



January 7, 2010

PAULA S. GARNER
SUPPLIES PORTFOLIO MANAGER

SUBJECT: Audit Report – Supplier Risk Mitigation in the Supplies Portfolio
(Report Number CA-AR-10-003)

This report presents the results of our audit of Supplier Risk Mitigation in the Supplies Portfolio¹ (Project Number 09YG014CA000). This was a self-initiated audit to assess U.S. Postal Service Supplies Portfolio actions to identify and mitigate risk for commodities with a limited supplier base. The audit addresses Postal Service operational risk. See [Appendix A](#) for additional information about this audit.

Conclusion

For the two Category Management Centers (CMC) identified as having a limited supplier base risk, we determined that CMC personnel can be more proactive in identifying and mitigating potential risks. Specifically, the audit found that Commodity Strategy Sourcing Plans (CSSP) were not supported with documentation or detailed analysis, CMC personnel did not identify limited supplier base as a risk for Information Technology (IT) mainframes, and CMC personnel did not conduct analyses of suppliers' financial health.

Sourcing Plans Were Not Supported With Detailed Written Analysis

Supply Management officials could not provide supporting documentation or detailed written analysis to support CSSPs beyond the minimal detail provided in CSSP snapshots and related briefing documents. Management did not maintain documentation and analysis due to time constraints and the general belief that documentation was not necessary. Postal Service guidelines state that the snapshot report should be a synopsis of the CSSP and summarize the results of the individual parts of the CSSP.² The CSSP template requires a description of the commodity and its history; identification of the suppliers' capabilities; and identification of market factors including existing market conditions, competition, and alternatives. Because no supporting documentation or detailed analysis is maintained to support the CSSP and

¹ The Supplies Portfolio includes the Information Technology (IT), Vehicles, and Delivery, Industrial Equipment, and Telecommunications Category Management Centers (CMC).

² *Supplying Principles and Practices* issued May 1, 2006, and updated through July 28, 2009.

the snapshots, the Postal Service has no assurance that the CSSP and the snapshots are based on adequate commodity analysis, or that all potential commodity and supplier risks were analyzed and mitigated. See [Appendix B](#) for our detailed analysis of this topic.

We recommend the Supplies Portfolio manager require all Supplies Category Management Center managers to:

1. Ensure that each category management center prepares and maintains full Commodity Strategy Sourcing Plans, supported by written analysis of risk identification and mitigation efforts.

Limited Supplier Base Risk Not Identified and Mitigated

The CSSP snapshot information provided does not identify a limited supplier base as a risk for the Postal Service's sole supplier of mainframes. A limited supplier base is not identified as a risk because the IT CMC manager believes the supplier is financially sound and the agency could rapidly fill their position in the market should they leave. In addition, discussions with CMC personnel indicate that a potential risk mitigation strategy might involve increasing the use of open source code on mid-range computers, but that strategy has not been fully developed and documented. Postal Service guidelines state that an effective commodity strategy provides for the elimination of unidentified risks and proactive risk management.³ Risks that may not be easily eliminated or mitigated should be recognized and addressed when a key commodity has a limited supplier base. Although alternative solutions may be available, potential supply disruptions from unidentified risks could negatively impact Postal Service operations.

The Postal Service has recently had to respond to supply chain disruption in one of its limited supply base commodities. The supplier of the Postal Service's long-life vehicle frames suddenly decided to exit the market. This required the Postal Service to purchase the supplier's existing inventory and find other sourcing options. While the Postal Service projects to have enough inventory to carry it through solicitation and implementation of a new contract, the need to purchase the existing inventory and rapidly develop and compete a solicitation was not without significant impact.

The Postal Service should not limit risk mitigation strategies to identifying potential additional suppliers, but could include inventory management to minimize the impact of unforeseen supply disruption. See [Appendix B](#) for our detailed analysis of this topic.

³ *Supplying Principles and Practices* issued May 1, 2006, and updated through July 28, 2009.

We recommend the Supplies Portfolio manager instruct the Information Technology Category Management Center manager to:

2. Reassess the risks associated with having a limited supplier base for Information Technology mainframes and establish and document risk mitigation strategies to address those risks.

Key Suppliers' Financial Health Risk Not Analyzed

Supply Management officials did not obtain and analyze suppliers' financial statements, or document other analyses of supplier financial health. The CMC managers stated that suppliers were financially sound and they did not believe ongoing financial statement analysis was warranted. As a result, the Postal Service supply chain could be vulnerable to an unexpected exit or sudden change in the business of their suppliers due to a change in suppliers' financial status. Postal Service guidelines states that management should conduct analyses of supplier capability before awarding a contract to determine the supplier's performance ability throughout the life of the contract. In addition, a financial capability analysis aids in determining a supplier's ability to remain financially solvent and protects the Postal Service from poor contract performance and risks.⁴ This type of analysis is important for commodities with a limited supplier base, particularly in the current economic environment. See [Appendix B](#) for our detailed analysis of this topic.

We recommend the Supplies Portfolio manager require all Supplies Category Management Center managers to:

3. Establish and implement a methodology to routinely analyze, document, and monitor the financial health of key suppliers.

Best Practices in Private Industry Study Results

As a part of our audit, we evaluated best practices on managing risk in supply management. We focused on those practices by best in class organizations. We found that best in class organizations approach supply chain risk management from the perspective of engaging in a disciplined set of steps to manage risk as a whole is the key to being successful at it. These steps include:

- Determining critical suppliers using segmentation.
- Analyzing the suppliers' marketplace and assessing individual suppliers.
- Defining risk performance metrics and reporting.
- Deploying risk mitigation strategies.

⁴ *Supplying Principles and Practices* (SP&Ps) issued May 1, 2006, and updated through July 28, 2009.

In general, we found that Supply Management policies and guidelines embrace these concepts.

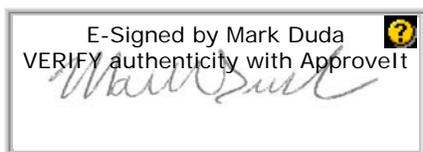
Management's Comments

Management generally agreed with the intent of the findings and recommendations. Although management indicated there was a fundamental difference of opinion as to the amount of documentation needed for the CSSPs, they plan to enhance the use of the CSSP through an ongoing strategic initiative that includes the development of a risk mitigation worksheet. This strategic enhancement has a target implementation date of May 2010. Management also stated they are in the process of further analyzing their IT mainframe limited supplier base risk and mitigation strategies and will provide documentation regarding those strategies by March 2010. To ensure that contracting officers are aware of the need to monitor supplier financial health, management intends to forward our final report to contracting officers — emphasizing this need — by February 2010. See [Appendix C](#) for management's comments in their entirety.

Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to the recommendations and management's corrective actions should resolve the issues identified in the report. We continue to find documentation of risk identification and mitigation strategies to be critical for commodities with a limited supplier base, and encourage current strategic streamlining efforts to look towards making such documentation more efficient, rather than discontinuing documentation of key risk identification and mitigation strategies.

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.



Mark W. Duda
Deputy Assistant Inspector General
for Support Operations

Attachments

cc: Joseph Corbett
Susan Brownell
Susan Witt
Sally K. Haring

APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

Supply Management works proactively with internal and external Postal Service business partners to deliver best value solutions that are timely, cost effective, and operationally efficient to integrate supply chains. These efforts include combining strategic and tactical buying, supplying processes, and managing customer and supplier relations so they further the business and competitive needs of the Postal Service. Within Supply Management, the Supplies Portfolio meets Postal Service needs for IT, vehicles, delivery and industrial equipment, and telecommunications through CMCs.

The CMCs develop the CSSP. The purpose of developing CSSP is to ensure the Supply Management organizations responsible for purchasing commodities use a systematic process for developing strategies to achieve supply chain management goals that fully support corporate, Supply Management, and cross-functional business objectives. It is a set of analyses that, together, support and determine the commodity strategy, providing a basis of support for Postal Service purchasing of specific products or services. The intended content of the CSSP includes stakeholder analysis, pricing analysis; market research; the Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis; and commodity strategy development. The CSSP also includes the Commodity Sourcing Quadrant Analysis.⁵

Each year selected CMCs present the CSSP snapshot to the Postal Service Supply Management Leadership Team⁶ to obtain concurrence with the commodity strategy. The snapshot is a high-level synopsis of the CSSP and summarizes the results of its individual parts.⁷

⁵ A tool developed by the Postal Service Supply Chain Management Strategies. It provides a list of questions that serve as the criteria for evaluating each commodity. Based on user input, the tool performs a weighted calculation to determine the overall relative value and risk of each commodity and graphs the results on a graduated chart.

⁶ The Supply Management Leadership Team includes the vice president of Supply Management, Portfolio managers, and managers from supply management-enabling organizations.

⁷ *Supplying Principles and Practices* issued May 1, 2006, and updated through July 28, 2009.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to assess Postal Service Supplies Portfolio actions to identify and mitigate risk for commodities with a limited supplier base and analyze best practices and benchmark supplier risk mitigation approaches for potential use by the Postal Service. To accomplish our objectives, we interviewed the Supplies Portfolio manager and the IT and Vehicles CMC managers and staff to discuss current risk mitigation strategies for commodities with limited supplier base risk.⁸ We reviewed CSSP snapshots to identify commodities with a limited supplier base, individual purchase plans, decision analysis reports, contracts and contract modifications, and national ordering agreements and modifications. We interviewed contracting officers and market analysts regarding market research, limited supplier base determination, commodity price and cost analyses, and determinations of supplier financial stability. Furthermore, we reviewed the SP&P sections relevant to our audit objectives and contracted for a benchmarking and best practices analysis regarding supplier risk mitigation.

We conducted this performance audit from February 2009 through January 2010 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our observations and conclusions with management officials on October 21, 2009, and included their comments where appropriate.

PRIOR AUDIT COVERAGE

We identified one OIG report issued within the past 5 years related to this subject. The audit, *Commodity Sourcing Activities within the Automation Category Management Center* (Report Number CA-MA-07-005, dated August 2, 2007) concluded that the Postal Service addressed the small supplier base through the CSSP, acquisition strategy and strategic partnerships with key suppliers, semiannual meetings, and contract protection clauses. The report did not identify any monetary impacts. The OIG recommended other sourcing efforts such as leader company contracting to increase the supplier base and implementation of protection clauses for Postal Service technology rights should the Postal Service debar or suspend a supplier. Management agreed with the findings and recommendations.

⁸ Relying on only one or two suppliers for the commodity.

APPENDIX B: DETAILED ANALYSIS

Sourcing Plans Were Not Supported With Detailed Written Analysis

We found that managers could not provide full CSSPs and did not maintain supporting documentation or detailed written analysis to support the CSSP snapshots in the Supplies Portfolio for commodities CMCs identified as having a limited supplier base. The IT CMC manager could not provide a reason why there was no full CSSP documentation and provided briefing documents that offered key information, but not full analysis. The Vehicles CMC manager confirmed there was no additional information and noted that he and his staff had detailed working knowledge of their commodity strategy, diminishing the need to document the analysis supporting the snapshot, a one-page document. In addition, the Vehicles CMC analyst staff stated they did not have time to complete a detailed written analysis due to time spent on the Green Initiative and other priorities.

The CSSP template requires descriptions of the commodity and its history, identification of suppliers' capabilities, and identification of the market factors including existing market conditions, competition, and alternatives. In addition, management should identify industry and market trends that are driving the market and document all relevant information resulting from the benchmarking study. Furthermore, the plan should include details on supplier involvement in the product design and supplier development plan, if applicable. Without maintaining a full CSSP or supporting documentation or detailed information behind the CSSP snapshots, the Postal Service has no assurance that it is based on adequate commodity analysis, or that all potential commodity and supplier risks were analyzed and mitigated.

Supply Management recognizes the need for a robust and well-supported commodity strategic sourcing approach in the SP&P and in their guidance for commodity strategic sourcing plans. Efforts are underway in Supply Chain Management Strategies to strengthen commodity strategic sourcing activities. Those efforts include developing a risk analysis model to incorporate into the CSSP or implement as a separate document. Competing priorities have delayed the development of this risk model and a draft had not yet been provided at the time of our audit.

We interviewed CMC staff and reviewed the contract files for the supplier for the mainframe computers in the IT CMC and the supplier for vehicle parts in the Vehicles CMCs to determine how limited supplier base risk is identified and mitigated. While CMC officials were knowledgeable of the information regarding their respective commodities and the snapshot, this knowledge of commodity risk was not documented in the CSSPs. Supply Management officials explained that there was no additional information except for the CSSP snapshot, but risk identification and mitigation would be found in each contract file. Within the contract files, the individual purchase plans for both suppliers reviewed identified the technical, cost, and schedule risks, but did not

address the limited supplier base risk. However, we found no further documentation of risk identification and mitigation in the contract file.

Limited Supplier Base Risk Not Identified and Mitigated

The CSSP snapshots provided for IT hardware do not reflect the limited supplier base risk for the Postal Service's sole supplier of mainframes. The IT CMC manager stated that while the supplier is the only manufacturer of mainframes, he believed they would not likely go out of business based on their financial strength. He further stated that, if they did have financial trouble, a buyer would likely purchase the company and the Postal Service would continue business with the new company. In addition, conversations with the IT CMC manager and his staff indicated that the risk might be mitigated through the use of open source code on mid-range computers; however, that mitigation plan was not fully developed and documented.

The SP&P general practices state that an effective commodity strategy, based on the CSSP and synopsis in the CSSP snapshot report, provides for the elimination of unidentified risks and proactive risk management. Although alternative solutions may be available, potential supply disruptions from unidentified risks could negatively affect Postal Service operations as officials act reactively rather than proactively to supply disruptions. In addition, management should recognize and address any risk that may not be easily eliminated or mitigated when a key commodity has a limited supplier base.

We reviewed the CSSP snapshots for IT hardware and noted that the threats identified in the SWOT analysis did not identify limited supplier base risk. Although mainframes were rated as high risk for commodity sourcing, officials stated that a limited supplier base risk was not listed because they do not perceive that as a risk for mainframes. Although they did not identify the risk, officials stated they have strategies in place such as the IT department's disaster recovery continuity plan, use of marketing contractor (The Gartner Group⁹), and moving to an open source environment with Linux.¹⁰ However, with 88 critical applications residing on mainframes, including payroll and the product tracking system, the CMC should identify limited supplier base risk and determine what mitigation practices, if any, should be included in the CSSP. Risk mitigation strategies for limited supplier base need not be limited to finding new suppliers. Documenting a supply chain disruption plan can include documenting the current inventory management strategy and the potential platform migration strategy.

⁹ The Postal Service uses the research report, which provides information on a company's strategies and organization; and the vendor report that provides a Gartner rating based on research, information on the company's marketing, market offerings, and financial information.

¹⁰ Linux is an operating system that facilitates the transfer of applications between servers or mainframes more easily.

Key Suppliers' Financial Health Risk Not Analyzed

Supply Management officials did not obtain or analyze suppliers' financial statements. CMC managers stated that suppliers were financially sound and they did not believe ongoing financial statement analysis was warranted. The SP&P states that analysis of supplier capability is conducted before contract award to determine the supplier's performance ability throughout the life of the contract. A financial capability analysis aids in determining the supplier's ability to remain financially solvent and protects the Postal Service from poor contract performance and risks. As a result, the Postal Service supply chain could be vulnerable to an unexpected exit or sudden change in the business of their suppliers due to a change in the supplier's financial status.

The contract files relevant to both the vehicles and IT commodities did not contain a financial analysis for the suppliers reviewed. The IT CMC did obtain a marketing report from the Gartner Group, which noted the company's revenue and net income trends, but did not contain a financial analysis. In addition, the Vehicles CMC manager stated the CMC obtained and analyzed Equifax reports, which identify a company's credit status. Any financial concerns were reviewed with the company during quarterly meetings. Although the vehicle parts supplier's National Ordering Agreement file contained an Equifax report dated June 15, 2009, there was no record of previous Equifax reports or records of previous discussions held with the suppliers. In addition, the Equifax report for the supplier in question showed a high-risk credit score.

Best Practices in Private Industry Study Results

We contracted with a firm to provide a report on managing risk in supply management by best-in-class organizations. To accomplish this task, the firm performed interviews at 10 private sector companies, literature research, and benchmarking, and interviewed company experts in the field of supply chain management. Their research suggested the following best practices:

- Develop a holistic approach to supply chain risk management to better understand the vulnerabilities within the supply chain.
- Align procurement staff strategically so that more procurement and sourcing staff are dedicated to value-added activities (e.g., spend analysis, supplier evaluation, ongoing supplier performance management) and fewer to transactional functions (e.g., requisitioning and order processing).
- Develop processes that drive risk, allowing the supply manager to be more proactive rather than simply reacting to specific events.
- Foster trust and collaboration with suppliers.

- Employ a multifunctional supply risk management team to lead efforts in identifying major risks, creating risk mitigation strategies, and developing tactical action plans when disruptions actually occur.
- Foster communication of risk management efforts so employees understand key principles and goals of risk management.
- Foster collaboration with key supply chain partners by proactively sharing information.
- Conduct market segmentation to identify suppliers most critical to strategy, operations, and reputation.
- Align the investment in risk management in those suppliers and supply markets that pose a risk to the strategic mission of the enterprise.
- Understand the supplier marketplace as well as the individual supplier.
- Combine financial data with qualitative information in order to obtain an accurate risk profile.
- Conduct a market analysis of each key supply market and, where appropriate, financial analysis of suppliers.
- Develop a robust and risk-based supplier framework that leverages self-reporting, financial and operational data collection, industry information, and on-site supplier reviews.
- Design supplier relationship management programs and reporting systems in a manner that encourages collaboration with suppliers both to manage risks and to encourage innovation and teamwork.
- Define metrics for monitoring risk that go beyond the traditional metrics for measuring contract compliance. These include metrics on quality, financial condition of supplier, technology leadership, price competitiveness, and location risk exposure.
- Conduct enhanced monitoring for those suppliers identified as being outside the risk limits.
- Foster supplier development and support programs for critical suppliers.
- Analyze supplier health over a period of time and compare it to industry averages.

- Develop a business continuity plan that included the sourcing of goods from alternative suppliers.

We provided the full contractor report to Supply Management for consideration as they look to further improve and strengthen their supply chain risk mitigation strategies.

APPENDIX C: MANAGEMENT'S COMMENTS



December 30, 2009

LUCINE WILLIS

SUBJECT: Draft Audit Report – Supplier Risk Mitigation in the Supplies Portfolio
(Report Number CA-AR-10-DRAFT)

Thank you for the opportunity to review and comment on the subject draft audit report. We have reviewed the report and generally agree with the intent of the findings and recommendations. However, it seems that there is a fundamental difference of opinion as to the amount of documentation required by Supply Management for our Commodity Strategy Sourcing Plans (CSSP's) and the amount of documentation that the Office of Inspector General (OIG) desires. The following is our response to the recommendations contained in the report.

Recommendations and Response:

We recommend the Supplies Portfolio manager require all Supplies Category Management Center (CMC) managers to:

Recommendation 1: Ensure that each CMC prepares and maintains full CSSP's, supported by written analysis of risk identification and mitigation efforts.

Response: While we agree with the intent of this recommendation, there is a fundamental difference of opinion as to the amount of written documentation required for the CSSP's. When Supply Management initiated the use of the CSSP's in 2002, we were requesting fully developed written plans which soon became extremely burdensome on our resources. In order to find a balance between the need for the CSSP's and lessening our resource burden, a strategic initiative was established to develop the CSSP snapshots and their accompanying worksheets. Effective in 2005, these snapshots and worksheets replaced the written plans. The CMCs within the Supplies Portfolio provided these snapshots and worksheets to the OIG during the audit process, but they seemed to have not met their expectations for documented written analysis, thus, our difference of opinion. As we continue to improve our organization, the CSSP's will evolve. Our future Strategic Plan includes a strategic initiative to enhance the CSSP's, with the development of a risk mitigation worksheet. This strategic initiative enhancement of the CSSP's has a target implementation date of May 2010.

Recommendation 2: Reassess the risks associated with having a limited supplier base for Information Technology mainframes and establish and document risk mitigation strategies to address those risks.

Response: Management agrees with the intent of this recommendation. The Information Technology Category Management Center (IT CMC) has identified within the CSSP under the Commodity Sourcing Quadrant Analysis that the Mainframe supplier is within the Strategic quadrant which indicates a high value business need and high risk impact. This was determined by the using the Quadrant Analysis Worksheet included in the CSSP documentation along with the IT CMC's knowledge of our business need, the market, and the supplier. Information

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Technology organization and IT CMC have been working together to determine alternatives and contingencies to ensure continued operations. One strategy noted within the CSSP snapshot is to build an open source environment. While there may be limited documentation for the OIG to determine if it is being addressed, there is research being completed and discussions being held within the organizations to support this strategy. For the purpose of addressing this recommendation, we will provide information regarding the open source environment strategy with potential implementation milestones. Target date for providing this document is March 2010.

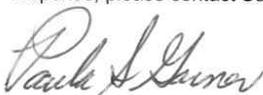
Recommendation 3: Establish and implement a methodology to routinely analyze, document, and monitor the financial health of key suppliers.

Response: Again, Management agrees with the intent of this recommendation, however, financials are only a part of a supplier's health. Supply Management has various methods of attempting to analyze and monitor the health of our key suppliers.

The CSSP concept was developed to assist with updating our market intelligence for anything we source and to look for opportunities and identify risk. Also, we use industry reports to collect, evaluate and monitor information about suppliers and their standing within the marketplace. These industry reports include elements of financial health along with many other indicators to determine an overall health of companies within the market. Along with these reports, we have supplier meetings and reviews where financial issues and performance are discussed. We have also begun institutionalizing Supply Chain Relationship Management System (SCRMS), a holistic approach towards managing and improving the relationship between Supply Management, its internal business partners, and their suppliers in order to improve performance overall. And, finally our guidance provides for financial analysis to be performed under supplier capability prior to award of a contract. Specifically, implementing a methodology to standardize the need to routinely analyze, document, and monitor the financial health of a key supplier throughout contract administration may be of value in some instances, but we believe this concept is already melded into our guidance and the logic behind the CSSP's, market intelligence, and our supplier relationship methodology.

However, in order to ensure that Contracting Officers are aware of the need to analyze supplier financials as a part of supplier capability prior to award and consider re-evaluating financial health during contract administration, Supply Management Infrastructure will cascade the final audit report within 30 days of receipt and emphasize this need. Target implementation is February 2010.

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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cc: Joseph Corbett
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