



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

Oversight of Performance-Based Contracts

Audit Report

June 17, 2013

Report Number SM-AR-13-002



HIGHLIGHTS

BACKGROUND:

Performance-based contracting emphasizes that all aspects of an acquisition be structured around the purpose of the work to be performed as opposed to how the work is performed. It is designed to ensure that contractors are free to determine how to meet performance objectives, that appropriate performance quality levels are achieved, and that payment is made only for services that meet these levels. Performance-based contracts contain four attributes: a statement of objectives that describes the desired outcome, measurable performance metrics, a quality assurance plan to monitor the contractor's performance, and incentives to encourage better performance. Our objective was to assess U.S. Postal Service controls for overseeing performance-based contracts.

WHAT THE OIG FOUND:

Postal Service contracting officials did not have adequate controls to oversee performance-based contracts. Specifically, they did not track these contracts and did not always take advantage of contracts benefits. Although officials did not track performance-based contracts, we identified six contracts with incentives valued at \$602 million. We also identified two additional contracts that could have been awarded as performance-based but were not. These

additional contracts contained all attributes except a statement of objectives.

Officials did not see a business need to track performance-based contracts, could not explain why they were not used, and indicated there was a lack of training and clear guidance on the use of these contracts. By not tracking and promoting the use of performance-based contracts, the Postal Service could miss opportunities to increase revenue and efficiencies.

Lastly, we identified six improperly coded contracts valued at \$120 million and one with about \$18 million in improperly certified payments. Inaccurate data and inadequate contract oversight increases financial risk to the Postal Service. Management corrected the six incorrectly coded contracts to reflect the correct contract type and enforced internal controls for certifying invoices on the other contract.

WHAT THE OIG RECOMMENDED:

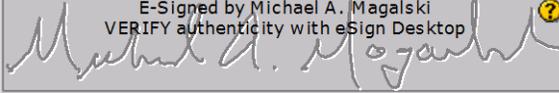
We recommended management develop a process to identify performance-based contracts, provide guidance and training on the use of these contracts, correct miscoded contracts, and enforce controls for certifying invoices.

[Link to review the entire report](#)



June 17, 2013

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 Performance-Based Contracts
(Report Number SM-AR-13-002)

This report presents the results of our audit of the Oversight of Performance-Based Contracts (Project Number 12WG010CA000).

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

Attachments

cc: Joseph Corbett
Trent Ensley
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 Performance-Based Contracts (Project Number 12WG010CA000). Our objective was to assess controls for overseeing performance-based contracts. This self-initiated audit addresses operational risk. See [Appendix A](#) for additional information about this audit.

Performance-based contracting emphasizes that all aspects of an acquisition be structured around the purpose of the work to be performed as opposed to how the work is performed. It is designed to ensure that contractors are free to determine how to meet performance objectives, that appropriate performance quality levels are achieved, and that payment is made only for services that meet these levels. These contracts contain four attributes: a statement of objectives that describes the desired outcome, measurable performance metrics, a quality assurance plan to monitor the contractor's performance, and incentives to encourage better performance.

Conclusion

U.S. Postal Service officials did not have adequate controls to oversee performance-based contracts. Specifically, contracting officials did not track this contracting method in their data system and did not always take advantage of the benefits of this approach.

Although officials did not track these contracts, we identified six performance-based contracts with incentives valued at \$602 million. We also identified two additional contracts that could have been awarded as performance-based contracts but were not. These contracts contained incentives, performance metrics, and a quality assurance plan. However, these additional contracts were missing a statement of objectives.

Officials did not see a business need to track performance-based contracts, could not explain why performance-based contracting was not used, and indicated there was a lack of training and clear guidance on the use of this contracting approach. By not tracking and promoting the use of performance-based contracts, the Postal Service could miss opportunities to increase revenue and efficiencies.

Lastly, we identified six improperly coded contracts valued at \$120 million and about \$18 million in improperly certified payments. Inaccurate data and inadequate contract oversight increases financial risk to the Postal Service. Management corrected the six incorrectly coded contracts to reflect the correct contract type and enforced internal controls for certifying invoices on the other contract.

Performance-Based Contract Tracking

Contracting officials did not track performance-based contracts in their Contract Authoring and Management System (CAMS).¹ There is no code or designator in CAMS to identify these contracts. By surveying officials and reviewing computerized contract data, we identified six performance-based contracts with incentives valued at \$602 million. One contract for building management and maintenance at a postal facility contained a statement of objectives outlining the services needed and the supplier's fee was adjusted, based on the supplier's performance. Specifically, the supplier's performance was evaluated quarterly and when performance exceeded established performance levels, the supplier received a percentage increase to its fee. This contracting approach allowed the supplier the opportunity to increase its profits and the Postal Service to achieve better supplier performance. All six contracts identified provided adequate evidence of performance monitoring and justifications for incentive payments.

There is no criterion to require an identification code for performance-based contracts and Postal Service officials indicated they do not see a business need to specifically identify these contracts in their contracting systems. However, in performance-based contracts, the supplier can provide the Postal Service with specific benefits, such as cost reduction or revenue generation. The inability to track performance-based contracts within contracting systems creates an increased risk that the Postal Service may not be identifying opportunities to use this contracting method to maximize revenue and efficiencies or effectively manage these types of contracts.

Further, federal agencies regulated by the Federal Acquisition Regulation (FAR)² are required to identify the use of performance-based acquisitions. The Federal Procurement Data System (FPDS)³ is the primary tool for tracking this information annually to evaluate the government's use of performance-based contracts. Although the Postal Service is not subject to FAR, this information is provided as a best practice.

Use of Performance-Based Contracts

We identified two contracts that could have been set up as performance-based. While both contained performance metrics, incentives, and a quality assurance plan — elements of performance-based contracting — they did not include a statement of objectives. A statement of objectives allows suppliers the flexibility to develop cost-effective solutions and the opportunity to propose innovative alternatives for meeting these objectives. One contract for [REDACTED] did not contain a statement of objectives to outline the desired result, which would have allowed the supplier to use its experience in [REDACTED] to propose potential cost-effective solutions to address the desired result.

¹ A Postal Service application that provides comprehensive management for all aspects of the procurement process.

² The FAR is a set of principles that govern the government procurement process. It regulates the purchasing of goods and services by the government.

³ FPDS is the central repository of information for U.S. federal government-wide procurement data.

The contracting officers (COs) for these contracts could not explain why performance-based contracting was not used because they were not the original COs and the rationale was not documented in the contract files. Although COs are not required to use performance-based contracting, policy⁴ encourages it because of the potential benefits, such as cost reduction or revenue generation.

Contracting officials indicated that there has been no recent internal training on performance-based contracting methods. Management also indicated during the exit conference that current policy on the use of performance-based contracting is not as clear as it could be and they will look into revising it.

Without increased focus and training on performance-based contracts and ways to implement their use, Postal Service contracting officials may be missing opportunities to find better ways of doing business. By using the performance-based contracting approach, the Postal Service has an opportunity to further the goals of streamlining and reinvention because contractors can be given more latitude for determining methods of performance, with more responsibility for performance quality.

Contract Data Integrity

Postal Service COs incorrectly coded six contracts valued at \$119,515,234 as fixed-price incentive contracts⁵ in CAMS when the contracts did not include incentives. COs stated that this occurred because the contract types were misclassified. Training provided in 2011 addressed contracting officials' roles and responsibilities to ensure data integrity. Specifically, the buyer or CO is responsible for ensuring that contract information is complete and accurate. Because employees did not accurately record or complete contract data in CAMS, Supply Management officials could not accurately report on the contract types.

Unreliable and inaccurate data increase risk to the Postal Service, impacting its ability to effectively support management's decisions and to assist officials across multiple Supply Management portfolios.⁶ We are reporting \$119,515,234 in data reliability errors due to the six misclassified contracts (see [Appendix B](#) for details).

During our audit, COs performed corrective action by changing the contract type for four of the six contracts. In addition, one contract was updated as a new type when it was renewed in December 2012 and the remaining contract was not updated because it expired in January 2013. However, the CO is in the process of issuing a new contract with the correct contract type.

⁴ *Supplying Principles and Practices*, Section 2-18.9, Performance-Based Contracts. *Supplying Principles and Practices* are advisory and illustrative of approaches that Postal Service employees may generally use but are intended to provide for flexibility and discretion in their application to specific business situations. Consistent with that intent, the *Supplying Principles and Practices* create no rights, substantive or procedural, enforceable against the Postal Service.

⁵ A fixed-price incentive contract provides an incentive to adjust the profit to establish the final contract price.

⁶ Supply Management has five portfolios that purchase goods and services for the Postal Service.

Contracting Officer Representative Roles and Responsibilities

The CO should strengthen enforcement of the contracting officer representative's (COR) roles and responsibilities for the Postal Automated Redirection System contract. Specifically, we found the COR did not retain copies of certified invoices in the COR file⁷ to validate whether the Postal Service properly certified 54 payments totaling about \$78 million, from September 17, 2010 through September 26, 2012. The CO stated that he relied on the COR to maintain copies of the certified invoices; however, during our fieldwork the COR could not locate his copies of the certified invoices for this contract.

Postal Service officials provided us with updated information after our fieldwork. Specifically, the CO provided documentation indicating that all 54 invoices were certified. However, a program manager without appropriate COR designation certified 28 of the 54 invoices totaling about \$18 million in Postal Service payments.

Invoices must be approved by the office specified in the contract;⁸ however, the contract does not specify who should approve invoices. The CO stated that he designates invoice certification and retention responsibilities for the contract through a COR delegation letter and it was an oversight on his behalf that he allowed the program manager to perform COR responsibilities on the contract without an executed letter of appointment.

Inadequate enforcement of COR roles and responsibilities puts the Postal Service at risk of paying unnecessary or improper costs. Supply Management staff must enforce internal controls for certifying invoices to ensure proper payment for services received. We are reporting \$18,000,213 as unsupported questioned costs because an individual who was not properly designated with an executed letter of appointment on one contract certified 28 invoices (see [Appendix B](#) for a detailed analysis). During our audit, the CO took corrective action to issue a COR letter of appointment and had the current COR sign it.

Recommendations

We recommend the vice president, Supply Management:

1. Develop a process to identify and track performance-based contracts.
2. Ensure that clear policy guidance is provided for contracting officers when considering the use of performance-based contracting.
3. Provide training to contracting officers on the use of performance-based contracting methods.

⁷ The COR letter on file at the time of our review required the COR to retain copies of certified invoices in the COR files.

⁸ *Supplying Principles and Practices*, Section 5-11.3, Approve Invoice.

4. Update the Contract Authoring Management System to ensure the six incorrectly coded contracts reflect the correct contract type.
5. Enforce internal controls for certifying invoices on the Postal Automated Redirection System contract to ensure properly designated contracting officials certify payments for services received.

Management took corrective action to address recommendations 4 and 5 during our audit; therefore, we are closing these recommendations with the issuance of the report.

Management's Comments

Management generally agreed with the findings in the report and the impact associated with recommendations 4 and 5, but did not agree with recommendation 1.

Regarding recommendation 1, management disagreed with the necessity for establishing a process for tracking contracts using performance-based methods. Management stated that they are identifying opportunities to streamline work and create efficiencies in their contracting process. Management further stated that, since our report noted that all six contracts identified had adequate evidence of performance monitoring and justifications for incentive payments, they determined that tracking a method used within a contract type does not add value or provide efficiencies within their purchasing process.

Regarding recommendation 2, management stated that they believe the Supplying Principles and Practices had well-defined guidance for performance-based contracting arrangements, but agreed to further research performance-based methods and determine whether any change in their guidance is necessary. The targeted implementation date is January 2014.

Regarding recommendation 3, management agreed to provide further communication to contracting officials on performance-based methods, with a target implementation date of January 2014.

Regarding recommendation 4, management took corrective action by updating the six incorrectly coded contracts in the CAMS.

Regarding recommendation 5, management stated that invoices were determined to be properly certified for payment but took corrective action to ensure properly certified invoices are maintained. Management also updated the contracting officer's representative appointment letter. See [Appendix C](#) for management's comments, in their entirety.

Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to recommendations 2, 3, 4, and 5 and corrective actions should resolve the issues identified in the report. Management disagreed with recommendation 1. Although performance-based contracts are tracked at the CO and commodity manager level, they are not tracked within a contracting system, preventing upper management from having a global view of how this contracting method is being used; therefore, they may not be able to identify opportunities to use this contracting method to maximize revenue and efficiencies or effectively manage these types of contracts. We believe management should implement recommendation 1 to develop a process to identify and track performance-based contracts; however, we will not pursue the formal audit resolution for this recommendation. We will address this issue in a future review on contracting internal controls; therefore, we are closing this recommendation with the issuance of this report.

The OIG considers recommendations 2 and 3 significant and, therefore, requires OIG concurrence before closure; consequently, the OIG requests written confirmation when 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.

Corrective actions in response to recommendations 4 and 5 have been completed; therefore, we are closing these two recommendations with the issuance of this report.

Appendix A: Additional Information

Background

Performance-based contracting emphasizes that all aspects of an acquisition be structured around the purpose of the work to be performed as opposed to how the work is performed. It is designed to ensure that contractors are free to determine how to meet the performance objectives that appropriate performance quality levels are achieved, and that payment is made only for services that meet these levels. These contracts contain four attributes: a statement of objectives that describes the desired outcome, measurable performance metrics, a quality assurance plan to monitor the contractor's performance, and incentives to encourage better performance. A portion of the contract price is linked to a series of key performance indicators that the supplier is responsible for meeting. Performance-based contracting necessitates a considerable amount of monitoring to determine whether performance measures are being met and payment is justified.

The Postal Service's *Supplying Principles and Practices* identifies fixed-price incentive contracts as the most frequently used contracts in performance-based contracting. Fixed-price incentive contracts involve adjusting profit and establishing the final price by applying a formula based on the relationship between the total final negotiated cost and the total target cost. The profit for the supplier varies inversely with the cost, so this type of contract incorporates an incentive for the supplier to control costs.

CAMS is an application used to facilitate the solicitation, award, and administration of supplies, services, and transportation contracts. CAMS interfaces with other Postal Service systems to provide data for internal transparency to manage contracts and spend data.

Objective, Scope, and Methodology

Our objective was to assess controls for overseeing performance-based contracts. We reviewed six active performance-based incentive contracts as of August 2012.

Scope Limitation

We identified the six contracts by surveying officials and reviewing computerized contract data. Because the Postal Service does not track performance-based contracts in CAMS, we cannot be certain that we identified all performance-based contracts with incentives.

To accomplish our objective we:

- Obtained and reviewed Postal Service criteria, guidelines, procedures, and contract terms for performance-based contracts.

- Met with Supply Management portfolio managers, determined their use of performance-based contracts, and obtained a list of performance-based contracts with incentives.
- Interviewed Postal Service COs and reviewed the six contracts to determine whether there is evidence of performance monitoring and whether performance measures are being met and payment is justified.
- Performed additional work to identify high dollar value contracts in the Mail and Operational Equipment and Commercial Products and Services portfolios that could have benefitted from a performance-based contracting approach.

We conducted this performance audit from August 2012 through June 2013 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 April 17, 2013, and included their comments where appropriate.

We assessed the reliability of performance-based incentive contract data by comparing the information obtained through the survey of portfolio managers to information in CAMS. We determined that the data were sufficiently reliable for the purposes of this report.

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 and Other Impacts

Monetary Impacts

Recommendation	Impact Category	Amount
5	Unsupported Question Cost ⁹	\$18,000,213

Other Impacts

Recommendation	Impact Category	Amount
4	Data Integrity ¹⁰	\$119,515,234

The \$119,515,234 represents the value of the six contracts incorrectly coded in CAMS as fixed-priced incentive. Unsupported questioned costs totaling \$18,000,213 represents 28 invoice payments in which an individual who was not properly designated as the COR certified invoices. During our audit, contracting officials took corrective action to address recommendations 4 and 5.

⁹ 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.

¹⁰ Data used to support management decisions that is not fully supported or completely accurate. This can be the result of flawed methodology; procedural errors; or missing or unsupported facts, assumptions, or conclusions.

Appendix C: Management's Comments

SUSAN M. BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT



June 6, 2013

JUDITH LEONHARDT

SUBJECT: Response to Draft Audit Report – Oversight of Performance-Based Contracts (Report Number SM-AR-13-DRAFT)

Thank you for providing the Postal Service with the opportunity to review and comment on this subject draft report. Management generally agrees with the findings within this report and the impact associated with recommendations 4 and 5. Further agreement or disagreement with the recommendations is discussed below.

OIG Audit Recommendations:

We recommend the vice president, Supply Management:

1. Develop a process to identify and track performance-based contracts.

Management Response: In response to this recommendation, management disagrees with the necessity for establishing a process for tracking contracts using performance-based methods. Our contract authoring systems are designed to capture contract types (e.g., firm fixed price, various cost type contracts, indefinite delivery etc.) in which a statement of work, statement of objective, or specification etc., may be used to determine how the contract will operate and describe performance metrics as necessary. The decision to use performance-based contracting is determined in the planning stages of the individual purchase; and is not necessarily suitable for use within all of our purchasing commodities. The Postal Service is to operate like a business, is not driven to set goals on the use of specific contract types or methodologies used in contracting, but to determine what would be the most beneficial use of available purchasing tools to achieve best value for the individual purchase.

As part of our 2013-2015 Strategic Plan, we are identifying opportunities to further streamline work and create efficiencies in our Supply Management contracting process to reduce cycle time, and increase speed to implement and improve compliance rates and controls. Currently, knowledge and control of performance-based contractual methods is at the contracting officer and commodity manager levels. As the OIG's report states, "All six contracts identified provided adequate evidence of performance monitoring and justifications for incentive payments." Therefore, I have determined that tracking a method used within a contract type does not add value or provide the efficiencies we are looking to implement within our purchasing processes.

Target Implementation Date: Not applicable.

Responsible Manager: Not applicable.

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2. Ensure that clear policy guidance is provided for contracting officers when considering the use of performance-based contracting.

Management Response: Our Supplying Principles and Practices (SP and Ps) address performance-based contracting arrangements, appropriate circumstances for its use, the different contract types used with these arrangements, key elements and indicators, use of incentives, the quality assurance plan component, and considerations when using a performance-based contract arrangement. We believe this guidance is well defined within the SP and Ps, but agree to further research this method and determine whether any change in our guidance is necessary.

Target Implementation Date: January 2014.

Responsible Manager: Manager, Supply Management Infrastructure

3. Provide training to contracting officers on the use of performance-based contracting methods.

Management Response: Management agrees to provide further communications to contracting officials regarding performance-based contracting methods.

Target Implementation Date: January 2014.

Responsible Manager: Manager, Supply Management Infrastructure

4. Update the Contract Authoring Management System to ensure the six incorrectly coded contracts reflect the correct contract type.

Management Response: Action to correct the contract coding was completed.

Target Implementation Date: Per the OIG, this recommendation will be closed with the issuance of the final report.

Responsible Manager: Contract specific portfolio managers within Supply Management

5. Enforce internal controls for certifying invoices on the Postal Automated Redirection System contract to ensure properly designated contracting officials certify payments for services received.

Management Response: All related invoices were determined to be proper for payment. Corrective actions to ensure retention of properly certified invoices were maintained and an updated contracting officer representative appointment letter was completed.

Target Implementation Date: Per the OIG, this recommendation will be closed with the issuance of the final report.

Responsible Manager: Manager, Mail and Operational Equipment Portfolio

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: Joseph Corbett
Trent Ensley
Robert D'Orso
Susan Witt
Corporate Audit and Response Management