



March 31, 2000

A. KEITH STRANGE  
VICE PRESIDENT, PURCHASING AND MATERIALS

SUBJECT: Management Advisory Report - Contract Audit  
Practices (Report Number CA-MA-00-001)

This management advisory report presents the results of our review to assess the extent to which Postal Service contracting officers used contract audits in obtaining fair and reasonable contract prices (Project Number 99RR009CA000).

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## Results In Brief

We determined that Postal Service contracting officials had increased their reliance on price analysis and reduced requests for Inspection Service contract audits from 61 in fiscal year (FY) 1997 and 94 in FY 1998 to 16 in FY 1999. They stated that this occurred because price analyses were less time intensive and had potential savings similar to contract audits when used in a competitive environment.

However, historical contract audit data showed that contract audits could also be of value to the Postal Service. To illustrate the potential value, we used a simple mathematical model to calculate an average questioned cost of about \$1 million per contract audit based on historical data. We then calculated that the Postal Service could potentially question costs of \$61 million per year if contracting officials requested 57 contract audits per year—the average number of audits requested during the period of FY 1997 through 1999. Although we believe contract audits provide value to the Postal Service when appropriately used, we recognize that price analysis and other techniques may be more appropriate to use in certain contracting situations.

We also determined that for seven contracts we reviewed, contracting officers completed price negotiations after work was completed and according to negotiation memoranda they did not consider \$7.5 million in costs questioned by

Inspection Service contract audits in their negotiations. We noted that Postal Service contracting officials may have paid approximately \$12.6 million more than our calculated prenegotiation objective on the seven contracts.

Furthermore, we found that the Postal Service assumed increased contract risk by using undefinitized contracts beyond the required time period without including controls to protect the Postal Service from potential cost growth and performance risks.

The report includes eight suggestions to the vice president, Purchasing and Materials to: (1) issue guidance encouraging contracting officials to request, as appropriate, additional contract audits; (2) improve contract file documentation; (3) use undefined contracts as a last resort; and (4) implement additional controls for undefined contracts when they are used.

Management agreed with the suggestions and has reinforced and discussed with its buyers the importance that contract audits can have on purchases. We commend the vice president, Purchasing and Materials for taking quick action to implement some of our suggestions prior to issuance of the final report. A copy of the full text of management's comments is included in the appendix of the report.

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## Background

Postal Service contracting officers are responsible for protecting the interests of the Postal Service by ensuring efficient and effective contracting, including negotiating the least costly contract type and aggressively pursuing and adequately documenting the attainment of fair and reasonable prices. In carrying out these responsibilities, contracting officers are required to follow Postal Service regulations, which provide them flexibility in exercising sound business judgement in contracting for goods and services.

In pursuing fair and reasonable prices on contract awards, contracting officers are required to consider the results of price analyses or a combination of price and cost analyses. A price analysis is the process of examining and evaluating an offeror's total proposed price without evaluating separate cost elements and proposed profit included in determining the price. Price analysis is required on all procurements; however, it is most effective in a competitive market. A cost

analysis is normally done only when there is not adequate price competition and price analysis alone would not ensure that prices are fair and reasonable. A cost analysis involves reviewing and evaluating the separate cost elements and proposed profit of an offeror's cost or pricing data.

Postal Service Administrative Instruction OP-5-002 required that a price or cost analysis be performed under the following circumstances:

- When a fixed-priced type proposal exceeded \$500,000.
- When a noncompetitive procurement or contract modification exceeded \$100,000.
- For all cost-reimbursement procurements.

The current Administrative Instruction is not a recognized directive and is neither policy nor regulation, but merely guidelines for the 80 or more Postal Service Headquarters Purchasing buyers.

Within the Postal Service, the contracting officer, with the support of the Postal Service Contract Pricing Group, generally performs price analyses. Prior to October 1999, at the request of contracting officers, the Postal Inspection Service generally performed contract audits in support of cost analyses and sometimes attended contract negotiations. Since October 1999 the Office of Inspector General has assumed responsibility for the performance of contract audits.

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**Objective, Scope,  
and Methodology**

The objective of the review was to determine the extent to which Postal Service contracting officers used contract audits in negotiating fair and reasonable contract prices.

We obtained contract audit data consisting of 171 contract audit reports from the Inspection Service for FY 1997 through FY 1999. The reports included the results of 154 audits of either cost incurred, cost claims, preaward cost proposals, or contract modifications. The remaining 17 reports were comprised of audits of rates and accounting and estimating systems reviews. We used this contract audit data in performing a simple calculation to determine an average questioned cost per audit.

In addition, we judgmentally selected and reviewed 11 contracts issued by Postal Service Headquarters

Purchasing, Automation Division that were audited by the Inspection Service. The proposed cost for these contracts was \$146.8 million. We also held discussions with Postal Service contracting personnel.

Our review was conducted from June 1999 through March 2000 in accordance with the President's Council on Integrity and Efficiency, Quality Standards for Inspections. We discussed our conclusions and observations with appropriate management officials and included their comments, where appropriate.

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**Contract Audit  
Requests**

In FY 1997 and 1998 the Inspection Service performed 61 and 94 contract audits respectively and questioned the allowability of \$27 million and \$152.7 million in costs respectively. By comparison, as of July 1999 the Inspection Service had only performed 16 contract audits and questioned the allowability of \$3.3 million in costs.

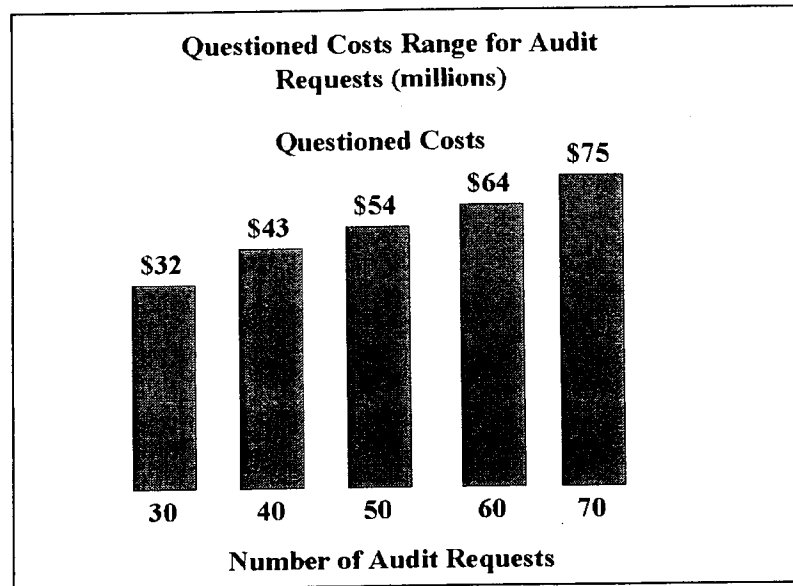
Historical contract audit data showed that contract audits had identified substantial questioned cost and could be of value to Postal Service in the future. To illustrate the potential value, we calculated that contract audits could potentially identify an average of \$1 million in questioned costs per audit, based on historical contract audit data.<sup>1</sup> We then calculated that contract audits could potentially identify about \$61 million in questioned cost if contracting officers requested an average of 57 audits per year--the average number of audits requested in FY 1997 through 1999.<sup>2</sup>

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<sup>1</sup> The Inspection Service audits performed in FY 1997, 1998, and 1999 identified an average of \$1,072,000 in questioned cost. In addition, the Inspection Service in FY 1997, 1998, and 1999 performed an average of 57 audits.

<sup>2</sup> Assuming the same contract audit mix during FY 1997 through FY 1999—ninety percent were audits that reviewed contractor costs.

The following chart shows our calculation of the potential for questioned costs at various levels of contract audit requests.



In a general survey, Postal Service contracting officers advised us that the decline in contract audits was due to them performing more price analyses in lieu of requesting contract audits to determine fair and reasonable prices for contracts. In addition, they stated that during FY 1997 through 1999 the Postal Service had achieved the same negotiated savings percentage<sup>3</sup> regardless of the number of contract audits requested.

While Postal Service contracting officials prefer using price analysis, during meetings with us they acknowledged the benefits of the appropriate use of contract audits, particularly when evaluating cost proposals in a noncompetitive environment. Although historical data showed that contract audits had provided value to the Postal Service, we recognize that they are just one tool available to contracting officers in determining fair and reasonable prices. Ultimately, it is the responsibility of the contracting officer to decide whether to request a contract audit after considering many factors including the time involved in performing a contract audit and the impact on project costs.

<sup>3</sup> Negotiated savings divided by total dollar awards.

In making this determination contracting officers should consider the other benefits of contract audits such as the opportunity to identify questionable or inadequate contractor accounting and estimating systems. In addition, contract audits can be used to assess contractor financial capability, cost claims, and cost or pricing data. For example, defective pricing audits, when used by other federal agencies, have identified contract cost savings and inaccurate, incomplete, or noncurrent cost or pricing data.

The data provided in the table below shows that between 1996 and 1998, a total of \$234 million was saved by other federal agencies as a result of defective pricing audits performed by the Defense Contract Audit Agency.<sup>4</sup>

Defense Contract Audit Agency Findings From Defective Pricing Audits			
<u>Year</u>	<u>Recommended Price Adjustment (In Millions)</u>	<u>Percentage Sustained</u>	<u>Sustained Amounts (In Millions)</u>
1996	\$ 124	46	\$ 57
1997	154	33	50
1998	<u>245</u>	52	<u>127</u>
<b>Total</b>	<b>\$ 523</b>		<b>\$ 234</b>

#### Postal Service Use of Questioned Costs

The Postal Service contracting officers negotiated contract prices after work was completed – an average of 1004 days after work was initiated on 7 of the 11 contracts we reviewed. According to negotiation memoranda, since performance was complete, the prices were negotiated without using contract audit questioned costs in negotiations; and instead were negotiated based on incurred costs, initial proposals, and budget limits. Inspection Service contract audits had identified \$7.5 million in questioned costs and inadequate accounting and estimating systems associated with the seven contracts.

Based on findings from the Inspection Service contract audits, we question the contracting officers' negotiation approach, especially since four contractors' accounting and

<sup>4</sup> The Defense Contract Audit Agency is responsible for performing all contract audits predominately for the Department of Defense and other federal agencies, as requested, providing accounting and financial advisory services regarding contracts and subcontracts for federal agencies components responsible for procurement and contract administration. These services are provided in connection with negotiation, administration, and settlement of contracts and subcontracts.

estimating systems were found to be unreliable for accumulating and estimating costs by the Inspection Service audits.

In the remaining four contracts, two were negotiated for less than the contractor's proposed costs and two had files with no documentation of negotiations or final contract amounts. Ultimately, the Postal Service may have paid approximately \$12.6 million in costs above the initial prenegotiation objective, which we calculated based on questioned cost and contractor initial proposals.

Although contract audits are advisory, contracting officers are required, by Postal Service Procurement Manual Section 4.5.3.e, to prepare memoranda of negotiations documenting negotiations rationale, including how contract audit recommendations were considered in negotiations. Audits that disclose contractors with inadequate accounting and estimating systems, coupled with questioned costs also indicate that the contractors' proposals, which were derived from their inadequate systems, were also questionable.

Following is a summary of information related to the seven contracts where contracting officers negotiated prices after the work was completed.

Summary of Prenegotiation Objectives and Final Negotiated Amounts					
<u>Contract #</u>	<u>Initial Proposal Amount</u>	<u>Inspection Service's Questioned Cost*</u>	<u>OIG Calculated Prenegotiation Objectives</u>	<u>Final Negotiated Amounts</u>	<u>Difference Between OIG Calculated and Final Negotiated Amounts</u>
102590-96-D-3521	\$4,507,140	\$781,813	\$3,725,327	\$4,507,140	\$781,813
102590-96-D-2878	4,887,437	729,719	4,157,718	4,962,578	804,860
102590-95-D-2839	2,673,617	292,824	2,380,793	3,952,491	1,571,698
102590-96-D-2300	4,751,080	763,356	3,987,724	4,963,478	975,754
102590-96-D-1603	4,943,407	662,072	4,281,335	4,961,453	680,118
102590-96-Z-2829	1,616,518	564,583	1,051,935	1,201,000	149,065
102590-96-Q-3021**	<u>42,557,163</u>	<u>3,740,300</u>	<u>38,816,863</u>	<u>46,463,771</u>	<u>7,646,908</u>
<b>Totals</b>	\$65,936,362	\$7,534,667	\$58,401,695	\$71,011,911	\$12,610,216
*Questioned costs resulting from contract audits.					
**Contract initially included four tray management system sites in which one site was deleted and replaced with another. Consequently, the amounts only represent three of four initial tray management systems sites. The fourth site is discussed separately in this report.					

Our review of one contract for tray management systems, 102590-96-Q-3021, disclosed that the contracting officer did not determine a contract price until after the work was completed – 785 days after the contract had started. According to negotiation memoranda, the final prices were negotiated based on incurred cost compared to the budget limit established on the contract and amounts contained in a Decision Analysis Report that included an engineering estimate. The Inspection Service audit of the initial proposal of \$42.5 million for three of four systems questioned \$3.7 million in cost and we believe a reasonable prenegotiation objective would have been \$38.8 million.

Ideally, we believe Postal Service contracting officials should have attempted to resolve the \$3.7 million in questioned costs before the contract was started, but certainly long before the contract was completed--more than two years. Ultimately, the Postal Service negotiated a final contract price of \$46.4 million, \$7.6 million more than our calculated prenegotiation objective of \$38.8 million. In addition, the contracting officer modified the contract from any future cost recovery by incorporating the following language in the contract.

The contractor and the Postal Service do remiss, release, and discharge each other, their officers, agents, and employees of and from all liabilities, obligations, claims and demands under or arising from this modification.

Although the language is intended to protect both the Postal Service and the contractor, we question the prudence of its use in the contract because it does not appear that the \$3.7 million in questioned costs were considered in negotiating the contract price. We believe the language may waive the Postal Service's ability to recover any costs that might be determined questionable or unallowable in the future.

Subsequent to negotiating the contract price, the Postal Service added another tray management system to the contract at a cost of about \$23.3 million. This cost consisted primarily of subcontract costs and was not audited, even though the Inspection Service had questioned \$3.7 million of the subcontractor's proposed costs on the first three systems.



In addition, on April 16, 1999, the Postal Service contracting officer negotiated \$13.1 million for work stoppage costs, without a review of supporting documentation. Included within the work stoppage costs were numerous engineering technical changes, statement of work changes, Davis-Bacon Wage increases, and training and nonrecurring effort related to all four tray management systems. To their credit Postal Service contracting officials requested an audit of the work stoppage costs in August 1999 and are awaiting the results of the audit. Postal Service contracting officials advised us that the costs could be reduced, depending on the results of the audit.

We noted that the work stoppage costs included \$500,000 to reimburse the contractor for preparing engineering designs based on a verbal commitment by Postal Service officials that additional systems were going to be added to its contract. Even though additional sites were not added to the contract, because of the verbal direction, the Postal Service paid \$500,000 in additional costs to the contractor.

In another contract 102590-96-Z-2829, the Postal Service paid the contractor \$1.29 million. The contracting officer negotiated a lower contract price of \$1.2 million after the work on the contract was completed and 1084 days after work on the contract was started. While a lower price was negotiated, the contracting officer failed to initiate recovery of the \$92,000 overpayment to the contractor. In addition, the negotiation memorandum did not document whether the Inspection Service's questioned cost of about \$565,000 was considered in negotiating the contract price.

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Unfinalized  
Contractual Actions

Contrary to Postal Service procurement requirements, 8 of the 11 contracts we reviewed were not negotiated and finalized until an average of 971 days after performance began. Four of these contracts were not negotiated until after contract work was complete. For two contracts we were unable to determine when the contracts were finalized and we found that one contract had been finalized in one day after contract performance began. The postal Procurement Handbook, Section 5.1.7 and the Purchasing Manual, Section 5.1.7 require contracts to be finalized within 180 days of initiating contractor performance. The following table shows the number of days it took the Postal Service to finalize the contracts we reviewed.

Summary of Days to Definitize Contracts					
	<u>Contract #</u>	<u>Date Work Began</u>	<u>Date Work Completed</u>	<u>Memorandum of Negotiation Date</u>	<u>Total Number Days to Definitize</u>
1	102590-95-B-1684	04/02/98	*	**	
2	102590-98-C-1156	01/08/98	on-going	**	
3	102590-95-Z-1770	03/31/98	*	03/31/98	1
4	102590-96-Q-3021	09/12/96	*	05/05/99	785
5	102590-96-Z-2829	06/25/96	06/27/97	***06/15/99	1084
6	102590-97-D-1449	04/15/97	02/02/99	***04/23/99	738
7	102590-96-D-3521	09/12/96	*	***05/28/99	988
8	102590-96-D-2878	07/22/96	02/26/99	01/15/99	905
9	102590-95-D-2839	07/28/95	02/26/99	01/15/99	1264
10	102590-96-D-2300	05/22/96	02/26/99	01/15/99	967
11	102590-96-D-1603	03/12/96	02/26/99	01/15/99	1036
					7767****
*Contracting officers' stated work was completed; however, the files did not adequately reflect this.					
**The contract files did not contain memorandums of negotiations.					
***Negotiated after contract work was complete.					
****Average number of days to negotiate and definitize 8 contracts was 971 (7467 divided by 8).					

## Contract Risk

Because fixed-price task order contracts were not definitized in a timely manner the Postal Service assumed more contract risk of increased costs and performance deficiencies. When fixed-price type contracts contain an undefinitized price, they are treated like cost-reimbursement contracts and unlike fixed price contracts there is little incentive for contractors to control costs.

Postal Service Procurement Handbook Section 5.1.7-10 and section 20 states that undefinitized contractual actions should only be used in situations that are truly urgent and only after closely examining all alternatives that would allow for a definitized contract award. According to the Postal Service Procurement and Purchasing Manuals, it is not prohibitive to use undefinitized contractual actions. However, the Manuals state that it is in the best interest of the Postal Service to initiate contract actions that are fully definitized, if possible.

Postal Service's Purchasing Manual Section 5.1.4b. also provides that cost type contracts should only be used when contractors' accounting systems are adequate for accumulating and estimating costs. The audits performed

by the Inspection Service revealed that four contractors, who received 6 of the 11 contracts we reviewed, did not have adequate accounting and estimating systems. Thus, as stated before, entering into undefinitized contracts, (essentially cost type contracts) exposed the Postal Service to the risk of cost growth. In addition, the contractors' proposed costs might not have been reasonable in the first place, since they were based on inadequate accounting and estimating systems. As stated before, Postal Service contracting officers relied on these proposals to determine contract prices.

In addition, we noted that once contract prices were negotiated, contracting officers did not modify the contracts to incorporate the negotiated prices. The Postal Service Procurement Manual and the Purchasing Manual require the issuance of either unilateral or bilateral modifications incorporating significant contract events, such as contract price negotiation results.

Because the contracts were undefinitized contractual actions similar to a letter contract and permitted contract performance to be completed before these actions were definitized, Postal Service contracting officers should have included the controls required for these types of contracts. Letter contracts are cost-reimbursement contracts until they are definitized and are required to include controls to protect the interest of the Postal Service. To ensure contract cost growth is limited, letter contracts are required to contain a negotiated definitization schedule, a date of submission of contractor's proposal, date to start negotiation, and a target date for definitization.

In summary, the Postal Service's ability to negotiate fair and reasonable prices for the seven contracts discussed in this report appeared to have been negatively impacted by contracting officers by:

- Not adequately incorporating contract audit findings into contract negotiations.
- Using undefinitized contracts without controls to protect Postal Service interests.

We also believe that Postal Service contracting officers have an opportunity to benefit from requesting more contract audits when appropriate.

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**Suggestions**

We offer the following suggestions:

The vice president, Purchasing and Materials should:

1. Issue Postal wide guidance encouraging contracting officers' to request contract audit support, as appropriate, to assist them in determining fair and reasonable prices when:
  - Awarding contracts and modifications particularly in non-competitive environments.
  - Using undefinitized contracts.
  - Relying on contractors' accounting and estimating systems.
2. Enforce and reiterate the importance of the requirement that contracting officers clearly document, in memorandums of negotiations, how contract audit results are used in determining fair and reasonable prices.
3. Review the practice of including language in contracts that waives the Postal Service ability to recover any future costs and ensure that this language is only used when it is in the best interest of the Postal Service.
4. Request the Automation Division's contracting officer to modify contract 102590-96-Z-2829 incorporating negotiated amounts into the contract and to recover the overpayment of \$92,214 from the contractor.
5. Enforce the requirement that contracting officers definitize open contractual actions within 180 days of the start of performance. When contracting officers are not able to definitize actions within 180 days, require them to report their inability to definitize the actions to the vice president, Purchasing and Materials.
6. Require contracting officers to expeditiously negotiate contracts, complete memorandums of negotiations immediately after holding negotiations, incorporate results of negotiations into contracts, and include the memorandums in contract files.
7. Require contracting officers who initiate undefinitized task orders and other contract actions to include the required controls for letter contracts in these contracts.

8. Require contracting officers to document within contract files the contract risk when using undefinitized contract actions.

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**Summary of  
Management's  
Comments**

Management agreed with the suggestions and has taken or proposed to take actions to implement all of the suggestions. Management agreed to use contract audits whenever there is not adequate price competition and no method of price analysis will ensure that prices are fair and reasonable. Management has taken the following actions:

- Management sent all headquarters purchasing buyers an electronic presentation in January 2000, on our suggestions and asked all commodity group managers to reinforce and discuss the use of contract audits in their staff meetings; the presentation was also sent to the Managers of Field Customer Support, Major Facilities Purchasing, and National Mail Transportation Purchasing for distribution to their buyers; management also plans to revise and reissue Administrative Instruction A.I. OP-5-2 to address this issue.
- On March 20, 2000, the contracting officer issued a modification for the contractor to refund a \$92,214 overpayment on contract 102590-96-Z-2829.

Management also plans the following actions:

- Require contracting officers to include in every contract file clear statements as to how the price was found to be reasonable.
- Review with the assistance of Postal Service counsel, the use of contract language that waives Postal Service's ability to recover any future costs and provides appropriate guidance to buyers.
- Develop a process to insure buyers comply with the 180-day control requirement and to report any inability to definitize actions within this timeframe.
- Sponsor a formal training class addressing the necessity of expeditiously negotiating contracts, completing memorandums of negotiations, and including the memorandums in contract files.

- Require buyers to include the required controls for letter contracts in all undefinitized contracts and task orders.
- Document in the contract file the risks of using letter contracts.

Management stated that a 30-day maximum turnaround on completing contract audits is reasonable and will help them in weighing all the factors when deciding to request a contract audit. In addition, based on a careful analysis, management was unable to substantiate our finding that the Postal Service may have paid \$12.6 million more than our calculated prenegotiation objective on seven contracts.

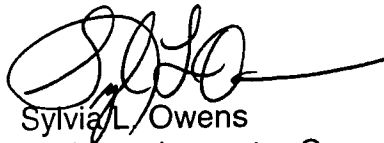
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**Evaluation of  
Management's  
Comments**

We considered the actions taken and proposed by management to be responsive to our suggestions. However, in response to management's comments on a 30-day turnaround for completing contract audits, we believe a 30-45 day timeframe is more reasonable. Also, this timeframe is dependent on various factors such as: the adequacy of contractor proposals, financial records, and accounting systems; delays imposed by contractors in providing supporting documentation; and the complexity of the procurement itself. The Office of Inspector General will certainly do everything it can to provide management with timely and adequate contract audits.

In response to management's comments on its inability to substantiate our finding that the Postal Service may have paid \$12.6 million more on seven contracts than we believe they should have, it is our opinion that the circumstances surrounding these contracts placed the Postal Service in a disadvantageous position to negotiate competitive contract prices. Management's planned actions should strengthen its contracting practices and hopefully prevent these types of contract circumstances from happening in the future.

We appreciated the cooperation of you and your staff during the review and commend you for expeditiously implementing some of the suggestions in the report. If you have any questions or would like to discuss this matter further, please contact [REDACTED] or me at (703) 248-2300.



Sylvia L. Owens  
Assistant Inspector General  
for Revenue/Cost Containment

cc: William J. Dowling  
John R. Gunnels

## APPENDIX. MANAGEMENT'S COMMENTS

HEADQUARTERS PURCHASING



March 28, 2000

SYLVIA OWENS

THRU: KEITH STRANGE

MAR 28 2000

SUBJECT: Contract Audit Practices (Report Number CA-MA-00-XXX)

I have reviewed the management advisory report on Contract Audit Practices, and agree with the recommendations.

1. Issue Postal wide guidance encouraging contracting officers' to request contract audit support, as appropriate, to assist them in determining fair and reasonable prices when:

- awarding contracts and modifications, particularly in non-competitive environments;
- using undefinitized contracts; and
- relying on contractors' accounting and estimating systems.

Action: I agree. Consistent with postal policy in the Postal Service Purchasing Manual (PM), we will use contract audits whenever there is inadequate price competition and no method of price or cost analysis will ensure that prices are fair and reasonable (PM 5.1.2.c). I sent all HQ Purchasing buyers an electronic presentation in January on these recommendations and asked all commodity-group managers to reinforce and discuss this policy in their staff meetings. I also sent the presentation to the Managers of Field Customer Support, Major Facilities Purchasing, and National Mail Transportation Purchasing for distribution to their buyers, as well.

New guidelines will be issued as a new Administrative Instruction (A.I.), currently in the draft stage, which will replace A.I. OP-5-2, referred to in the report. Like its predecessor, the new A.I. will address when contracting officers should request Contract Pricing support for price or cost analyses and, as the recommendation suggests, when support should be requested for financial determinations, accounting system reviews, the writing of award summaries, and provisional approvals. I anticipate that the A.I. will be written and issued by the end of PQIII, FY00—and under the signatures of the four Purchasing Operations Managers, instead of just the manager of Headquarters Purchasing.

I also believe that a balance needs to be struck between the time required to complete an audit (an average of 76 days in 1998 and 1999—and currently rising) and the return on the investment in an audit as well as other lost opportunities. It is my recommendation that the OIG track DCAA audits to assure that they are performed in a timely manner. I believe the 30-day maximum turnaround suggested by the OIG is reasonable and will help achieve this balance.

2. Enforce and reiterate the importance of the requirement that contracting officers clearly document, in memorandums of negotiations, how contract audit results are used in determining fair and reasonable prices.



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Action: I agree, and I will take this recommendation a step further, requiring buyers to include a clear statement as to how the price was found to be reasonable in every contract file, not just those where audits were used. The recommendation itself is already standard operating procedure for contracting officers. I will reinforce the requirement for contracting officers to clearly document their use of audit results in negotiations and ensure that this practice is followed in the future, which will provide better audit trails for the auditors to follow and to understand how audit recommendations were addressed.

Such documentation will provide the perspective necessary to understand how questioned costs were considered and analyzed by the Contracting Officer; whether they were found to be supportable or not, whether they were found to be allowable under Generally-Accepted Accounting Principles, what the effect of the Cost Analysis was on their use once they were examined in light of the engineer's technical analysis, and the many other considerations, changes, and negotiation decisions that occur between a supplier's initial proposal and the final price—particularly for the types of unique programs examined for this review. Clearer documentation may have helped explain why \$7.5 million in "questioned costs" in the initial proposals submitted for these programs would result in an aggregate price above the simple difference between proposal prices before they were analyzed and unexamined questioned costs. Based on a careful analysis of the factors involved in, and the history of, these programs, it does not appear that the \$12.6 million figure in the finding can be substantiated.

I will also sponsor a Just-in-Time Training program for the Purchasing & Materials group to prepare a memorandum of negotiations so that documentation is clear and fully explains how buyers analyzed and used contract audit findings in their discussions with suppliers.

3. Review the practice of including language in contracts that waives the Postal Service ability to recover any future costs and ensure that this language is only used when it is in the best interest of the USPS.

Action: I agree. This language was developed by Postal Service counsel to protect Postal Service interests by preventing additional supplier claims on a matter which resulted in a contract modification, and it was used with that intent. We will review the use of this contract language with counsel and provide appropriate guidance to our buyers.

4. Request the Automation Division's contracting officer to modify contract 102590-96-Z-2829, incorporating negotiated amounts into the contract, and to recover the overpayment of \$92,214 from the contractor.

Action: I agree. A modification to refund \$92,214 was signed by both parties on March 20 to recover the overpayment.

5. Enforce the requirement that contracting officers definitize open contractual actions within 180 days of the start of performance. When contracting officers are not able to definitize actions within 180 days, require them to report their inability to definitize the actions to the Vice President, Purchasing & Materials.

Action: I agree. I will establish a process to insure buyers comply with the 180-day control and report any inability to definitize actions within this timeframe. However, in lieu of requiring the reporting of undefinitized actions in excess of the 180 days to the Vice President, the Vice President believes buyers should report this discrepancy to the respective purchasing-operations manager (the Manager of HQ Purchasing, Field Customer Support, Major Facilities Purchasing, or National Mail Transportation Purchasing).

6. Require contracting officers to expeditiously negotiate contracts, complete memorandums of negotiations immediately after holding negotiations, incorporate results of negotiations into contracts, and include the memorandums in contract files.

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Action: I agree. This is already a requirement. I will take action to assure compliance and reinforce the necessity of doing this with the staff. As previously mentioned, I will sponsor a training class for the buyers which will address these issues.

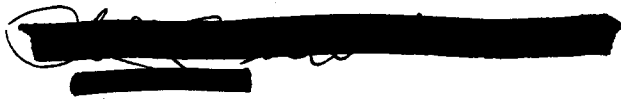
7. Require contracting officers who initiate undefinitized task orders and other contract actions to include the required controls for letter contracts in these contracts.

Action: I agree. I will require contracting officers to include the required controls in all letter contracts and task orders.

8. Require contracting officers to document within contract files the contract type and risk when using undefinitized contracts.

Action: I agree. I will ensure that contracting officers document the risks of using letter contracts when they request their use, and this will be included in the contract file. The contract type will be documented in the Purchase Plan included in the contract file.

We appreciate this review, which we believe will result in improvements to our purchasing work. Please feel free to contact me directly for any assistance needed with our response.

  
cc: William Dowling  
Alan B. Kiel  
John R. Gunnels

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**Major Contributors to  
This Report**

[REDACTED]

**RECEIVED**