OFFICE OF
INSPECTOR
GENERAL
UNITED STATES POSTAL SERVICE

Advertising Program

Audit Report

January 4, 2013

Report Number MS-AR-13-002

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

HIGHLIGHTS

January 4, 2013

Advertising Program

Report Number MS-AR-13-002

BACKGROUND:
The United States Postal Service spent $147 million on advertising in fiscal year 2011. Our objective was to evaluate the oversight of this advertising program.

WHAT THE OFFICE OF INSPECTOR GENERAL FOUND:
The Postal Service was not adequately monitoring its two largest advertising contracts, which threatened the effectiveness and integrity of its advertising program. Specifically, the Postal Service:

- Did not clearly define or understand the roles and responsibilities of the primary team members for its major advertising contractors, who were paid $10 million in fiscal year 2011.
- Paid $631,712 in questionable bonuses to these two contractors in fiscal years 2011 and 2012.
- Did not sufficiently track or allocate certain advertising costs.
- Did not comply with internal controls for certifying and retaining advertising invoices.

We also identified misuse of position by [redacted] which we have referred to our Office of Investigations for further review.

These deficiencies, particularly related to the lack of clear understanding of contractor staff roles and responsibilities and the misuse of position, are concerning because of the structure and magnitude of the contractors' wage rates and total labor costs, which were $11.4 million in fiscal year 2011.

Senior management expressed concern over these contracts during our audit and allowed the major advertising contract to expire. Management has taken significant steps to restructure advertising contract processes for consistency with current industry practices and maximize the effectiveness of its advertising investments.

Overall we identified nearly $7 million in unsupported questioned costs as a result of incorrectly certified and questionable contractor support staff labor costs and bonus payments.

WHAT THE OFFICE OF INSPECTOR GENERAL RECOMMENDED:
We recommended the Postal Service establish a clearly defined process to perform contractor evaluations; and appropriately review, certify, and maintain invoices. We also recommended the Postal Service track contractor labor costs and appropriately allocate advertising costs.

Link to review entire report.

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

January 4, 2013

MEMORANDUM FOR: NAGISA M. MANABE
CHIEF MARKETING/SALES OFFICER AND EXECUTIVE VICE PRESIDENT

SUSAN M. BROWNELL
VICE PRESIDENT, SUPPLY MANAGEMENT

Darrell E. Benjamin, Jr.

FROM: Darrell E. Benjamin, Jr.
Deputy Assistant Inspector General
for Revenue and Performance

SUBJECT: Audit Report – Advertising Program
(Report Number MS-AR-13-002)

This report presents the results of our audit of the U.S. Postal Service's Advertising Program (Project Number 12RG015MS000).

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Janet M. Sorensen, director, Marketing and Service, or me at 703-248-2100.

Attachments

cc: Susan A. Witt
Corporate Audit and Response Management

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Introduction

This report presents the results of our audit of the U.S. Postal Service's Advertising Program (Project Number 12RG015MS000). Our objective was to evaluate the effectiveness of the Postal Service's oversight of its advertising program. This self-initiated audit addresses strategic and financial risk. See Appendix A for additional information about this audit.

The Postal Service uses a variety of means — including direct mail, print and digital media, mobile technologies, television, and radio — to advertise, market, promote, and brand its organization, products, and services. The Postal Service spent about $147 million on advertising in fiscal year (FY) 2011, with over $138 million attributed to specific products (see Table 1). The majority of this expense (about $108 million) was for Priority Mail, which included the "if it fits, it ships"® Flat Rate Box campaign. According to the Postal Service, this has been one of its most successful campaigns to date and has won awards for its effectiveness.

Table 1: Advertising Expense by Product, FY 2011

Product	Expense (in millions)
Priority Mail	[redacted]
Direct Mail	[redacted]
Post Office Boxes	3.1
First-Class Mail	3.1
Corporate Backend Support[1]	2.1
Retail Access	[redacted]
Automated Postal Centers	1.9
Stamps	1.8
Package Services	[redacted]
USPS.com	0.9
Other[2]	[redacted]
Total	**$ 138.4**

Source: Postal Service *FY 2011 Cost, Revenue, and Analysis* report.

The Postal Service's advertising group, which consists of 13 staff members, is responsible for overseeing advertising contracts, as the Postal Service contracts out nearly all of its advertising work. The Postal Service paid its primary advertising

[1] Includes elements such as website maintenance, database support, inventory management, metrics, etcetera.
[2] Includes other advertising products and categories such as International Mail, Express Mail, Global Priority Mail, Research, Core Team Travel, and Brand.

contractor $126 million[3] in FY 2011, making the firm its sixth largest supplier overall. The Postal Service began contracting with this firm in August 2002 and extended their contract on a non-competitive basis through September 2012. This contractor was responsible for such activities as purchasing media, developing creative content and providing strategic direction, publishing *Deliver* magazine,[4] and producing commercials. This contractor had two types of staff that worked on the Postal Service account: (1) a [redacted]-member core team responsible for creative content and strategic direction and paid for on a firm-fixed price[5] basis and (2) various other specialists and staff (non-core team) responsible for 'day-to-day' administrative and technical work. The work for the non-core team staff was billed to the Postal Service monthly.

The Postal Service's second major advertising contract is primarily for advertisements at retail post offices (such as signage, posters, and displays). This contract started in 2009 and includes a core team of [redacted] staff members. The Postal Service spent about $10 million in FY 2011 on this contract. The Postal Service also has separate advertising contracts for marketing database management, campaign analytics and data processing, and other smaller campaigns. The costs for the other advertising contractors was about $11 million in FY 2011.

The Postal Service has designated 'Brand Advancement' as one of its Delivering Results, Innovation, Value, and Efficiency initiatives. As part of this initiative, the Postal Service seeks to (1) advance the value of the Postal Service's brand essence and increase the value of the Postal Service's brand among internal and external stakeholders, (2) align and motivate the organization around the core brand essence principle, and (3) increase coordination with other key organizations to promote the use of the Postal Service's brand essence. The Postal Service spent about $169,000 on brand initiatives in FY 2011.

Conclusion

The Postal Service was not adequately monitoring its two largest advertising contracts, which threatened the effectiveness and integrity of its advertising program. Specifically, the Postal Service:

- Did not have a clear understanding of the roles and responsibilities of the core team members for its major advertising contractors, who it paid $10 million in FY 2011 because they were not clearly defined in the contract. Without this information, the

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[3] According to Postal Service advertising officials, the vast majority of the Postal Service's contractor costs ([redacted] million in FY 2011) are 'pass-throughs,' whereby the contractor procures certain media or other services on behalf of the Postal Service and passes payment directly through to the service provider (such as to the television studio that aired the Postal Service's commercial).

[4] *Deliver* magazine is published six times a year by the Postal Service's main advertising contractor. The Postal Service spent over $3 million on the *Deliver* magazine program in FY 2011. This magazine is free to all subscribers and provides marketers with research, news, and commentary impacting the Direct Mail industry.

[5] The price is normally not subject to adjustment and is typically used when there is minimal risk or risk can be predicted with a high degree of certainty. Postal Service policy states that firm-fixed price contracts pay suppliers a fixed amount over a 12-month period. The amount of compensation does not depend on revenue generated.

Postal Service was unable to provide adequate oversight of what work should be completed by the core team and what should appropriately be accomplished by non-core team personnel. As such, we found $4 million in questionable payments to non-core team staff members in FYs 2010 and 2011.

- Paid $631,712 in questionable bonuses to these two contractors in FYs 2011 and 2012, even though the process for evaluating contractor performance was unclear.

- Did not sufficiently track costs associated with non-core staff members or allocate core team travel costs to specific projects — issues that made it difficult to objectively evaluate the effectiveness of the contractor's performance and the Postal Service's overall advertising efforts.

- Did not comply with internal controls for certifying and retaining invoices from its advertising contractors. We found $2.3 million in invoices that had not been certified properly and determined there were $4 million in invoices missing from the contracting officer representative's (CORs) files.

We also identified an instance of misuse of position [redacted] We also found that the contents of our informal draft report were improperly released to officials outside of the Postal Service who were connected to the major contractor.

These shortcomings associated with the Postal Service's oversight of these contracts are especially troubling since (a) the largest contract was originally awarded in August 2002 and was non-competitively extended from July 2006 to September 2012 and (b) the second contract was awarded non-competitively in 2009. Furthermore, the structure and magnitude of these contracts — particularly the wage rates, labor costs, and bonus payments — should have been accompanied by a more stringent oversight structure that protected the Postal Service's investment.

Inadequate oversight and internal controls put the Postal Service's advertising program and spending at risk. The issues we have identified are significant enough to warrant immediate action to prevent additional questionable expenditures. We met with the Postal Service's chief Marketing and Sales officer who agreed with the concerns we raised. She initiated corrective actions by not extending the contract with its major advertising contractor into FY 2013; significantly updating, restructuring, and resoliciting various portions of the advertising contract to be make them consistent with current industry practices and maximize the effectiveness of its advertising investments; and changing leadership in the Advertising group. We are reporting $2.3 million in improperly certified invoices, $4 million in non-core labor costs, and the performance bonuses of $631,712 as questioned costs. See Appendix B for monetary impact. Additionally, we are reporting $380.4 million for FY 2010-2012 total disbursements made on the two largest contracts as other impact, disbursements at risk.

Oversight of Major Advertising Contracts

The Postal Service was not adequately overseeing and monitoring its two major advertising contracts, which threatened the effectiveness and integrity of its advertising program. The shortcomings associated with the Postal Service's oversight of these contracts were especially troubling considering:

- The Postal Service originally awarded its major advertising contract in August 2002, extended it non-competitively since July 2006, and anticipates another non-competitive extension for FY 2013. The Postal Service non-competitively extended this contract on the grounds of 'compelling business interests,' [6] which the Postal Service defines as 'a business interest so compelling that purchasing non-competitively outweighs the benefits of competition, as well as its overall satisfaction of the contractor's performance. The Postal Service allowed this contract to expire at the end of FY 2012.

- The Postal Service's second largest advertising contract was awarded non-competitively in 2009. This followed a 7-year period in which this firm was a subcontractor under the larger Postal Service advertising contract. The Postal Service decided to enter into a contract with this firm to reduce overall advertising costs and have direct access to the firm. The Postal Service recently non-competitively extended this contract into FY 2013.

While the non-competitive justification may have been sufficient to comply with Postal Service requirements, we believe the Postal Service could benefit from re-competing and restructuring these contracts to take advantage of available competition in the advertising marketplace and better align these contracts with current advertising contracting practices.

Core and Non-Core Team Roles and Responsibilities

Postal Service contractual payments for contractor core team and non-core team staff members are questionable due to their lack of oversight and magnitude. The Postal Service did not have a clear understanding of the core team's roles and responsibilities because they were not clearly defined in the contract. Furthermore, while certain roles and responsibilities for core team members were outlined in an amended technical proposal, contracting and program officials did not have this document readily available and were unfamiliar with its contents. Without this information, it is difficult for the Postal Service to understand the following:

- *Performance of the core team throughout the year*. Through discussions with Postal Service advertising and contracting staff and reviews of the Postal Service's

[6] Compelling business interest situations can include, but are not limited to, the urgency of the requirement, supplier innovation that furthers business objectives, or undue costs or delays that would result from a contract reward to a new supplier.

contracting files, there was limited documentation indicating the roles and responsibilities of core team members. Having information that lists key personnel roles and describes their responsibilities readily available to contracting and program staff is a common — usually required — practice in the federal government, particularly considering the scope and magnitude of the core team and the related costs. Documents that described these roles and responsibilities were not included in the contracting files or held by any Postal Service advertising staff COR or the contracting officer (CO). Although Supply Management officials subsequently provided an amended technical proposal from May 2002 that included some information on the general roles of the core team, this document did not provide comprehensive detail about the roles and responsibilities of specific core team members ([redacted]). Without clear, readily available information that established what is expected of specific core team members throughout the year, the Postal Service was unable to effectively assess the team's performance throughout the year.

- *Why non-core team staff members perform some work.* Postal Service contracting staff noted that the contractor could delegate core team work to junior-level staff. Such an arrangement would put these Postal Service payments at risk because the Postal Service would be paying for the same service twice, once as part of the core team's fees and again as part of invoiced non-core work. For example, we found invoices and documents that illustrated potential issues associated with having work performed by non-core staff that could have been completed by the core staff. Specifically, we found invoices that contained written narratives from Postal Service officials that questioned the billing of this work — such as "This work….should not be charged to the USPS [as a non-core expense], the core team should do the work." However, in each of these examples, no changes were made to the invoice and Postal Service advertising managers approved the invoiced amount for payment. When we asked the approving COR about these comments, the official stated that when questions regarding payment of invoices arose, there were discussions among Postal Service advertising staff and possibly the contractor to resolve the issues. The official also stated that in the examples above, these discussions lead to approval of the invoices for payment.

The structure and magnitude of these core team costs should have been accompanied by a more stringent oversight structure to protect the Postal Service's investment. The Postal Service agreed to pay over $10 million for core team staff costs in FY 2011 as part of these contracts. There were [redacted] core team staff members for the largest advertising contract and [redacted] for the second largest advertising contract. These staff members were paid on a firm-fixed price agreement regarding staffing hours and hourly labor rates. This firm-fixed price structure, however, only applied to the work the core team performed. The core team could delegate work to non-core staff or subcontractors, both of whom could potentially invoice their costs back to the Postal Service.

The overall construct of this labor payment structure has not changed significantly since the original contract was signed in 2002. The CO who oversaw the solicitation and award of the original contract stated that this payment structure was typical of advertising services at that time. Our research indicates that this labor payment structure should have been re-evaluated, particularly considering the oversight deficiencies we uncovered. Specifically, General Services Administration (GSA) contracting experts on advertising services contracts stated that they are not aware of any federal advertising service contracts that use this structure and that without diligent oversight, this contracting structure leaves the Postal Service vulnerable to significant labor costs. Furthermore, the fact that various groups could perform work under these contracts underscores the importance of conducting quality oversight in this area and ensuring the contract requirements were clearly defined — the Postal Service should have had a clear understanding of who should perform what work. The Postal Service's inability to clearly understand the core team's specific roles and responsibilities, combined with other issues we found related to whether a core team member or non-core team member should have completed a particular task, resulted in the Postal Service being vulnerable to potentially duplicative labor costs.

In addition, we found the Postal Service agreed to pay hourly labor rates to its largest advertising contractor that exceeded the rates this contractor would charge other federal agencies as set forth by the GSA's Federal Supply Schedule Price List.[7] For example, the maximum wage rate in the GSA schedule for this contractor was $302.27 per hour — the Postal Service paid wage rates that exceed this amount for 21 percent of contractor staff, with two contractors earning [redacted] per hour. These fees also covered, on average, between 22 and 32 hours of work each week on Postal Service campaigns (see Table 2).

[7] Although the Postal Service is not subject to the wage rates defined in GSA's Advertising and Integrated Marketing Solutions, Schedule 541, we consider these rates to be an appropriate benchmark to evaluate the reasonableness of these contractor costs. The wage rates for the Postal Service contract and included in the GSA schedule are both fully loaded wage rates that includes labor, overhead, and profit. Furthermore, although Postal Service officials stated that the advertising services they solicited as part of their advertising contracts were greater in magnitude and complexity than those found under the GSA schedule, we consider these wage rate comparisons appropriate because the contractor's employee titles (such as creative director) included in both the GSA schedule and Postal Service contract were identical.

Table 2: Select Postal Service Advertising Contractor Fees for FY 2011

Title	Hours (average per week)	Hourly Labor Rate	Total FY 2011 Fee
Creative Director	32	[redacted]	[redacted]
Account Director	32		
Vice President (VP) Group Account Director	32		
Business Planner	29		[redacted]
Creative Director – Direct	32		
Creative Director – Direct	32		
Account Director	22		
VP Strategic Planning	25		
Associate Creative Director – Retail	29		
Account Director	32		[redacted]
Account Director	32		
Account Director	32		
VP Account Director – Retail	32		
Media Director	32		
VP Account Planner	32		
Account Director	32		
Account Director – Retail	32		

Source: Postal Service contracts with its two largest advertising firms.

While we recognize the Postal Service did not have to follow the GSA schedule and had the authority to negotiate its own contractor rates, the magnitude of these rates — particularly considering the Postal Service's recent financial challenges — necessitated a corresponding amount of oversight to protect the Postal Service's financial interests. The Postal Service's limited understanding of the core team's roles and responsibilities did not provide an appropriate amount of oversight commensurate with the magnitude of these costs. As a result of the lack of information in the contract regarding the core team's roles and responsibilities, we are designating the $4 million in non-core team labor costs in FY 2010 and 2011 as questionable. Without this information, the Postal Service was vulnerable to potentially duplicative labor costs because it did not have a clear understanding of which staff, core team or non-core team members should be performing what work.

Tracking and Allocating Costs

The Postal Service did not appropriately track the contractor's non-core team staff costs or allocate contractor travel costs to specific projects — issues that made it difficult to objectively evaluate the effectiveness of the contractor's performance and the Postal Service's overall advertising efforts.

For example:

- *Insufficient tracking of non-core team staff costs*: During our audit, the Postal Service was unable to provide current numbers when requested. The most recent figure provided during our audit was $8.5 million in FY 2009. In reviewing labor-related invoices and meeting with Postal Service officials and Postal Service contracted data staff, we found that there are two types of billing methods for non-core labor:

  - An hourly labor rate, where a non-core team member would work on a project and bill their hours directly back to the Postal Service; and

  - A flat fee or 'rate card,' where the Postal Service and the contractor agreed on the total cost for a particular task (such as making a poster). This total cost would include a non-core team labor component, as well as other materials. Postal Service officials stated the aforementioned $8.5 million was provided to them by their main advertising contractor and that they did not have readily available access to either of the non-core labor amounts based on the following:

    - Hourly labor rates — Postal Service officials stated there was no readily available reporting mechanism for the hourly labor rate for non-core team costs for the specific contractors and that the reports available to them only contained hourly non-core labor costs for all advertising contractors. We subsequently worked with Postal Service staff and contractors to estimate hourly non-core team labor expenses of $2.8 million in FY 2010 and $1.2 million in FY 2011.

    - Flat fee or 'rate card' — Postal Service officials stated that, although they know the labor component comprised more than 50 percent of all flat-fee work, they were unable to determine the exact non-core team labor component of flat-fee work ($11.5 million in FY 2010 and $11 million in FY 2011). During our audit, however, we found several invoices for work completed on a flat-fee basis that specified the exact amount of the non-core team labor component.

The Postal Service's inability to sufficiently track and monitor non-core team labor costs incurred by each of the respective contractors hindered its ability to provide effective contractor oversight and objectively evaluate their performance. Although the Postal Service implemented a new tracking system in 2012, it still does not have the capability of sufficiently tracking these costs. For example:

- *Misallocated travel expenses*: The Postal Service misallocated $17,800 in non-core team travel expenses to core team travel between October 2010 and May 2012. Core team travel expenses are not allocated to specific advertising products (see the table in Appendix A), while travel for non-core team members is allocated to specific advertising projects.

- *Misallocated contractor executive costs*: Between October 2009 and September 2011 the Postal Service allocated $37,790 in costs incurred by an executive official for the largest advertising contractor as 'Miscellaneous,' when some of the costs should have been tied to specific products. For example, work specifically performed on the Every Door Direct Mail[8] advertising campaign was allocated to the Miscellaneous account instead of the Direct Mail account.

Invoice Retention and Certification

The Postal Service did not comply with internal controls for certifying and retaining invoices from its advertising contractors. Select Advertising staff who are CORs[9] are required as part of their COR certification to, among other things, verify invoices and, upon receipt, promptly certify them for payment and forward a copy of the certified invoice to the CO for retention in the contract file. These officials "may not re-delegate any of the contractual authority listed above, except for clerical tasks associated with that authority." During our review of the Postal Service's advertising invoices we found:

- Sixty-one invoices totaling $2.3 million in Postal Service payments made between October 2010 and March 2012 that were either not certified or were certified by someone without appropriate designation. Certifying invoices for payment is a key responsibility of contractor-certified Advertising staff and, as such, should not be re-delegated.

- Eleven invoices totaling $4 million in Postal Service payments missing from COR files in our review of 348 payments of over $100,000 made between October 2010 and March 2012. We subsequently located the invoices in the Postal Service's Accounts Payable records in San Mateo, CA.

- Copies of certified invoices were not retained in the contract file.

Postal Service officials explained that a prior budget specialist lost some invoices and also stated that improper invoice certification occurred when no CORs were available. These officials stated that they now have a sufficient number of CORs available to prevent these issues in the future. Postal Service officials recently provided us with updated information on some of the aforementioned invoices. Specifically, this updated documentation indicated that 12 invoices totaling $846,535 were appropriately certified.

Inadequate internal controls put the Postal Service at risk of paying for services that were not rendered or did not meet contract requirements. Since we cannot ascertain whether services the Postal Service paid for were adequately rendered when invoices were not properly certified, we are reporting $2.3 million in invoices that were incorrectly certified as unsupported questioned costs. We did not include the $4 million in invoices

[8] Every Door Direct Mail is a program the Postal Service developed to enable businesses to send postcards or advertisements to a target audience without purchasing a mailing list or print-specific addresses on a mailpiece.
[9] Advertising staff who are trained and designated as CORs.

missing from the COR files in our monetary impact calculations because they were subsequently retrieved from the Accounts Payable records in San Mateo. However, non-retention of these invoices by COR staff was not consistent with Postal Service policy. The Postal Service's Advertising and Supply Management staff must enforce internal controls for certifying and retaining invoices in order to avoid paying for services that are not rendered or do not meet contract requirements.

Questionable Contractor Bonus Payments

The Postal Service made questionable bonus payments totaling $631,712 to two contractors in FYs 2011 and 2012, basing these performance incentive payments on quantitative and qualitative factors and specific metrics it agreed to with the contractors. The Postal Service, however, did not have a clear, defined process for calculating the qualitative factors that accounted for 80 percent of these contractor evaluations. Therefore, [redacted] adjusted some qualitative rankings to offset the views of internal advertising clients [redacted] found unfairly critical and to incorporate the views of other Postal Service executives who did not submit rankings. The lack of a clear, defined process for determining the qualitative scores and the subsequent adjustment of scores [redacted] raise questions about the appropriateness of these bonus payments.

Misuse of Position and Improper Release of Information

We discovered [redacted] impairs the Postal Service's oversight and objectivity of these contracts, causing a perception of bias. We also believe this violates impartiality controls.[10] In addition, we discovered that the contents and findings of our informal draft report were released to officials outside of the Postal Service connected to the major contractor. The draft report sent to the Postal Service contained clear language stating that "Distribution should be limited to those within the Postal Service with a need to know." We referred these issues to the Office of Investigations and, therefore, are not making a recommendation at this time.

Advertising Program Changes

The Postal Service faces major challenges in its advertising and marketing program. These include declining demands for key mail categories, frequent public stories about its overall financial troubles, and competitors with greater advertising resources.[11] The extent to which the Postal Service can promote effective oversight of its advertising program and comply with its internal controls should help mitigate these challenges and increase the effectiveness of its advertising efforts.

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[10] 5 CFR §2635.502.

[11] For example, FedEx recorded spending $375 million on advertising in 2011, which is about two-and-a-half times what the Postal Service spent that year.

The chief Marketing and Sales officer informed us that she is in the process of evaluating the Postal Service's overall advertising program. Specifically, she agreed with the concerns we raised about the Postal Service's main advertising contracts and has already initiated corrective action. The Postal Service is separating the two largest advertising contracts into multiple contracts. Specifically, it is focusing on competing the media planning and strategy portion but is also planning to compete the creative strategy and developments and media-specific portions. The chief Marketing and Sales officer stated that restructuring these contracts would allow the Postal Service to take advantage of available competition in the advertising marketplace, better align these contracts with current advertising contracting practices, and maximize the effectiveness of the Postal Service's advertising investments. The Postal Service also ended the contract with its major advertising contractor at the end of FY 2012 and has changed the leadership in its Advertising group.

Recommendations

We recommend the chief Marketing and Sales officer and executive vice president:

1. Establish a clearly defined process for performing contractor evaluations when determining incentive payments.

2. Ensure that all invoices are properly reviewed, certified, and maintained.

3. Ensure that a mechanism is in place for tracking non-core team labor costs.

4. Develop a strategy for reasonably allocating costs to specific advertising campaigns.

We recommend the chief Marketing and Sales officer and executive vice president and vice president, Supply Management:

5. Determine a strategy to ensure that certified invoices are retained in accordance with Postal Service policy.

Management's Comments

Management agreed with the findings, recommendations, and monetary impact. Regarding recommendation 1, management stated that the new competitive advertising contracts will not contain incentive fee payments. Management also stated that, through renegotiations and modifications, the incentive payment option was removed from the one remaining legacy contract. Management will provide support to the Office of Inspector General (OIG) to close this recommendation.

Regarding recommendation 2, management stated that a new internal process for properly reviewing, certifying, and maintaining invoices will be developed. New CORs will be instructed by Supply Management COs on these processes and currently are taking the Contracting Officer's Representative and Ethics training. Management also stated they will perform periodic reviews to ensure compliance. This training, instruction, and internal process development is scheduled to be implemented by the end of February 2013.

Regarding recommendation 3, management determined that the current tracking system does capture labor costs and they are developing a custom report to provide visibility into these costs that is scheduled to be implemented by March 2013.

Regarding recommendation 4, management stated that they are assessing the current tracking system to determine the associated costs and feasibility of allocating costs to specific advertising campaigns. An action plan for implementing system changes is scheduled to be implemented by March 2013.

Regarding recommendation 5, management stated that Supply Management COs will be instructing new CORs on the policies and processes for retaining certified invoices. They also stated that Marketing and Sales officials will be developing and communicating an internal process for certifying invoices and performing periodic reviews to ensure compliance. These actions are scheduled to be implemented by February 2013.

Management also clarified two other items in the report, the first regarding the ability of the core team to delegate work to non-core staff or subcontractors. The second clarification concerns the use of the term 'bonus payments' as management stated that it mischaracterized the nature of these payments.

See Appendix C for management's comments, in their entirety.

Evaluation of Management's Comments

The U.S. Postal Service OIG considers management's comments responsive to the recommendations in the report.

The OIG considers all recommendations significant, and therefore requires OIG concurrence before closure. Based on management's corrective actions, we have closed recommendation 1. For recommendations 2 through 5, 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.

Regarding the first area of clarification that management provided in their comments, we recognize that the contract allowed for non-core staff and subcontractors to perform certain project-specific work subject to Postal Service review. However, based on our concerns about the quality of the Postal Service's oversight in this area — particularly its inability to clearly understand the core team's specific roles and responsibilities — we continue to believe the Postal Service may have been vulnerable to potentially duplicative labor costs in this area

Regarding management's second clarification, we are choosing to retain the term bonus payments because the initial 2012 contract extension with the Postal Service's major advertising contractor specifically refers to these as incentive 'bonus' payments.

Appendix A: Additional Information

Background

The Postal Service uses a variety of strategies and mediums (such as direct mail, print and digital media, mobile technologies, *Deliver* magazine, television, and radio) to advertise, market, promote, and brand its organization and product and service offerings. The Postal Service spent about $147 million on advertising in FY 2011. The most significant of these efforts has been the campaign for Priority Mail Flat Rate Box: 'if it fits, it ships.' The Postal Service spent nearly $108 million on this specific product campaign in FY 2011 (see Table 3). According to the Postal Service, this was one of its most successful campaigns to date and it has won awards for its effectiveness.

Table 3: Advertising Expense by Product, FY 2011

Product	Advertising Expense
Priority Mail Flat Rate Box	[redacted]
Direct Mail	[redacted]
PO Boxes	3,111,366
First-Class Mail	3,107,674
Corporate Backend Support	2,058,736
Retail Access	[redacted]
Automated Postal Centers	1,914,490
Stamps	1,768,839
Package Services	[redacted]
USPS.com	895,264
International Mail	[redacted]
Passports	567,775
Express Mail	[redacted]
Global Priority Mail	[redacted]
Research	[redacted]
Core Team Travel	[redacted]
Package Pickup	[redacted]
Global Express Guaranteed	[redacted]
Global Express Mail	[redacted]
Brand	168,639
Greeting Cards	[redacted]
ReadyPost	[redacted]
Parcel Select	[redacted]
Special Services	86,140
Premium Forwarding Service	45,252
Retail Merchandise	[redacted]
Public Notices	2,400
Total	**$138,363,334**

Source: Postal Service *FY 2011 Cost, Revenue, and Analysis* report.

The Postal Service's advertising group, which consists of 13 staff members, is managed by an Advertising manager who reports directly to the chief Marketing and Sales officer.

A significant portion of this group's responsibility entails overseeing the Postal Service's advertising contracts, as the Postal Service contracts out for nearly all of its advertising work. Key contracts include:

- *Largest advertising contractor*: This contract began August 1, 2002. Under the FY 2012 structure of this contract, which was valued at $160 million, the Postal Service paid for a dedicated core team of over 30 staff who specialized in creative content and strategic direction and their support staff who helped with day-to-day responsibilities. The Postal Service repeatedly 'non-competitively' extended this contract due to what is referred to as 'compelling business interests,' as well as its overall satisfaction with the contractor's performance. The Postal Service allowed this contract to expire at the end of FY 2012.

- *Second advertising contractor*: This contractor is primarily responsible for advertisements at retail Post Office locations. This contractor had originally been a subcontractor under the primary advertising contractor, but began contracting directly with the Postal Service in 2009 for a contract valued at $10 million. This contract was extended on a 'non-competitive' basis through FY 2012 (at a value of $12 million in FY 2012). The Postal Service recently non-competitively extended this contract into FY 2013.

The Postal Service also has other advertising contracts that support its information technology, priority mail maintenance, work with stamps, a few smaller campaigns, and Direct Marketing Association membership dues. The costs for these other advertising contractors totaled just over $10.7 million in FY 2011.

Objective, Scope, and Methodology

Our objective was to evaluate the Postal Service's oversight of its advertising program. To accomplish our objective, we reviewed the Postal Service's current and past advertising efforts. We interviewed key officials regarding advertising and branding efforts, their methods of calculating return on advertising investment, and their methods for evaluating contractors. We reviewed the Postal Service's contracts for work performed for the Advertising group, metrics the Postal Service uses to evaluate contractors, contractor-generated invoices, and Postal Service payments to contractors. We researched additional marketing and brand promotion strategies the Postal Service could employ and constraints to implementation it might face.

We conducted this performance audit from November 2011 through January 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 November 13, 2012, and included their comments where appropriate.

We identified data systems used to record financial transactions for the advertising group at the local and national levels and gained access to this data as necessary. We analyzed and compared accounts payable data to physical invoice data. Additionally, we assessed the usefulness of the data systems to determine whether they assisted the Postal Service in managing and tracking financial transactions. We assessed the reliability of financial data maintained in Accounts Payable Excellence by comparing payments over $100,000 for FY 2011 and the first half of FY 2012 to their source invoices. We discussed any disparities with management. We determined that the data were sufficiently reliable for the purposes of this report.

Prior Audit Coverage

Report Title	Report Number	Final Report Date	Monetary Impact
Advertising Cost Reporting	CRR-AR-10-004	8/18/2010	None
Report Results: The Postal Service did not accurately report advertising costs to the Postal Regulatory Commission (PRC). Specifically, the Postal Service understated Priority Mail advertising costs, which made the product appear to be more profitable. The Postal Service lacked written guidance for collecting and reporting costs for their *Annual Compliance Report*. In addition, during FY 2009, advertising managers changed procedures for allocating advertising costs without notifying finance personnel of the change. The new procedures did not follow the PRC's established cost methodology. Management did not agree with all of the assertions, methodologies, and conclusions in the finding; however, they stated they agree and intend to comply with all of the recommendations.			

Appendix B: Monetary and Other Impacts

Monetary Impact

Recommendation	Impact Category	Amount
2	Unsupported Questioned Costs[12]	$7 million

We calculated unsupported questioned costs by adding the following:

- $2.3 million in incorrectly certified invoices between October 2010 and May 2012.
- $4 million in non-core team labor costs in FYs 2010 and 2011.
- $631,712 in performance bonus payments in FYs 2011 and 2012.

Other Impact

Recommendation	Impact Category	Amount
2	Disbursements at Risk[13]	$380.4 million[14]

We calculated disbursements at risk by adding the following:

- $127.8 million for total FY 2010 disbursements.
- $136.3 million for total FY 2011 disbursements.
- $116.3 million for total FY 2012 disbursements.

[12] Unsupported questioned costs are a weaker claim and a subset of questioned costs that are claimed because of failure to follow policy or required procedures, but do not necessarily connote any real damage to Postal Service.
[13] Disbursements at risk are a non-monetary impact claim that falls under other impacts. These are disbursements made when proper Postal Service internal controls and processes are not followed.
[14] The disbursements at risk amounts for FYs 2010-2012 represent total costs paid to these contractors during these years. Postal Service advertising officials stated that the majority of these costs represent 'pass-throughs' whereby the contractor procures certain media or other services on behalf of Postal Service and passes payment directly through to the service provider (such as to the television studio that aired the Postal Service's commercial). These pass-through payments do not include any mark-up from the contractor such as profit, general and administrative, or overhead. We included all of the costs as disbursements at risk because the contractor managed the relationship with the service provider and received a percentage of the pass-through fees as payment for negotiating the rates and services.

Appendix C: Management's Comments

NAGISA M. MANABE
CHIEF MARKETING AND SALES OFFICER
EXECUTIVE VICE PRESIDENT

UNITED STATES
POSTAL SERVICE

December 21, 2012

JUDITH LEONHARDT

SUBJECT: Response to Draft Audit Report – Advertising Program
(Report Number MS-AR-13-DRAFT)

Thank you for providing the Postal Service with the opportunity to review and comment on the subject draft audit report. It was a pleasure working with you and your audit team and we appreciate the effort and time allowed for addressing the various concerns within this report. Management generally agrees with the report's findings, recommendations, and monetary impact.

The Postal Service believes that our advertising campaigns were effective and that we received best value under the advertising contracts. However, we agree that oversight and internal controls needed improvement in some areas. Therefore, we have implemented two major changes that will provide the Postal Service additional insight and program management over the advertising aspects of the business. The first was the Chief Marketing and Sales Officer (who joined the Postal Service in May 2012) and Supply Management's review of the advertising program that led to redefining current and future contractual needs. And, the second was Marketing and Sales' organizational redesign.

Marketing and Sales and Supply Management collaborated to determine future contractual needs, which led to a decision not to extend the Postal Service's main advertising contract at the end of its performance period. A new vision for advertising was also developed, which has reshaped the strategy on how the Postal Service will purchase advertising services and products in the future. The Postal Service's advertising program will no longer be supported by one main agency but will use multiple agencies and service providers that are best-in-class within their defined disciplines such as media strategy; planning and buying; creative strategy and development; digital advertising; retail advertising; marketing strategy and support; and brand innovation and management.

On December 13, the Marketing and Sales organization was redesigned. The new structure is built on the best practices of the private sector. It is designed to improve strategic planning and execution, streamline activities, and establish clear lines of accountability and responsibility. It is also designed to sharpen our focus on the most profitable revenue generating opportunities, and places the highest priority on marketing and promoting our core products and services. Most of all, it is designed to accelerate outreach to our customers and the marketplace.

As part of this response, we would like to provide further clarification on a few items within the report:

- The basic concept of the core team was that, contractually, they would be providing the creative, strategy, and overall management services in support of the Postal Service's advertising program for a firm fixed-price; and, that fixed-price rate card and hourly labor

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rate schedules would be used for the execution and production processes. The report indicated that "the core team could delegate work to non-core staff or subcontractors, both of whom could potentially invoice their costs back to the Postal Service." The work that is being referred to here as delegated was execution components of an approved strategy and creative design. This is project specific non-core work subject to the fixed-price rate card and hourly labor rate schedules incorporated in the contract. Subcontract work was routinely competed using the reverse auction features of the Postal Service's eSourcing application. Both the labor hours and the rate card schedules were reviewed for cost and performance.

- Also, we believe the Office of Inspector General's (OIG) use of the term "bonus payments" throughout the report mischaracterizes the nature of these conditional payments under the contract. "Bonus," as used in the usual and customary sense, does in fact refer to the extra pay due for good performance but typically in the context of an employer-employee relationship. Given that our relationship with the advertising agency was that of an independent contractor, the appropriate term is "incentive award opportunity" payments as specified in the contract. We would appreciate the OIG considering this change when issuing the final report.

OIG Audit Recommendations:

We recommend the chief Marketing and Sales officer and executive vice president:

1. Establish a clearly defined process for performing contract evaluations when determining incentive payments.

Management Response: Management agrees, and going forward it has been determined that the new competitive advertising contracts will not contain incentive fee payments. We have also renegotiated and modified the one remaining legacy advertising contract to remove the incentive payment option.

Target Implementation Date: With the above mentioned actions taken by management, we believe that this recommendation has been addressed and request the OIG consider closure with their final report. A copy of the modification will be provided separately to assist with closure of this recommendation.

Responsible Manager: Executive Director Brand Marketing, and Manager, Commercial Products and Services Portfolio, Supply Management.

2. Ensure that all invoices are properly reviewed, certified, and maintained.

Management Response: Management agrees with this recommendation. Discussions were held by Supply Management with the current contracting officer representatives during the audit process. They were informed of their roles and responsibilities and a process was re-established to ensure that all invoices related to the current advertising contracts were properly reviewed, certified, and maintained back in April 2011.

With the Marketing and Sales organizational redesign and the issuance of new contracts, further instruction by Supply Management contracting officials to future appointed contracting officer's representatives will need to be performed; and an internal process for properly reviewing, certifying and maintaining invoices will need to be developed and communicated within the Marketing and Sales organization. These new contracting officer's representatives have been identified and are currently in the process of taking the Contracting Officer's Representative and

Ethics courses. Additionally, Marketing and Sales plan to perform periodic reviews to ensure compliance.

Target Implementation Date: Training, instruction, and internal process development will be completed by the end of February 2013.

Responsible Manager: Executive Director Brand Marketing, and Manager, Commercial Products and Services Portfolio, Supply Management.

3. Ensure that a mechanism is in place for tracking non-core team labor costs.

Management Response: Management agrees with this recommendation. We have determined that the current tracking system does capture labor costs; however, there was not, as part of the original commercial off-the-shelf system, a pre-defined report that would provide that visibility. However, a custom report is in the process of being developed that will accomplish that goal. The current reporting capabilities include spend by products and spend by budget categories. In coordination with recommendation 4 below, management will ensure labor costs will be included within reporting capabilities and align with specific advertising campaigns.

Target Implementation Date: March 2013.

Responsible Manager: Executive Director Brand Marketing

4. Develop a strategy for reasonably allocating costs to specific advertising campaigns.

Management Response: Management agrees with this recommendation. In coordination with recommendation 3 above, assessment of the system will be completed to determine the feasibility and associated costs of enhancing the system to include the grouping of allocated costs to specific advertising campaigns. A determination will be made and based upon availability of funding, an action plan for implementing system changes will be provided in response to this recommendation.

Target Implementation Date: March 2013.

Responsible Manager: Executive Director Brand Marketing

We recommend the chief Marketing and Sales officer and executive vice president and vice president, Supply Management:

5. Determine a strategy to ensure that certified invoices are retained in accordance with Postal Service policy.

Management Response: We agree with the recommendation. As stated within recommendation 2 above, further instruction by Supply Management contracting officials to the future appointed contracting officer's representatives will be performed and an internal process for certifying invoices will be developed and communicated by the Marketing and Sales organization. Additionally, Marketing and Sales plan to perform periodic reviews to ensure compliance.

Target Implementation Date: February 2013.

Responsible Manager: Executive Director Brand Marketing, and Manager, Commercial Products and Services Portfolio, Supply Management.

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All addressees on this report are in agreement with the response. 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 Dan Barrett at (202) 268-7494 or Susan Witt at (202) 268-4833.

Nagisa Manabe