February 29, 2000

GEORGE L. LOPEZ
VICE PRESIDENT, SOUTHWEST AREA OPERATIONS

SUBJECT: Transmittal of Audit Report –Southwest Area Expenditures for Extra Highway Trips Using Leased Equipment
(Report Number TR-AR-00-005)

This report presents the results of our audit of leased equipment for extra highway trips under the Southwest Area's service improvement initiative (Project No. 00PA020TR000). This audit was conducted to determine whether payments to contractors who leased equipment for extra trips under the Southwest Area's service improvement initiative were reasonable and appropriate.

The audit revealed that excessive payments were made to highway contractors who leased equipment to provide extra trip service. We are recommending the Postal Service recover approximately $848,000 in overpayments and correct contracting practices to avoid excessive expenditures in the future. Management agreed with our findings and recommendations, but disagreed with the magnitude of overpayments reported. Management's comments are included, in their entirety, in Appendix B.

We appreciate the cooperation and courtesies provided by your staff during the review. If you have any questions or need additional information, please contact Debra Ritt, director, Transportation, at (703) 248-2300.

//Signed//
Richard F. Chambers
Assistant Inspector General
for Performance

Attachment

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EXECUTIVE SUMMARY

Introduction

In April 1997 the Southwest Area Distribution Networks office established an initiative to improve transportation service between the Dallas Bulk Mail Center and other Texas locations. To meet the requirements of this initiative the Postal Service procured extra trips from contractors, many of whom used leased equipment to provide the service. The objective of the audit was to determine whether extra trip payments to contractors who leased equipment were reasonable and appropriate.

Results in Brief

Contracting officials in the Southwest Area overpaid highway contractors approximately $848,000 for extra highway trips that operated between the Dallas Bulk Mail Center and other Texas locations from April 1997 to December 1999 as part of the area's service improvement initiative. This amount included vehicle and operational costs, vehicle registration expenses, and taxes which contractors did not incur as a result of using leased equipment.

Although required by postal policy, contracting officials did not negotiate rate adjustments for extra trip service or amend the contracts to authorize the use of leased equipment. Contracting officials told us they did not follow postal policy because they believed the extra trips would be short-term, as the service improvement initiative was a pilot program. Also, contracting officials were rushed to procure additional trips to meet operational goals of the service improvement initiative. However, after the service improvement initiative was extended, contracting officials did not reevaluate the reasonableness of the contract rate and the appropriateness of payments for leased equipment. As a result, the Postal Service continued to make excessive payments to contractors, 33 months after the service improvement program was initiated.[1]

[1] At the end of the 33-month period, December 1999, contractors still follow this practice for three of the six contracts.

Summary of Recommendations

We recommend the vice president, Southwest Area direct contracting officials to seek recovery of $848,000 in overpayments for leased equipment between April 1997 and December 1999. When equipment is leased for extra trips, contracting officials should also determine whether adjustments are needed in the contract rate and ensure additional contract costs are properly authorized through contract amendments. We further recommend contracting officials review all other contracts where equipment was leased for extra trips since April 1997 to determine whether additional overpayments have occurred, and recover such costs, as appropriate.

Summary of Management's Comments

Management agreed with our findings and recommendations, but disagreed with the magnitude of overpayments reported. They believe only $410,000 of the $848,000 should be recovered because the remaining amount—repair costs and taxes—cannot be recovered because they are estimated costs. Management indicated they planned to assess the need for adjusting contract rates when equipment is leased for extra trips, ensure any additional extra trip costs are negotiated and properly authorized, and review all contracts in which equipment was leased and recover any overpayments.

Overall Evaluation of Management's Comments

Management's comments are generally responsive to our findings and recommendations, and actions taken and planned should correct the issues identified in the report. However, we disagree with management's estimate of the overpayment. We believe the full $848,000 should be recovered because contractors were paid for repairs and taxes which were unsupported. Further, according to a Purchasing official, four of the six contractors are continuing to operate the same trips with leased equipment, but are now being reimbursed only the contract rate for this service.

INTRODUCTION

Background

In April 1997 the Southwest Area Distribution Networks office established a "Quality Service End-to-End" program to improve transportation service between the Dallas Bulk Mail Center and other Texas locations. To carry out the objectives of the program, the Postal Service authorized contractors to perform extra trips on existing highway routes. Contractors who operated extra trips often leased equipment to provide the Postal Service with the additional service required.

Contracting guidelines specify that prior to procuring extra trips, contracting officials are to negotiate the rate to be paid for the additional service. If this is not possible, the policy provides for the contractor to be paid the rate for regular contract service. Since the regular contract rate includes operating costs such as depreciation, repair, taxes, etc., it assumes contractors will use contractor-owned or long-term leased equipment. On those occasions where the regular contract rate does not cover all costs, the contractor may, with fully documented support, receive a lump sum payment. For service or equipment not already delineated in the contract, the contract must be modified or amended to include the additional requirements.

Objective, Scope, and Methodology

The objective of the audit was to determine whether payments to contractors who leased equipment for extra trips under the Southwest Area's service improvement initiative were reasonable and appropriate. To meet this objective we reviewed six contracts identified by the Southwest Area where extra trips were made primarily with leased equipment, and analyzed related payment records for the 33-month period, April 1997 to December 1999. We also interviewed Southwest Distribution Networks officials, headquarters Purchasing and Materials, as well as Networks Operations Management officials.

Our review was conducted between November 1999 and February 2000 in accordance with generally accepted government auditing standards and included tests of internal controls, as were considered necessary under the circumstances.

Prior Audit Coverage

In our September 29, 1999, report, Emergency and Extra Trip Expenditures on Highway Routes (TR-AR-99-003), we determined contracting officials did not negotiate special rates for extra trips. Instead, they routinely used the regular contract rate as allowed by contracting guidelines. This practice resulted in excessive expenditures. Further, contracting officials did not monitor extra trip costs to ensure expenditures were reasonable.

AUDIT RESULTS

Reasonableness and Appropriateness of Extra Trip Expenditures

Contracting officials overpaid highway contractors approximately $848,000 for extra trips that were operated between April 1997 and December 1999, to improve service between the Dallas Bulk Mail Center and other Texas locations (see Appendix A). This amount includes vehicle and operational costs, vehicle registration expenses, and taxes which contractors did not incur as a result of using leased equipment.

According to Postal Service management instructions,[2] the regular contract rate includes depreciation and interest paid on vehicles purchased or leased. Therefore, the Postal Service should have reimbursed contractors for either the contract rate or leased equipment costs, but not both. Because contractors incurred equipment lease costs to provide the additional service, the Postal Service was correct in reimbursing contractors for such costs. However, contracting officials should have adjusted the contract rate to exclude vehicle-related costs not incurred when contractors leased equipment. For example, the Postal Service reimbursed one contractor about $331,000 for vehicle repair, maintenance, and other costs for equipment the contractor did not own.

Contracting officials indicated they did not have time to negotiate an adjusted rate for extra trips because they had little time to procure the trips under the service improvement initiative. While this may have been the case, postal policy allows contracting officials to apply the regular contract rate for extra trip service in situations such as this. However, in addition to paying contractors the regular rate, contracting officials separately reimbursed contractors for leased equipment invoices. Paying leased equipment invoices without first assessing whether contractor expenses exceeded reimbursement under the contract was inappropriate and resulted in excessive payments.

According to postal policy,[3] contracting officials are required to negotiate rate adjustments and amend the contract when changes are made in service requirements such as adding leased equipment. However, contracting

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[2] Management instructions – Economic Pay Adjustments for Highway and Inland Domestic Water Contracts.
[3] Management instruction – Highway Contracts—Negotiated Service Changes.

officials in the Southwest Area did not negotiate rate adjustments or amend the contracts because they believed the need for the extra trips was short term because the service improvement initiative was just a pilot. Also, contracting officials were rushed to provide additional service improvements to meet operational goals. However, after the service improvement initiative was extended, contracting officials did not reevaluate the reasonableness of the contract rate and the appropriateness of paying contractors to lease equipment. As a result, the Postal Service continued to make excessive payments to contractors, 33 months after the service improvement program was initiated.

Recommendations

We recommend the vice president, Purchasing and Materials, direct contracting personnel in the Southwest Area Distribution Networks office to:

1. Recover $848,000 in overpayments identified in this report and any additional amounts incurred subsequent to December 1999.

Management's Comments

Management agreed with our finding and recommendation, but disagreed with the amount owed the Postal Service from overpayments. Management indicated they have initiated discussions with the contractors to determine the additional costs, but believe the total possible recovery to be $410,491 instead of $848,000.

2. Determine whether adjustments are needed in the contract rate when equipment is leased for extra trip service.

Management agreed with our findings, but indicated in special circumstances, such as observed in our report, they may not always be able to adjust the contract rate immediately as we recommended. They added their preference is to negotiate costs for extra trips prior to the start of service.

3. Ensure all additional contract costs are properly authorized through contract amendments.

Management agreed with our recommendation and indicated they will ensure all additional contract costs are negotiated and properly authorized through contract amendments.

4. Review all other contracts in which equipment was leased for extra trips and recover any overpayments, as appropriate.

Management agreed with the recommendation and recently contacted each Distribution Networks Office to ensure that documentation for all costs above the contract rate is obtained and appropriate rate adjustments made.

Evaluation of Management's Comments

Generally, management's actions taken and plans are responsive to the issues identified in the report. However, we believe the full $848,000 should be recovered because contractors were paid for repairs and taxes that were unsupported. Management states repair costs and taxes cannot be recovered because they are estimated costs. While we recognize these costs are estimates, they nonetheless were included in the rate paid to contractors. Further, according to a Purchasing official, four of the six contractors are continuing to operate the same trips, but now are being reimbursed only the contract rate for this service.

APPENDIX A. CALCULATION OF MONETARY BENEFITS

Overpayments Resulting From Excessive Contract Rates[4]

Contract Route #	Miles Driven		Excess Contract Rate Charges/Mile		Total Overpayments
75124	1,295,332	X	0.25564193	=	$ 331,141
75194	285,280	X	0.29219628	=	$ 83,358
78650	7,806	X	0.09103852	=	$ 711
75391	336,667	X	0.27150678	=	$ 91,407
75192	690,611	X	0.26665484	=	$ 184,155
75398	795,225	X	0.19771514	=	$ 157,228
	3,410,921				$ 848,000

[4] Disallowable costs include vehicle costs from lines 1A(1) and (2); operational and repair costs from line 1B; taxes from line 2; and vehicle registration costs from line 3.

APPENDIX B. MANAGEMENT'S COMMENTS

NATIONAL MAIL TRANSPORTATION PURCHASING

UNITED STATES POSTAL SERVICE

February 29, 2000

RICHARD F. CHAMBERS

THRU: KEITH STRANGE For [illegible]

SUBJECT: Transmittal of Draft Audit Report – Southwest Area Expenditures for Extra Highway Trips Using Leased Equipment (Report Number TR-AR-00-Draft)

This is written in response to the recommendations contained in the subject report, dated January 27, 2000. The report identifies a series of issues regarding several contracts awarded by the Southwest Area Distribution Network Office and indicates that the supplier was overpaid approximately $848,000.00. Based on our analysis of the available information and in light of our current purchasing and contract management policy, we think the possible overpayment (if any) will be in the neighbor-hood of approximately $410,491.00, although it might run a bit higher or lower. If the supplier cannot provide acceptable documentation for the cost above pro-rata, we will seek to recover any over payments. The following is our analysis of the operation and resulting cost.

Background (Operations Program):
Extra trips of service are normally run on an infrequent basis and can normally be performed with the use of existing equipment. However, in this case, the additional service could not be performed using the existing equipment assigned to the contract. It was also not possible for the suppliers to obtain long term leases for the equipment because the postal service could not provide them with an estimated term. Therefore, the supplier had to lease additional equipment on short notice for an undetermined period of time, which typically has significant impact on the cost of leased equipment and the resulting transportation services.

The "Quality Service End to End' (QSETE) program was established to improve transportation service in the Southwest area. The contracting office was notified the program was to be a pilot and it was determined that scheduled extra service would be added to those contracts that would be supporting the program. Based on determinations at the time the requirement was presented, there was not sufficient time to negotiate extra trip rates with the suppliers nor, since this was a pilot program, would it have been in the best interest of the Postal Service to negotiate rates into the contract and then pay indemnity if they were removed.

Clause B-67 b. of the Purchasing Manual states; extra trips shall be negotiated in advance of the performance when the contracting officer deems it appropriate. In this case, it was determined QSETE was an experimental program (pilot) and therefore, the statement of work was subject to change week to week until firm requirements were made, and negotiations would require fixed costs to the contract subject to indemnity should the service be reduced, the contracting officer deemed it inappropriate to negotiate at that time.

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The clause further states the contracting officer may order the supplier to perform such extra service at pro rata pay, the supplier shall perform the service as ordered and may after the fact file claims for reimbursement above the pro rata costs. The suppliers were paid for the additional service at pro rata and have filed claims for costs above pro rata by requesting reimbursement for rental equipment (tractors and trailers). This approach is consistent with our policy and practice. Although we manage the overall unit cost of highway very well, there have been and will continue to be those instances where we will have to quickly purchase services to either protect and/or improve failed service to our customers.

Cost Analysis and Next Steps:
We have established the contracting official deemed it appropriate to pay the additional service at pro rata and allow the contractor to file a claim for cost above pro rata, therefore, the amount in question becomes the additional cost of leased equipment. We differ with the report in the methodology to arrive at that rate.

Most lines (units and total cost) on the suppliers cost statement are estimates and line 1B includes cost of repairs, repair labor, tires and other miscellaneous operational costs not carried in other items on this form. This line is also adjustable by CPI with no documentation. Line 2 taxes shows in one contract for $1,000 and we do not consider that to be a correct representation of the taxes. Therefore, since the amount at this time involves the lease of the equipment we have used lines: 1A1, Motor Vehicles, Line 1A2, Trailers and line 3 vehicle registration ($410,491.00).

We do not agree with the methodology, your second report added your methodology, lines 1B, 2 and 3 to our methodology, lines 1A1, 1A2 and 3 (minus the double count on line 3) for a total of $848,000.00.

The suppliers claimed and were paid $1,536,130 for leased equipment and received through pro rata payments $410,491 for equipment and registration. The contracting officer has notified the suppliers that we feel there is a possible overpayment and they must provide documentation to support additional costs or reimburse the monies.

Current Status:
The report states that contracting officials did not reevaluate the reasonableness of the contract rate and the appropriateness of payments for leased equipment. Based on the continuing operational requirements of the Postal Service and the uncertainty of final requirements, the service continued to be provided as scheduled extra trips. The newly appointed DN Manager eliminated some of the service requirements and we have negotiated contract modifications for all except two of the initial service changes requiring leased equipment. At this point, plans are to finalize requirements and negotiate the two remaining contracts within the next ninety days.

Specific Recommendations:

1. Recover $848,000 in over payments identified in this report and any additional amounts incurred subsequent to December 1999.

As mentioned above, the Contracting Officer has initiated discussions with the contractors to determine the additional cost above pro-rata. We agree with this finding that if documentation of cost cannot be provided a possible recovery might be warranted. Based on the feedback and documentation provided by the contractors and subsequent evaluation by the Contracting Officer, we will decide to seek a reimbursement or close the case. As mentioned above, we think the total possible recovery might be $410,491.00.

2. Determine whether adjustments are needed in the contract rate when equipment is leased for extra trip service.

We agree with this recommendation. Based on feedback from our Southwest area office and the other 12 transportation purchasing units throughout the system, it is not our practice to reimburse suppliers without appropriate documentation. In our view, the occurrence in the Southwest area is an exception activity rather than the norm.

As is the case now, the contracting officers prefer to negotiate costs prior to the start of service. however, since the purpose of mail transportation is to support mail-processing operations that will not always be possible or practical. If operations change and transportation needs to be adjusted immediately, it may require the ordering of the service with lease equipment and negotiations later. A key point to remember is that the contractor must proceed to provide the service at pro rata (that is a financial cap). After the fact, we can negotiate any additional cost with the contractor. As we have mentioned in previous correspondence, such changes in operating requirements drive the need for many of the Postal Service's emergency contracts and extra trips.

3. Ensure all additional contract costs are properly authorized through contract amendments.

We agree. We will ensure that all additional contract costs are negotiated and properly authorized through contract amendments. As mentioned in item 2 above, there will be exceptions driven by the needs of the operations. Since the additional service in question was not added to the contract, rather, a pilot program, it was ordered as scheduled extra service and paid on form 5429 which is in accordance with current postal regulations.

4. Review all other contracts in which equipment was leased for extra trips and recover any overpayments, as appropriate.

We agree. The Contracting Officer for each DN office was polled some weeks ago and they all responded, that when a supplier was paid in excess of pro-rata they required documentation of cost and the contracts were appropriately modified or the service is paid through one of our standard exception processes. As we conduct our field contract reviews, we will pay particular attention to this issue.

In summary, we thank you and the members of your staff for working with us towards continuous improvement. In the future, we look forward to working with you through additional business and process reviews.

J. Dwight Young

J. Dwight Young, Manager
National Mail Transportation Purchasing

Major Contributors To This Report

[redacted]