid Convergys a \$2.5 million equitable adjustment without maintaining adequate support. Supply Management officials believe the [REDACTED], in consultation with the Vice President, Supply Management, calculated the

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<sup>4</sup> *Supplying Principles and Practices*, issued May 1, 2006.

equitable adjustment; however, the details of that calculation, including any claim from the contractor, were not maintained in the contract file. During our audit, [REDACTED] found evidence that the Postal Service Law Department reviewed the equitable adjustment and [REDACTED] incorporate that information into the contract file. While this documentation did not show a detailed legal analysis, it is nevertheless evident that management consulted the Law Department. The Postal Service must ensure it fully supports, analyzes, and documents claims and resultant equitable adjustments. The *Procurement Manual*, Issue 2, Clause 4-1.C.2, states that any written or oral order [REDACTED] that causes a change will be treated as a change order, provided that the supplier gives [REDACTED] written notice stating the date, circumstances, and source of the order, and that the supplier regards the order as a change order.<sup>5</sup> In addition, Section 6.5.2.C3 states that before negotiating an equitable adjustment, [REDACTED] that price and cost analyses, as appropriate, are made and must consider the supplier's segregable costs of the change.<sup>6</sup> As such, the claim and equitable adjustment in question are not adequately supported. We therefore identified the \$2.5 million as disbursements at risk. (See [Appendix B](#).)

We recommend that the Vice President, Supply Management, take steps to ensure [REDACTED]:

1. Performs price and/or cost analyses for future contract modifications and any rough order of magnitude proposals submitted by the contractor and documents those analyses in the contract file.
2. Properly receives, analyzes, and documents contractor claims and related equitable adjustments in the contract file.
3. Incorporates into the contract file recently uncovered evidence of partial claim and pricing analyses and consultation with the Postal Service Law Department.

### Management's Comments

Management partially agreed with the finding and recommendation 1 regarding performance of price and/or cost analyses for future contract modifications and the inappropriate use of rough order of magnitude estimates. Management stated [REDACTED] applied cost realism as the principal method of analysis in reaching a determination of price reasonableness for the ITF and the Kahala Project Initiative. Regarding the rough order of magnitude estimates, management stated that the OIG observed that the rough order of magnitude estimates were more complete and viewed them overall as equivalent in detail and precision to a proposal. Management believes this is a misuse of terminology by the supplier and will inform them to use the correct terminology when submitting proposals in the future. Management's response to recommendation 1

<sup>5</sup> *Procurement Manual*, Issue 2, Clause 4-1, General Terms and Conditions, Section C.2, issued January 2002.

<sup>6</sup> *Procurement Manual*, Issue 2, Section 6.5.2.C3, issued January 2002.

included plans to correct the identified documentation deficiencies through improved processes and tighter controls for determining price reasonableness. Management expects to complete these actions by June 2009.

Management agreed with recommendations 2 and 3 and stated the Postal Service will process future requests for equitable adjustment and claims in accordance with its policies and procedures. Management also incorporated the documents in question into the contract file upon locating them in January 2009.

Management also stated that only \$2.5 million of the \$15,207,140 non-monetary impact should be reported in the *Semiannual Report to Congress*. See [Appendix C](#) for management's comments, in their entirety.

### Evaluation of Management's Comments

Regarding recommendation 1 and the application of cost realism, we do not believe application of this approach provides sufficient price and/or cost analysis. As defined by the Postal Service *Supplying Principals and Practices*, cost realism is a test to determine if the contractor can fulfill the contract requirements based on the estimated terms, not whether those terms are reasonable and in the best interest of the Postal Service.

Regarding recommendation 1 and the use of rough order of magnitude estimates from the contractor, contrary to management's comments, we did not evaluate this particular contractor's rough order of magnitude estimates and find them to be equivalent to a full proposal. Regardless of the type of proposal the contractor presented, thorough price and/or cost analysis best protects the interest of the Postal Service. [REDACTED]

[REDACTED] the program office does not always have the technical expertise to question the Convergys cost estimates and generally approves the rough order of magnitude estimates. We believe more thorough analysis is necessary and can assist with audit services, if requested. Therefore, we are reporting disbursements at risk totaling \$15,207,140, and will include this non-monetary impact in our *Semiannual Report to Congress*.

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

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

E-Signed by Darrell E. Benjamin, Jr.   
VERIFY authenticity with ApproveIt

Darrell E. Benjamin, Jr.  
Deputy Assistant Inspector General  
for Support Operations

Attachments

cc: Joseph Corbett  
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## **APPENDIX A: ADDITIONAL INFORMATION**

### **BACKGROUND**

The Postal Service entered into a fixed price incentive agreement with Convergys under contract number 2APSER-03-P-2597, on February 1, 2003, for contact center support. The Convergys contract is a 4-year base contract with six 1-year renewal options. The base contract is valued at approximately \$255 million, with each 1-year renewal option valued at approximately \$64 million. Currently, the Convergys' contract is in its second 1-year renewal period.

The purpose of the contact center is to provide customers access to local post office hours and locations, information on domestic and international rates, Zip Code lookup, stamp sales transactions, telephone change of address, tracking and tracing of Express Mail, information on Certified Mail, and Delivery and Signature Confirmation Services. The center has a "one-call-does-it-all" philosophy by which it provides a centralized channel for customers requesting a variety of services, such as placing their mail on vacation hold, inquiring about a change of address, or scheduling redelivery of a mail item. The center also serves as a customer comment channel to let local post offices know about customer concerns and service issues. The contact center network includes electronic mail and a website to provide some of the services offered through the toll-free telephone number. The contact center has three locations: Denver, CO; Orem, UT; and Jacksonville, NC.

As of July 2008, there had been 81 modifications to the contract, currently valued at approximately \$407 million. The contract expires on January 31, 2013.

### **OBJECTIVE, SCOPE, AND METHODOLOGY**

Our objective was to determine whether there were unnecessary or inappropriate increased costs due to changes to the Postal Service's contract with Convergys. Specifically, we reviewed contract modifications to determine the reasons for any changes and determined whether those changes were necessitated by inadequate contract planning or inappropriate concessions to contractors.

To accomplish our objective, we reviewed the Convergys contract and the 81 modifications to determine whether management executed them in a timely manner and whether they made significant changes to the original requirements for deliverables. We also determined whether management appropriately priced the changes and performed market research and price and cost analyses for non-administrative contract modifications.

Further, [REDACTED] the [REDACTED] Convergys' [REDACTED] and Postal Service Law Department officials and reviewed the appropriate Postal Service policies and procedures used in managing the Convergys contract.

We conducted this performance audit from August 2008 through April 2009 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 November 19, 2008, and included their comments where appropriate. We did not rely on computer-generated data to support our audit findings.

### **PRIOR AUDIT COVERAGE**

We did not identify any prior audits or reviews related to the objective of this audit.

**APPENDIX B: CALCULATION OF NON-MONETARY IMPACT**

<b>Number of Obligations</b>	<b>Description</b>	<b>CLIN Obligation Amount</b>
	<b>International Task Force</b>	
	Modification (MOD) 50	\$150,000
	Mod 53	1,600,000
	Mod 58	2,500,000
	Mod 68	4,200,000
	Mod 74	3,600,000
<b>5</b>	<b>Total Obligations – International Task Force</b>	<b>\$12,050,000</b>
	<b>Kahala Project Initiative</b>	
	Mod 39	\$266,140
	Mod 50	91,000
	Mod 53	300,000
<b>3</b>	<b>Total Obligations – Kahala Project Initiative</b>	<b>\$657,140</b>
<b>8</b>	<b>Total Obligations ITF and Kahala</b>	<b>\$12,707,140</b>
<b>1</b>	A \$2.5 million Fiscal Year (FY) 2004 equitable adjustment payout - Mod 31	<b>2,500,000</b>
<b>9</b>	<b>Total Disbursements at Risk</b>	<b>\$15,207,140</b>



## APPENDIX C: MANAGEMENT'S COMMENTS

SUSAN M. BROWNELL  
VICE PRESIDENT, SUPPLY MANAGEMENT



April 2, 2009

LUCINE M. WILLIS

SUBJECT: Draft Audit Report –Management of Contract Changes: Convergys Government Solutions, LLC (Report Number CA-AR-09-DRAFT)

Thank you for the opportunity to review and comment on the subject audit report. Management agrees with Recommendations 2 and 3 of the audit report, and partially agrees with Recommendation 1 regarding performing price and/or cost analyses for future contract modifications. However, we only believe \$2.5 million of the \$15,207,140 should be reported as non-monetary impact in the *Semiannual Report to Congress*. The following addresses our complete response.

**Non-Monetary Impact:** In part, the OIG identified \$2.5 million of non-monetary impact, disbursements at risk. This finding is based on the fact that the supplier's request for equitable adjustment and the Postal Service's disposition of the request are not adequately supported. As stated in the report, the contracting officer was able to provide evidence of the partial claim, price analysis, and consultation with USPS contract attorneys. What could not be located in the contract file are the initial claim request from the supplier, the Postal Service's original counter claim, and a more detailed legal review. Therefore, we agree that the equitable adjustment was not fully documented in accordance with Postal Service policies and procedures.

With respect to the remaining \$12.7 million identified as non-monetary impact, disbursements at risk, we partially agree with the OIG's finding that "there is no evidence that management performed sufficient price and/or cost analyses for the two contract line items, International Task Force and Kahala Project Initiative." Various documents were provided to the OIG to support that the proposals were reviewed by the purchase team and negotiated properly consistent with established practice. Historical prices were used to support the price analysis, but, more importantly, cost realism was used to ensure the proposed hours fairly represented the costs likely to be incurred for the proposed services.

When the hourly labor rate is fixed and has been previously determined to be reasonable through competition, cost realism analysis is more important to a price reasonableness determination than cost and price analysis. Cost realism analysis is performed to determine whether the supplier's cost estimates accurately reflect the probable costs of performance (i.e., it attempts to answer such questions as whether the labor hours are in line with the work to be accomplished, considering such factors as precision, quality, complexity, risk, delivery schedule, etc.). This was the circumstance applicable to the International Task Force and Kahala Project Initiative, and the contracting officer appropriately applied cost realism as the principal method of analysis in reaching a determination of price reasonableness. We do agree that the cost and price analysis documentation, which was needed to ensure the overall prices were reasonable, could have been better and needs improvement. We found, however, that all of the available documentation taken as a whole supported the [REDACTED] pricing decision. Therefore, we believe the \$12.7 million was not at risk and request that this amount not be reported as non-monetary impact in the *Semiannual Report to Congress*.

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The OIG requested that the Vice President, Supply Management take steps to ensure the contracting officer implements the following recommendations:

Recommendation 1: Performs price and/or costs analyses for future contract modifications and any rough order of magnitude proposal submitted by the contractor and documents those analyses in the contract file.

Management Response: Management partially agrees with the finding and recommendation. The overall conclusion of this audit suggests management did not perform sufficient price and/or cost analysis for two contract line items, inappropriately used rough order of magnitude estimates to develop negotiation positions, and did not provide adequate support for an equitable adjustment to the contract.

We acknowledge the contract file documentation needs improvement. However, it is important to note that most of the documentation was located (emails and CD files), provided to the OIG, and incorporated into the contract file. We do not agree the Postal Service may have incurred unnecessary costs, and, as indicated above, the [REDACTED] applied an appropriate analytic model (cost realism) to determine price reasonableness.

While audits of supplier rough order of magnitude cost estimates are generally found by the OIG to be not well supported and often may be significantly reduced in price, the OIG audit team observed that the rough orders of magnitude provided by the supplier, were more complete and viewed them overall as equivalent in detail and precision to a proposal. We believe this is a misuse of terminology by the supplier and will inform them to use the correct terminology when submitting proposals in the future.

Therefore, we plan to correct identified documentation deficiencies through improved processes and tighter controls for determining price reasonableness. The [REDACTED] will review the current process and refine it to include forms and/or documentation to be used in future contract modifications. Targeted completion is June 2009.

Recommendation 2: Properly receives, analyzes, and documents contractor claims and related equitable adjustments in the contract file.

Management Response: Management agrees with the finding and recommendation. Future requests for equitable adjustment and claims will be processed in accordance with Postal Service policies and procedures. Given our commitment, Supply Management requests that this recommendation be closed.

Recommendation 3: Incorporates into the contract file recently uncovered evidence of partial claim and pricing analyses and consultation with the Postal Service Law Department.

Management Response: Management agrees with the finding and recommendation. These documents were incorporated into the contract file when they were located in January 2009. Therefore, Supply Management requests that this recommendation be closed.

We do not believe that this report contains any proprietary or business information and may be disclosed pursuant to the Freedom of Information Act. If you have any questions about this response, please contact Susan Witt at (202) 268-4833.



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