



OFFICE OF
**INSPECTOR
GENERAL**
UNITED STATES POSTAL SERVICE

Oversight of Equitable Adjustments

Audit Report

September 28, 2012

Report Number CA-AR-12-006



HIGHLIGHTS

BACKGROUND:

An equitable adjustment (EA) is intended to compensate the U.S. Postal Service or a supplier for changes to a contract. Contracting officers (COs) must promptly negotiate EAs with suppliers.

The Postal Service does not track EAs in its contract management systems. As a result, our audit scope was limited to 40 contract change orders identified by a survey of Postal Service managers for fiscal years 2010 and 2011. We determined that 24 change orders (totaling about \$33.1 million) resulted in an EA being paid to suppliers, but we cannot be certain that we identified all EAs.

Our objective was to evaluate EA oversight in accordance with Postal Service policies and procedures to protect Postal Service interests.

WHAT THE OIG FOUND:

The 24 EAs generally received review and oversight consistent with current Postal Service policies and procedures. Postal Service personnel performed price/cost analyses and appropriate reviews and approvals. However, they did not require the supplier to sign a

release discharging the Postal Service from further costs and liabilities for 14 EAs (58 percent). As a result, the Postal Service is exposed to unnecessary risks from future legal claims, protests, adjustments, and contract termination.

Additionally, the level of tracking of EAs within the Postal Service's contracting systems was not adequate to protect its interests. As EAs can have a significant impact on contract costs, they should be tracked and monitored to assure adequate oversight. Finally, Postal Service personnel were unable to locate the contract file for two EAs with payments totaling \$80,347.

WHAT THE OIG RECOMMENDED:

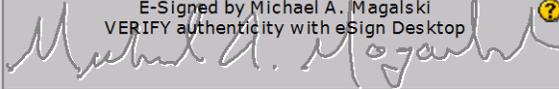
We recommended management require COs to include a general release of claims in all supplemental agreements or a more specific release in complex or contentious EAs. We also recommended that management enhance contracting systems to identify EAs and reiterate the contract file tracking process to ensure the accountability of contract files.

[Link to review the entire report.](#)



September 28, 2012

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

E-Signed by Michael A. Magalski
VERIFY authenticity with eSign Desktop


FROM: Michael A. Magalski
Deputy Assistant Inspector General
for Support Operations

SUBJECT: Audit Report – Oversight of Equitable Adjustments
(Report Number CA-AR-12-006)

This report presents the results of our audit of the Oversight of Equitable Adjustments (Project Number 12WG005CA000).

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.

Attachments

cc: Stephen J. Masse
Susan A. Witt
Corporate Audit and Response Management

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Introduction

This report presents the results of our audit of the Oversight of Equitable Adjustments (EAs) (Project Number 12WG005CA000). Our objective was to evaluate EA oversight in accordance with Postal Service policies and procedures to protect Postal Service interests. This self-initiated audit addresses operational risk. See [Appendix A](#) for additional information about this audit.

An EA is an adjustment to a contract pursuant to a changes clause and is intended to compensate a supplier for Postal Service actions or compensate the Postal Service for contract reductions.¹ Contracting officers (COs) must promptly negotiate EAs resulting from change orders and follow up when EA claims are not received within 30 days of the order. Before negotiating an EA, the CO must ensure that price and cost analyses are completed and must consider the supplier's segregable costs² for the change. To avoid controversies that may result from making an EA, the CO should ensure that all elements of the EA have been presented and resolved and include a release of claims in the supplemental agreement.

Because the Postal Service does not track EAs within its contract management systems, we limited our audit scope to 40 contract change orders identified by surveying Category Management Center (CMC) managers for fiscal years (FY) 2010 and 2011. We determined that 24 change orders (totaling about \$33.1 million) resulted in EAs being paid to suppliers. The following table details the disposition of the 40 contract change orders.

Table 1. Disposition of Sample Universe

| Disposition of Sample Change Order | Number of Occurrences |
|---|-----------------------|
| EAs included in our review | 24 |
| Contract modification out of our audit scope ³ | 14 |
| Change orders related to lost contract file | 2 |
| Total Universe | 40 |

Source: U.S. Postal Service Office of Inspector General (OIG) review of contract change orders identified by surveying CMC managers.

¹ We did not review any EAs paid to the Postal Service.

² Cost of added work that is allocatable to the change order.

³ Contract modification not made pursuant to a changes clause or involving zero dollars.

Conclusion

The 24 EAs generally received review and oversight consistent with current Postal Service policies and procedures. Specifically:

- Suppliers timely submitted written notice of EA requests.
- Postal Service personnel performed price/cost analyses.
- Postal Service personnel requested legal counsel and third-party (for example, Defense Contracting Audit Administration [DCAA]) audits/reviews when appropriate.
- Postal Service personnel negotiated EAs timely.
- Postal Service personnel performed appropriate reviews and approvals.

However, the release of claims was not included in the supplemental agreement for 14 EAs (58 percent). As a result, the Postal Service is exposed to unnecessary risks from future legal claims, protests, adjustments, and contract termination.

In addition, the level of tracking was not adequate to protect the Postal Service's interests. Specifically, the Postal Service does not track EAs within its contracting systems. As EAs can have a significant impact on contract costs, they should be tracked and monitored to ensure adequate oversight. Finally, Postal Service personnel were unable to locate the contract file for two EAs⁴ with payments totaling \$80,347.

Equitable Adjustments Generally Received Review and Oversight Consistent With Policy

The 24 EAs we reviewed generally received review and oversight consistent with current Postal Service policies and procedures. Specifically, Supplying Principles and Practices⁵ (SP&P) state that, to avoid controversies that may result from a supplemental agreement making an EA, the CO should ensure that all elements of the EA have been presented and resolved.

Table 2 shows that 94 percent of the EA elements we reviewed were presented and resolved in accordance with SP&P.

⁴ The two EAs were related to the same contract.

⁵ Supplying Practices 5-8.9, Administration of Change Orders.

Table 2. Analysis of EA Elements

| EA Elements Reviewed | Yes | No | Total |
|---|-----------------|----------------|--------------|
| The CO included applicable clauses in the base contract. | 11 ⁶ | 0 | 11 |
| The supplier submitted timely ⁷ written notice. | 24 | 0 | 24 |
| The CO performed price/cost analysis. | 24 | 0 | 24 |
| The CO requested a DCAA audit when appropriate. | 24 | 0 | 24 |
| The CO requested legal counsel when appropriate. | 23 | 1 | 24 |
| The CO negotiated the EA timely ⁸ . | 23 | 1 ⁹ | 24 |
| The CO documented negotiations as necessary. | 24 | 0 | 24 |
| The CO negotiated the maximum price as necessary. | 24 | 0 | 24 |
| The CO ensured funds were available for the EA. | 24 | 0 | 24 |
| Postal Service personnel properly reviewed and approved the EA. | 24 | 0 | 24 |
| The CO ensured there was a signed release of claims. | 10 | 14 | 24 |
| The CO properly documented the contract file. | 24 | 0 | 24 |
| Total | 259 | 16 | 275 |
| Percentage | 94% | 6% | 100% |

Source: OIG review of 24 EAs.

Release of Claims not Included in the Supplemental Agreement

The 14 instances that did not include a release of claims in the supplemental agreement occurred because:

- The CO did not believe a release of claims was necessary (four EAs).
- There was an oversight on the part of the CO (six EAs).

⁶ A base contract can have multiple EAs. We reviewed 11 base contracts with a total of 24 EAs.

⁷ SP&P Clause 4-1, General Terms and Conditions, states the supplier's claim for an EA must be asserted within 30 days of receiving a written change order. A later claim may be acted upon if the CO decides the facts justify such action but not after final payment under the contract.

⁸ Supplying Practice 5-8.9 states that, before negotiating an EA, the CO must ensure that price and cost analyses, as appropriate, are done and must consider the supplier's segregable costs of the change, if available.

⁹ The EA was not negotiated timely; however, the CO negotiated a fair and reasonable settlement with the supplier that protected the Postal Service's interests.

- The release of claims was included at contract close-out instead of with the supplemental agreement (four EAs).

SP&P¹⁰ state that, to avoid controversies that may result from a supplemental agreement making an EA, the CO should include a release of claims in the supplemental agreement.

It is important that a release of claims be included for each EA because the contractor has to agree that the compensation provided by the modification constitutes full and complete satisfaction for all costs. Additionally, a release of claims discharges the Postal Service from all liabilities under an EA. As a result of the release of claims not being included for every supplemental agreement, the Postal Service is exposed to unnecessary risks from future legal claims, protests, adjustments, and contract termination.

The Postal Service Does not Track Equitable Adjustments

The Postal Service does not track EAs within its contracting systems.¹¹ Specifically, the systems do not contain codes that identify contracting actions as EAs. Postal Service personnel recently changed the action reason codes in CAMS; however, the codes do not specifically identify EAs. Therefore, to identify a universe of EAs, we had to survey CMC managers. This level of tracking is not adequate to ensure proper management of EAs and protect the Postal Service's interests.

Postal Service Personnel Could not Locate Contract File

Postal Service personnel could not locate the contract file for two EAs with payments totaling \$80,347. The contract was for the construction of a security fence. The EAs were for a revised scope to include clearing of trees, changes to fence quantities, and additional labor. The contract file was lost during the transfer of responsibilities from one Facility Services Office to another in August 2011. Postal Service personnel stated they instituted a process to track contract files.¹² However, the contract file could not be located. Postal Service policy¹³ states that contract records are required to be closed at the end of the fiscal year during which they become inactive and must be retained for 6 years thereafter. When the contract file is missing, signature copies of the contract, modifications and other decision documents are not available to support key contract decisions. These costs will be reported as unsupported questioned costs (see [Appendix B](#)).

¹⁰ Supplying Practice 5-8.9.

¹¹ The systems included in our review were the Contract Authoring Management System (CAMS) and electronic Facility Management System (eFMS).

¹² *Contract File Transfer Process*, dated May 2011.

¹³ Handbook AS-353, *Guide to Privacy, the Freedom of Information Act, and Records Management*, Appendix C, Section USPS 400.00, Supplier and Tenant Records.

Recommendations

We recommend the vice president, Supply Management:

1. Require contracting officers to include a general release of claims in all supplemental agreements that constitute a release by the supplier for additional costs beyond that which is provided for in the contract modification or a more specific release in complex or contentious equitable adjustments.
2. Enhance contracting systems to identify equitable adjustments.
3. Reiterate the contract file tracking process to ensure contract files are not lost when they are transferred from one office to another.

Management's Comments

Management generally agreed with the findings and monetary impact. Regarding recommendation 1, management stated that its current administration of task orders policy is adequate and disagreed with an absolute requirement for COs to include a release of claims with every EA. However, management agreed to re-educate employees on the use of release of claims to ensure the best interests of the Postal Service by November 2012.

Regarding recommendation 2, management disagreed and stated that its contracting systems provide proper coding to identify a contracting action that may result in an EA. Management also stated that, in FY 2011, it updated the contract modification action reasons in CAMS to be consistent with the Federal Procurement Data System and an EA, by itself, is not a contract action. Therefore, management stated that it does not believe a separate code to identify an EA is necessary. However, management agreed to provide information on the use of the contract modification action reason coding to employees by November 2012.

Management agreed with recommendation 3 and will provide further guidance regarding the contract file tracking process to employees by November 2012. See [Appendix C](#) for management's comments in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to recommendations 1 and 3 and corrective action should resolve the issues identified in the report. Regarding recommendation 1, we believe the planned action will satisfy the recommendation if COs are instructed to include a justification in the contract file for situations where a release of claims is not obtained. Regarding recommendation 3, we believe the planned action to provide further guidance regarding the contract file tracking process to employees will address the respective issue identified in the report.

We do not consider management's comments to be responsive to recommendation 2 but do not plan to pursue the issue through the formal audit resolution process. Therefore, we are closing the recommendation with the issuance of this report. We agree that current contract modification action reasons in CAMS generally match those in the Federal Procurement Data System. However, during the audit, the Postal Service could not readily provide a universe of EAs. This level of tracking is not adequate to protect the Postal Service's interests and alternatives should be considered.

The OIG considers recommendations 1 and 3 significant, and, therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation that corrective actions are completed. These recommendations should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

Appendix A: Additional Information

Background

An EA is an adjustment to a contract pursuant to a changes clause to compensate a supplier for expenses incurred due to actions of the Postal Service or to compensate the Postal Service for contract reductions. An EA includes an allowance for profit.

The Postal Service SP&P¹⁴ identifies two types of contract modifications:

1. Bilateral modifications (supplemental agreements) are signed by both the supplier and the CO. Bilateral modifications include modifications to 1) make EAs under Paragraph C of Clause 4-1, General Terms and Conditions, Clause B-37, Changes (Construction), or other clauses providing for EAs; and 2) reflect other agreements of the parties modifying contract terms.
2. Unilateral modifications are signed only by the CO in accordance with a contract clause. Unilateral modifications include modifications to 1) make administrative changes (unilateral changes, in writing, that do not affect the substantive rights of the parties, such as a change in the paying office); 2) issue change orders; 3) make changes authorized by specific clauses or contract provisions (such as exercising an option or suspending work); and 4) issue termination notices.

Contract modifications — including changes that can be issued unilaterally — must be priced before they are signed if it can be done without adversely affecting the interests of the Postal Service. If a significant cost increase could result from a contract modification and time does not permit negotiating a price, at least a maximum price must be negotiated whenever possible.

COs must promptly negotiate EAs resulting from change orders and follow up when EA claims are not received within 30 days after the order.¹⁵ Before negotiating an EA, the CO must ensure that price and cost analyses, as appropriate, are made and must consider the supplier's segregable costs of the change, if available. If additional funds are required as a result of the change, the funds must be available before the supplemental agreement is signed. To avoid controversies that may result from making an EA, the CO should ensure that all elements of the EA have been presented and resolved and include a release of claims in the supplemental agreement.

Objective, Scope, and Methodology

Our objective was to evaluate EA oversight in accordance with Postal Service policies and procedures to protect Postal Service interests. To accomplish our objective we:

¹⁴ Supplying Practices 5-8.1, *Types*.

¹⁵ Supplying Practices 5-8.9.

- Surveyed CMC managers and identified 40 contract change orders awarded in FYs 2010 and 2011 that they identified as EAs. We reviewed the identified contract files and determined that 24 were actual change orders that resulted in EAs being paid to suppliers.
- Reviewed the contract files at the applicable CMCs for the identified contract change orders to determine compliance with Postal Service policies and procedures and whether documentation was adequate and complete.
- Interviewed CMC managers and COs regarding related EAs and policies relating to identifying, tracking, and managing EAs.

We conducted this performance audit from March through September 2012, 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 August 22, 2012, and included their comments where appropriate.

We assessed the reliability of EA data by comparing the information obtained through the survey of CMC managers and the review of contract files to the information in CAMS and eFMS. We determined the data were sufficiently reliable for the purposes of this report.

Scope Limitation

Because the Postal Service does not track EAs in CAMS and eFMS, we cannot be certain that we identified all EAs paid in FYs 2010 and 2011.

Prior Audit Coverage

The OIG did not identify any prior audits or reviews related to the objective of this audit issued during the past 3 years.

Appendix B: Monetary Impact

| Recommendation | Impact Category | Amount |
|-----------------------|--|---------------|
| 3 | Unsupported Questioned Costs ¹⁶ | \$80,347 |

The \$80,347 represents total payments for the contract with the lost file. The contract had two EAs totaling \$6,334.80 (\$2,597 + \$3,737). The remaining contract payments totaled \$74,013.

¹⁶ A weaker claim and a subset of questioned costs, claimed because of failure to follow policy or required procedures, but does not necessarily connote any real damage to Postal Service.

Appendix C: Management's Comments

SUSAN M. BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT



September 26, 2012

LUCINE M. WILLIS

SUBJECT: Response to Draft Audit Report – Oversight of Equitable Adjustments
(Report Number CA-AR-12-DRAFT)

We appreciate the opportunity to review and comment on the subject draft report. Management is in general agreement with the Office of Inspector General's findings and impact. Our position on each recommendation is provided below.

AUDIT RECOMMENDATIONS

We recommend the vice president, Supply Management:

Recommendation 1. Require contracting officers to include a general release of claims in all supplemental agreements that constitute a release by the supplier for additional costs beyond that which is provided for in the contract modification or a more specific release in complex or contentious equitable adjustments.

Management Response/Action Plan: Management believes the current policy on the administration of change orders that states in part:

... To avoid controversies that may result from a supplemental agreement making an equitable adjustment, the contracting officer should do the following:

- Ensure that all elements of the equitable adjustment have been presented and resolved.
- Include a release of claims in the supplemental agreement.

is adequate and, therefore, disagrees with an absolute requirement that would necessitate contracting officers to include a release of claims in every situation raised above. However, we do agree that there is an opportunity to re-educate employees to ensure the best interests of the Postal Service are protected and will provide effective communications on this policy and cascade the final report to appropriate staff.

Target Implementation Date: November 2012

Responsible Official: Manager, Supply Management Infrastructure, Supply Management.

475 L'ENFANT PLAZA SW
WASHINGTON, DC 20260-6200
202-268-4040
FAX: 202-268-2755
WWW.USPS.COM

Recommendation 2. Enhance contracting systems to identify equitable adjustments.

Management Response/Action Plan: We believe that our contract systems provide the proper coding to identify a contract action that may result in an equitable adjustment; and, therefore, disagree with this recommendation. During fiscal year 2011, Supply Management performed a review of our contract authoring management system and made several contract coding enhancements that were based upon the results of benchmarking data elements reported by the Federal Procurement Data System (FPDS), which does not seem to report or have a separate code for equitable adjustments. Our current coding provides for contract modification action reasons of: 05-Change Order, 06-Definitization Change Order, 08-Supplemental/Bilateral within Scope, and 18 Supplemental/Bilateral Outside Scope Noncompetitive, among others, and are consistent with FPDS codes. An equitable adjustment, by itself, is not a contract action. Equitable adjustments are necessitated by some modification of the contract effort; and the equitable adjustment, if any, will be reflected in the resultant contract action. Our system coding provides adequate coverage for capturing contract actions; we do not believe that a separate code to identify an equitable adjustment is necessary.

However, we will include information on the use of the contract modification action reason coding in the communication planned under recommendation 1 above.

Target Implementation Date: November 2012.

Responsible Official: Manager, Supply Management Infrastructure.

Recommendation 3. Reiterate the contract file tracking process to ensure contract files are not lost when they are transferred from one office to another.

Management Response/Action Plan: Management agrees with this recommendation and will provide further communication on this subject.

Target Implementation Date: November 2012.

Responsible Official: Manager, Supply Management Infrastructure, Supply Management.

This report and management's response do not contain proprietary or sensitive business information that may be exempt from disclosure pursuant to the Freedom of Information Act. If you have any questions about this response, please contact Susan Witt at (202) 268-4833.



cc: Stephen Masse
Trent Ensley
Robert D'Orso
Paul McGinn
Susan Witt
Corporate Audit and Response Management