



May 27, 2010

SUSAN M. BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT

SUBJECT: Audit Report – Contract Payment Terms (Report Number CA-AR-10-004)

This report presents the results of our audit of contract payment terms (Project Number 09YG003CA003). Our objective was to determine if the U.S. Postal Service received consideration when contract payment terms were less than net 30 days. The report was self-initiated to address financial risks associated with the contracting process.

The Prompt Payment Act (PPA) requires the Postal Service and federal agencies to make payment on a proper invoice no later than 30 days after receipt of the invoice. The PPA does not prohibit entering into contracts with payment terms of less than 30 days. However, it strongly discourages this practice unless the supplier provides consideration, such as an early payment discount in return for a shortened payment period. When the Postal Service pays invoices earlier than 30 days after receipt, it incurs an opportunity cost¹ associated with the amount of the payment for the days paid early. Therefore, it is important that the Postal Service ensure that the supplier provides equitable consideration before agreeing to payment terms of less than net 30 days. See [Appendix A](#) for additional information about this audit.

Conclusion

In some cases, the Postal Service agreed to contract payment terms less than the standard of net 30 days and did not receive an early payment discount² or some other type of consideration in return. Consequently, the Postal Service incurred an opportunity cost of \$19.3 million³.

¹ The opportunity cost represents the assumption that the Postal Service could use the temporarily available cash to pay down long-term debt and decrease the amount of its interest expense.

² An example of an early payment discount would be payment terms of "2/10, net 30", which indicates that a 2 percent discount can be taken by the Postal Service only if the invoice is paid within 10 days and that full payment is expected in 30 days.

³ After the issuance of the draft audit report, we discussed the classification of monetary impact with Postal Service personnel and changed the classification of monetary impact from unrecoverable revenue loss to unrecoverable unsupported questioned costs to more accurately reflect that the cash held for a longer period of time could be used to pay down long-term debt.

Contracts with Payment Terms of Less Than Net 30 Days

The Postal Service did not receive consideration for 10 of the 14 contracts we reviewed⁴. For those 10 contracts with contract values totaling nearly \$9 billion, the contract files did not include supporting documentation showing the Postal Service received something in exchange for payment terms of less than net 30 days. In addition, Postal Service personnel did not calculate the costs associated with the shorter payment terms.

Consequently, because Postal Service officials agreed to payment terms of less than net 30 days without receiving an early payment discount or some other type of consideration in return, the Postal Service incurred an opportunity cost of \$19.3 million. See [Appendix B](#) for our detailed analysis of this topic.

Postal Service officials gave the following reasons for agreeing to payment terms of less than net 30 days:

- They did not negotiate specific line items on the contracts — such as payment terms — separately.
- Payment terms were acceptable given the overall service and value of the contracts.
- Shorter payment terms were industry standards.
- Shorter payment terms were necessary to comply with Electronic Data Interchange (EDI) billing requirements.

Because the Postal Service did not calculate the cost associated with shorter payment terms, it was not possible to determine if the overall service and value of the contracts compensated for the shorter payment terms. In addition, the Postal Service did not provide documentation to support that shorter payment terms were industry standards. Further, EDI billing automates the bill payment processes but it should not dictate the payment terms of a contract. One of the main benefits of EDI billing is that it facilitates a more precise on-time payment structure. This ensures that payments are made as close as possible to the payment due date, allowing for payment terms of net 30 days.

We recommend the vice president, Supply Management:

1. Revise the Postal Service's *Supplying Principles and Practices*, Section 5-12.2, Payment Time Frame, and other sections as necessary, with language stating that when contracting officers negotiate payment terms other than net 30 days they

⁴ The 14 contracts had payment terms of less than net 30 days and contract values totaling approximately \$9.3 billion.

include the business rationale and associated documentation for the payment terms in the contract file.

Management's Comments

Management agreed with the recommendation. However, management disagreed with the finding and monetary impact. Management stated the report focused only on costs associated with shorter payment terms when the Postal Service received value in other ways during negotiations for the contracts reviewed. See [Appendix E](#) 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 recommendation, as management's corrective action should resolve the issue identified in the report.

However, management disagreed with our finding and monetary impact of \$12,189,632. We believe the monetary impact represents an opportunity cost to the Postal Service. Management's response indicated that the Postal Service received value in other ways during contract negotiations. However, there was no evidence in the contract files to support the assertion that projected costs associated with payment terms of less than the standard of net 30 days were part of the negotiations and that the Postal Service received something of value in exchange for agreeing to shorter payment terms.

The OIG considers the recommendation significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective action is completed. The recommendation should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendation can be closed.

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

E-Signed by Mark Duda 
VERIFY authenticity with ApproveIt


Mark W. Duda
Deputy Assistant Inspector General
for Support Operations

Attachments

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

APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

The PPA requires the Postal Service and federal agencies to make payment on a proper invoice no later than 30 days after receipt of the invoice. The PPA does not prohibit the Postal Service and federal agencies from entering into contracts with payment terms of less than 30 days. However, it strongly discourages this practice unless the supplier provides consideration, such as an early payment discount in return for a shortened payment period. In addition, the PPA stipulates that even if the supplier offers an early payment discount or some other type of consideration, the Postal Service or federal agency should carefully weigh the economic benefit before agreeing to the early payment terms.

Also, on October 8, 2009, the Center for Advanced Procurement and Supply (CAPS) Research released a survey they conducted on payment terms. Specifically, they asked a total of 150 companies from 15 different industry sectors what their typical payment terms were. They also asked if companies receive a discount for paying early. Sixty-six companies responded to the survey and 65 of the companies (or 98.5 percent) said their typical payment terms were net 30 days or more. In addition, 59 of the companies (or 89.4 percent) said they receive discounts for paying early.

As of March 10, 2010, the Postal Service's Enterprise Data Warehouse (EDW) showed 17,170 open contracts. Of these contracts, 1,930 contracts (or 11.2 percent) had payment terms of less than net 30 days and did not include an early payment discount in return for the shortened payment period.⁵ Only 234 of the 17,170 open contracts (or 1.4 percent) had payment terms offering an early payment discount.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to determine if the Postal Service received consideration when contract payment terms were less than net 30 days.

To accomplish our objective we reviewed:

- The requirements of the PPA and applicable sections of the Code of Federal Regulations.
- The Postal Service's Management Instruction Number FM-610-2000-2, *Compliance with the Prompt Payment Act*, and the Postal Service's *Supplying Principles and Practices*.

⁵ Although the Postal Service did not receive an early payment discount, it may have received some other type of consideration. For example, the Postal Service could have negotiated a lower contract price in exchange for reducing the payment terms.

- The results of a survey CAPS Research conducted on standard payment terms.

We used the Postal Service's EDW and identified 3,597 contracts⁶ with payment terms of less than net 30 days that did not include an early payment discount in return for the shortened payment period. The Postal Service either awarded these contracts with payment terms of less than net 30 days or agreed to contract modifications, which changed the payment terms to less than net 30 days. The payment terms for these contracts included terms of next day, net 5 days, net 7 days, net 10 days, net 14 days, net 15 days, net 20 days, and net 25 days. Of the 3,597 contracts, we selected all 14 contracts with a spend amount of \$10 million or more for review.

For the 14 contracts, we obtained contract information from the Contract Authoring Management System (CAMS) and distributed a questionnaire to contracting officers. The questionnaire assisted us in determining whether the Postal Service received consideration in exchange for agreeing to payment terms of less than net 30 days.

We conducted this performance audit from December 2009 through May 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 finding and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective. We discussed our observations and conclusions with management officials on April 6, 2010, and included their comments where appropriate. We relied on data obtained from the Postal Service's EDW and CAMS. We did not test the validity of controls over the systems. However, we obtained documentation that validated the data we relied on.

PRIOR AUDIT COVERAGE

The OIG issued *Universal Computing Connectivity Contract* (Report Number CA-AR-06-003) on September 1, 2006. The audit determined the Postal Service incurred increased costs of \$67,360 because Postal Service personnel agreed to a contract modification, which changed the payment terms of the contract from net 30 days to net 15 days. The OIG made no recommendations because the Postal Service partially terminated the contract prior to issuance of the report.

⁶ This represents open contracts as of December 15, 2009, and contracts closed after October 1, 2007. We excluded the Postal Service's Universal Computing Connectivity contract with Lockheed Martin because we previously reviewed the contract payment terms.

APPENDIX B: DETAILED ANALYSIS

Contracts with Payment Terms of Less Than Net 30 Days

The PPA encourages the Postal Service to weigh the economic benefit before agreeing to payment terms of less than net 30 days. In addition, CAPS Research indicates that payment terms in the private sector are generally net 30 days or longer.

The table below displays the 14 contracts we reviewed. The Postal Service did not receive consideration in exchange for agreeing to payment terms of less than net 30 days for 10 of these contracts. See [Appendix C](#) for the opportunity cost calculations for the 10 contracts.

Supplier Name	Contract Number	Contract Value	Payment Terms	Consideration Received
American Bank Note	2BRPSR-08-B-0015	\$54,100,000	Contract Modified – Net 15 Days	Yes ⁷
MDI Government Services	3CMTEQ-06-B-0004	17,405,567	Contract Modified – Net 10 Days Modified to Net 20 Days	Yes
MDI Commercial Services Inc.	3CMTEQ-06-B-0002	14,799,776	Contract Modified – Net 20 Days	Yes
Manpower International Inc.	102592-02-B-1200	177,587,751	Contract Modified – Net 5 Days	n/a ⁸
Federal Express Corporation	FXNET-2006-01	8,002,150,000	Contract Awarded – Net 10 Days	No
UPS Worldwide Forwarding Inc.	UPSNET-2006-01	505,321,152	Contract Awarded – Net 14 Days	No
DaimlerChrysler Motors Company LLC	1DVPLE-05-B-3018	60,501,660	Contract Awarded – Net 15 Days	No
Constellation New Energy Inc.	1AUTIL-05-B-3004	50,885,753	Contract Awarded – Net 10 Days Modified to Net 7 Days	No
Amerada Hess Corp.	1AUTIL-05-B-3008	21,439,941	Contract Awarded – Net 10 Days Modified to Net 7 Days	No

⁷ See [Appendix D](#) for an example of the Postal Service receiving consideration in exchange for agreeing to payment terms of less than 30 days.

⁸ After the life of the contract, the Postal Service changed the payment terms to net 5 days to expedite payment to the supplier for outstanding invoices. The Postal Service did not place any orders for services after changing the payment terms to net 5 days.

Supplier Name	Contract Number	Contract Value	Payment Terms	Consideration Received
Amerada Hess Corp.	1AUTIL-06-B-0003	21,529,816	Contract Awarded – Net 7 Days	No
Amerada Hess Corp.	1AUTIL-06-B-0016	12,633,497	Contract Awarded – Net 7 Days	No
SUEZ Energy Resources Inc.	1AUTIL-05-B-3009	24,109,539	Contract Awarded – Net 10 Days Modified to Net 7 Days	No
Marriott Hotel Services Inc.	479984-90-B-0399 & 2WNCED-08-B-0001 ⁹	239,130,233	Contract Awarded – Net 15 Days	No
Dolce International	2DPSCM-04-P-1337	55,000,000	Contract Awarded – Net 15 Days	No
Total		\$9,256,594,685		

[Federal Express Corporation and UPS Worldwide Forwarding Inc. Contracts](#)

Postal Service personnel said they agreed to payment terms of less than net 30 days because they felt payment terms were acceptable given the overall service and value of the contracts. However, because they did not calculate the cost associated with the shorter payment terms, it was not possible to determine if the overall service and value of the contracts compensated for the shorter payment terms. In addition, Postal Service personnel said they did not negotiate specific line items on the contracts, such as payment terms.

[DaimlerChrysler Motors Company LLC Contract](#)

There was no evidence in the contract file showing the Postal Service received something in exchange for shorter payment terms. The contract file showed that the Postal Service received a price reduction based on a volume discount.

[Constellation New Energy, Amerada Hess Corp., and SUEZ Energy Resources Inc. Contracts](#)

Postal Service personnel said they agreed to payment terms of less than net 30 days because, according to the contracting officer, EDI billing requires shorter payment terms and shorter payment terms were industry standards. However, EDI billing automates the bill payment processes but should not dictate the payment terms of a contract. One of the main benefits of EDI billing is that it facilitates a more precise on-time payment structure. This ensures that payments are made as close as possible to the payment

⁹ In October 2007, the Postal Service replaced the original contract number (479984-90-B-0399) with a new contract number (2WNCED-08-B-0001).

due date, allowing for payment terms of net 30 days. In addition, the Postal Service did not provide documentation to support that payment terms of net 7 days was the industry standard.

[Marriott Hotel Services Inc. and Dolce International Contracts](#)

Postal Service personnel said they agreed to payment terms of less than net 30 days because the shorter payment terms were industry standards. However, they did not provide documentation to support that shorter payment terms were industry standards.

APPENDIX C: MONETARY IMPACT

Supplier Name	Contract Number	Contract Value	Opportunity Cost	Opportunity Cost Beginning 4/1/2008 ¹⁰
Federal Express Corporation	FXNET-2006-01	\$8,002,150,000	\$17,505,177	\$11,285,684
UPS Worldwide Forwarding Inc.	UPSNET-2006-01	505,321,152	867,436	589,227
DaimlerChrysler Motors Company LLC	1DVPLE-05-B-3018	60,501,660	124,496	0
Constellation NewEnergy Inc	1AUTIL-05-B-3004	50,885,753	143,566	44,559
Amerada Hess Corp	1AUTIL-05-B-3008	21,439,941	57,249	31,370
Amerada Hess Corp.	1AUTIL-06-B-0003	21,529,816	59,686	24,215
Amerada Hess Corp.	1AUTIL-06-B-0016	12,633,497	35,417	13,060
SUEZ Energy Resources Inc.	1AUTIL-05-B-3009	24,109,539	64,486	32,619
Marriott Hotel Services Inc.	479984-90-B-0399 & 2WNCED-08-B-0001	239,130,233	338,311	117,040
Dolce International	2DPSCM-04-P-1337	55,000,000	92,350	51,858
Totals		\$8,992,701,591	\$19,288,174	\$12,189,632

¹⁰ The opportunity cost represents unrecoverable unsupported questioned costs. OIG internal policy limits reporting of these costs to a period of 2 years prior to the audit. Therefore, we are only claiming \$12.2 million of the total \$19.3 million as unrecoverable unsupported questioned costs. These are costs that are unnecessary, unreasonable, or an alleged violation of law or regulation. These costs are also not supported by adequate documentation.

APPENDIX D: AMERICAN BANK NOTE CONTRACT

Modification 7 of the American Bank Note contract provides a positive example where the Postal Service received consideration in exchange for agreeing to payment terms of less than net 30 days. See paragraph 4 below.

CONTINUATION SHEET		REQUISITION NO.		PAGE	OF	
CONTRACT/ORDER NO. 2BR.PSR-08-B-0015/007		AWARD/ EFFECTIVE DATE 07/01/2009	MASTER/AGENCY CONTRACT NO.	SOLICITATION NO.	2	2
ITEM NO.	SCHEDULE OF SUPPLIES/SERVICES	QUANTITY	UNIT	UNIT PRICE	AMOUNT	
	<p>3) In consideration for the base period extension and removal of the AMI paragraph, ABN will decrease contract costs \$50,000 a year for each year of the 2-year extension. Contract cost reductions will begin immediately with credits to monthly invoices. The calculation for monthly cost reductions as stated above is as follows:</p> <ul style="list-style-type: none"> - \$100,000 = total cost reduction for both extension years to 09/30/2012. - 39 = months remaining on extended base period through September 30, 2012 - \$100,000 / 39 months = \$2,564.10 in cost reductions per month <p>4) In consideration for modifying the payment terms from Net 30 to Net 15 payment terms, ABN will offer cost reductions of \$31,428 per year through September 30, 2012. Net 15 payment terms will remain in effect throughout the life of the contract.</p> <p>ABN will reduce the price of each monthly invoice by 1/12th of \$31,428 or \$2,619 per month. Total monthly contract price reductions will begin July 1, 2009.</p> <p>Total invoice reductions through September 30, 2012 as follows: 2,564.10 + 2,619 = \$5,183.10 in monthly reduced costs. Reductions will be taken as a credit on each monthly invoice issued from July 1, 2009 through September 30, 2012.</p> <p>5) Total reductions from July 1, 2009 through 9/30/2012 = \$202,141.00.</p> <p>Period of Performance: 11/01/2008 to 09/30/2012</p>					

APPENDIX E: MANAGEMENT'S COMMENTS

SUSAN M. BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT



May 14, 2010

LUCINE M. WILLIS

SUBJECT: Transmittal of Draft Audit Report – Contract Payment Terms
(Report Number CA-AR-10-DRAFT)

Thank you for the opportunity to review and comment on the subject draft report. The following is our full response to the audit report.

Management Response - General and Monetary Impact:

While we agree with the recommendation that our guidance specific to payment terms and their negotiations will be updated, the audit report focuses only on showing the costs associated with shorter payment terms when value was received in other ways during negotiations. Because of our inability to provide associated documentation specific to the various payment terms of less than 30 days, the assessment is that the Postal Service had \$12,189,632 as unrecoverable revenue loss – foregone interest. However, that assessment is narrowly focused and there is no mention of the overall valuable consideration that was achieved during negotiations that would offset costs associated with shorter payment terms. We want to express that these payment terms were negotiated and determined as reasonable for each of the specific contracts.

As an example, in the last column of the table on page 6 of the subject report, there is no mention of the total value of consideration that the Postal Service received from both Federal Express and United Parcel Service for acceptance of less than net 30 days among other concessions the Postal Service gave for good and valuable financial considerations. We would agree with your comment that the savings are not attributed to any specific concession (such as payment terms) by the Postal Service or the supplier, but showing the cumulative savings of [REDACTED] (FY2007-2009) that was achieved in our negotiations with Federal Express and [REDACTED] (FY2007-2009) resulting from our efforts with United Parcel Service provides more of a balance to the report and, as such, negates the foregone interest conclusion.

The OIG recommends the Vice President, Supply Management:

Recommendation 1: Revise the Postal Service's Supplying Principles and Practices, Section 5-12.2, Payment Time Frame, and other sections as necessary, with language stating that when contracting officers negotiate payment terms other than net 30 days, they include the business rationale and associated documentation for the payment terms in the contract file.

Management Response - Recommendation 1: Management agrees with this recommendation. Further clarification for contracting officers will be provided within the Supplying Principles and Practices. The proposed language is anticipated to be reviewed and approved by the Supply Chain Management Committee and issued on the annual update to the Supplying Principles and Practices in February 2011.

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We do not believe that this report contains any proprietary or business information and may be disclosed pursuant to the Freedom of Information Act. However, please consider redacting the negotiated savings from our response as proprietary under Exemption 3, 39 U.S.C. 410(c)(2) where disclosure of the information could materially increase procurement costs. If you have any questions about this response, please contact Susan Witt at (202) 268-4833.

A handwritten signature in cursive script that reads "Susan M. Brownell". The signature is written in black ink and is positioned above the distribution list.

cc: Joseph Corbett
Sally Haring